SIMPLIFYING NON-GEOGRAPHIC NUMBERS

EE response to Ofcom's:

- Policy position and consultation on the introduction of the unbundled tariff and changes to the 080 and 116 ranges; and

- Consultation on proposed dispute resolution guidance for the 080 and 116 number ranges

28 May 2013

Non-Confidential version

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Introduction and summary

Introduction

Everything Everywhere Limited ("EE") sets out below and in the attached two Annexes its response to Ofcom's consultations on its "*Simplifying Non-Geographic Numbers Policy Position*" dated 15 April 2013 ("Ofcom's final policy position") and "*080 and 116 Number Ranges Proposed Dispute Resolution Guidance*" dated 25 April 2013 (the "Draft 080 DRG").

All comments in this response should be considered as representations made to Ofcom under section 60(5) of the *Communications Act* 2003 ("the Act").

Those parts of the response that are confidential to EE have been marked as such by highlighting in yellow and the use of the [✂] symbol. Disclosure of this commercially sensitive information is likely to harm EE's commercial interests and EE accordingly requests that Ofcom does not publish or otherwise disclose this information without EE's prior written consent.

Ofcom's final policy position follows a series of prior consultations by Ofcom on this topic. EE has responded in detail to those previous consultations. Subject to any express comments to the contrary in this response, EE maintains the points raised in its previous responses and does not repeat them here.

Summary

High level overview of EE's key concerns

Almost all of EE's concerns regarding the legal validity and proportionality of Ofcom's proposals expressed in response to Ofcom's consultation on simplifying non-geographic numbers published in April 2012 ("the April 2012 Consultation") endure. The notable exceptions are Ofcom's confirmation that it will not mandate its proposals in respect of business customers or require under its unbundling proposals for the 084/087 ("08x"), 09 and 118 ranges that the Access Charge ("AC") is separately split out on customer bills from the Service Charge ("SC"), which EE welcomes.

Since the April 2012 Consultation, Ofcom has made a number of very material adjustments to its cost benefit analyses ("CBA") of both its mandated free-to-caller proposals for the 080 and 116 ranges and unbundling proposals in respect of the 08x, 09 and 118 ranges. Several of those changes were necessary to address clear deficiencies in Ofcom's previous CBA and EE welcomes them. These welcome changes include splitting out the CBA for the 08x ranges from the CBA for the 09 and 118 ranges and correcting Ofcom's assessments of misdialling costs.

Other changes that Ofcom has made to its CBA were far less obviously required yet have led to material changes in the results of the CBA. By way of just one example, EE notes that the forecast decline in overall non-geographic call volumes beyond 2015 has been dramatically reduced from the April 2012 Consultation assumptions without there being any clear objective justification for the change and flying in the face of the available empirical evidence. EE considers that it is highly inappropriate that Ofcom has failed to consult on these changes.

Considering the impact of Ofcom's new CBA results in the round, EE believes that it has become even more clear than it was in the April 2012 Consultation that the significant costs of Ofcom's proposals are likely to far outweigh the limited consumer benefits, and that there are many more proportionate, targeted and effective responses that Ofcom should first engage in before proceeding with such wide ranging interventionist retail level pricing regulation. In particular, EE highlights that:

- It is now abundantly clear that there is no consumer protection requirement for Ofcom to implement unbundling on the 09 and 118 ranges and that Ofcom's proposals in this regard are accordingly *ultra vires*.
- It is beyond argument that the non-geographic calls market, including the market for 08x calls, is a naturally dwindling one. Service Providers ("SPs") of all descriptions including banks, utilities and government departments are increasingly utilising more cost effective but equally, if not more, customer friendly service models such as online ordering and service provision and real time web chat / VoIP services, as well as mobile alternatives like SMS, premium SMS and mobile voice short codes.
- Ofcom's CBA also fails to factor in any impact from the impending government legislative changes requiring post sales helplines to be charged at no more than a basic rate. If the government maintains its current proposals to ban the use of any revenue share ranges for these services, the impact on 08x volumes and revenues could be material and substantial.

In relation to the 080 and 116 ranges, EE maintains its position that the mobile maximum price ("MMP") option would generate greater net consumer benefits than Ofcom's proposed mandated free-to-caller proposal. To the extent that Ofcom does press ahead with its mandated free-to-caller proposals, EE considers that practical considerations regarding the wholesale arrangements that are required to be in place for these proposals to succeed continue to strongly indicate that Ofcom should first conclude a market review in relation to the supply of these services, in order that it may regulate the freephone origination charge by way of appropriate Significant Market Power ("SMP") regulation imposed on the relevant monopoly terminating communications providers ("TCPs") who terminate 080 and 116 calls.

In terms of the details underpinning the design of, and legal framework for, Ofcom's proposals, EE makes the following high level comments:

- EE welcomes Ofcom's final policy position that there should be no cap on the AC and that bespoke SCs should be banned;
- EE considers that Ofcom's impact assessment range ("IAR") and base case scenario range in respect of a "fair and reasonable" charge for the mobile origination of 080 calls have each been set manifestly too low;
- Ofcom's anticipated implementation framework for setting 080 and 116 origination charges (including its Draft 080 DRG) and draft access condition on TCPs has been inadequately thought through from a practical perspective, making much of it simply unworkable; and

- Ofcom has also failed to ensure that the design and drafting of its proposed obligations regarding the unbundled tariff are no more interventionist and burdensome than strictly necessary for the protection of consumers; provide the requisite degree of regulatory certainty and are able to be implemented without the expenditure of undue time, money and resources by the industry. In particular:
    - EE continues to strongly believe that there is no case for mandating a single AC in respect of all 08x, 09 and 118 calls, and that requiring the AC for all ranges to be either in or out of bundle will result in perversely adverse pricing for consumers;
    - EE considers that many of the proposed changes to the General Conditions (“GCs”), Numbering Plan and the new condition on SPs are unnecessary, confusing, unduly interventionist and liable to cause severe and unanticipated difficulty in ensuring compliance for both the industry and the relevant regulators; and
    - EE is extremely concerned that the process of making the necessary amendments to wholesale and retail billing systems and inter-operator billing arrangements is so ill thought out and lacking in specificity that the burdens of implementation are likely to dwarf current Ofcom estimates, crushing an already struggling industry segment.

EE very briefly elaborates on some of these key points below. Further details are set out in the body of, and Annexes to, this response.

IAR and base case scenario range for 080

It is crucial that Originating Communication Providers (“OCPs”) are able to recover their efficiently incurred costs of freephone origination. In the case of mobile OCPs, this necessarily entails the ability to recover a fair share of common costs from such charges. Accordingly, the starting point for Ofcom’s IAR and base case scenario ranges must in no case ever be lower than one which allows recovery of LRIC+ cost measures (2.4ppm for mobile OCPs on Ofcom’s current estimates of these costs).

In addition, these ranges should include at least some allocation towards OCPs’ acquisition and retention (“A&R”) costs. The activities engaged in by SPs both cause and benefit from these costs, a fact which is reflected by SPs’ willingness to pay net 080 origination charges that would allow for recovery of a substantial proportion of these costs. Ofcom’s concerns that this would lead to inefficient cost recovery are unsubstantiated and fail to stand up to scrutiny when the context in which they will be recovered is fully taken into consideration.

Leaving aside these points, a number of elements in Ofcom’s cost calculations are out of date or incorrect and need to be updated. The impact of these changes is material. Specifically:

- Using more up to date and consistent inflation figures leads to an inflation factor[1] of 1.251 rather than Ofcom’s figure of 1.197.

[1] For increasing costs from the 2008/09 prices of the MCT cost model to the 2014/15 price basis which Ofcom uses.

- Ofcom's exclusion of billing costs is mistaken. Costs will still be incurred in relation to the metering and billing of these calls at the wholesale level.
- Ofcom's model requires adjustments to ensure that the common costs no longer recovered from call termination are treated consistently between the fixed and mobile sectors (currently it is inappropriately favourable to fixed operators).
- Ofcom needs to update its customer care costs estimates, as EE has previously submitted. Ofcom's justifications for determining not to do so fail to stand up to scrutiny. Consequently, Ofcom has introduced a material risk of OCP cost under-recovery.

Taking into account the required adjustments, EE estimates that Ofcom's current mobile origination LRIC+ range of between 2.4ppm and 5.5ppm should increase to 2.8ppm to 6.0ppm.[2]

In terms of the likely net impact of SPs on permitting OCPs to recover these ranges of costs, Ofcom has materially changed its previously assumed levels of fixed to mobile substitution. EE considers the new ranges to be seriously inflated above realistic forecasts as a result of their focus on a relatively short term and variable increase in the traffic of just one SP, as well as invalid reliance upon trends in 080 calls made by business customers, which are now outside the scope of Ofcom's mandatory proposals.

Finally, EE believes that each of the new "asymmetric risk", "caller externality" and "LRIC differential" analyses that Ofcom has included in its current analytical framework are invalid and should not be given any weight by Ofcom whatsoever. Certainly EE does not agree that any of these considerations should cause Ofcom to consider it fair and reasonable that mobile OCPs should be forced to subsidise SPs / TCPs by recovering less than their full LRIC+ costs of origination.

CBA of unbundling the 09 range

Ofcom has not provided evidence of market failure on the 09 number range (and in the limited cases where Ofcom does so, the effects are significantly mitigated by market forces). Ofcom claims that there is harm to consumers, including in the form of suppressed demand on the 09 number range but has not shown any evidence for this conclusion. Any limited benefits to be generated by Ofcom's proposals are likely to be well outweighed by the costs. In contrast to Ofcom's CBA, EE considers that there is a substantial incremental cost of unbundling the 09 number range, especially when the impact of the strictures of a single AC across the 08x, 09 and 118 ranges is factored in.

Ofcom's increasingly historic and limited evidence contrasts with the considerable body of irrefutable evidence on substitutes to 09 calls. The proportionality and net consumer welfare benefit of imposing costly, heavy handed and untested regulatory measures in such a dwindling market when

[2] These figures also remain an underestimate, as they use Ofcom's current out of date Customer Acquisition, Retention and Service ("CARS") costs estimates.

there are clear market based solutions that are in fact better at responding to Ofcom's alleged market imperfections is highly questionable.

CBA of unbundling the 118 range

Ofcom has provided no real evidence of market failure on the 118 range (and in the limited cases where Ofcom does so, the effects are significantly mitigated by market forces). Ofcom has also failed to undertake a separate detailed assessment of the CBA for unbundling calls to 118 numbers, despite the distinct characteristics of, and substitutes for, 118 services.

EE considers that, as for 09, there are many new services which are available for accessing directory information and services which represent far better long term solutions to any alleged market imperfections than Ofcom's approach, which has not been substantiated and will be intrusive and costly. These services are also, in any event, causing a highly perceptible decline in the volume of 118 calls and revenues generated from these services, with every indication suggesting that such declines are only likely to increase in the period to 2015 and beyond. Together, all of these factors suggest that Ofcom's objectives of maximising net customer welfare are most likely to be achieved by Ofcom refraining from further intervention on the 118 range, and simply letting the market take its natural path of technological evolution towards more evolved solutions that better meet the requirements of both consumers and SPs.

Proposed changes to the General Conditions

Ofcom's final policy position proposes substantial amendments to a number of the General Conditions of Entitlement ("GCs"), the Numbering Plan, the Numbering Condition and the PRS Condition. The number of changes made to these instruments throughout the years has a led to a decrease in transparency, a duplication of obligations, and an unwieldy and complex set of regulations which impacts the understanding and therefore the ease of compliance. EE re-iterates its previous requests for Ofcom to undertake a thorough and consistent overhaul of these instruments.

There is also a more general question as to the amount of information customers can absorb and process. Ofcom's approach appears to be adding more information to an already long list, rather than assessing which information is *relevant* to a customer at which point in their contract, and what the best way would be to provide this information. As a result, EE considers that the changes Ofcom is proposing (and several of the obligations that Ofcom is proposing to maintain in spite of the move to the new regime) fail the consumer protection, proportionality and practicability tests. In particular:

- EE considers that Ofcom's proposed retention of the existing obligations regarding non-geographical numbers for business customers is disproportionately burdensome and confusing. The GCs already contain a number of existing obligations around information provision and transparency, for instance GC9.2 and GC10. EE considers these obligations to be sufficient to protect the interests of business customers.
- The added transparency obligations in GC14 (despite a separate GC on transparency) and the inclusion of a detailed description of a bundle in GC17 are unduly prescriptive, creating unnecessary costs and risks of market distortion.

- Providing a link in all OCP communications material as to where exactly details of the AC can be found is both highly impractical and likely to be of virtually no added consumer benefit.
- Ofcom proposes to retain the obligation to provide information about the tariffs that apply on an OCP's network for calls to any PRS number range. Since the central database with the SCs sits with Ofcom, EE believes this obligation should be amended and OCPs should simply refer customers to the Ofcom SC database instead.
- EE does not consider it necessary or appropriate to single out the AC with an express reference in GC23 and 24 when simple guidance on this matter by Ofcom would suffice.
- The proposed new GC 14.11 is entirely disproportionate. There are sound reasons why the general point of sale information requirements in GCs 23 and 24 do not apply in certain circumstances. These reasons apply equally to point of sale information about the AC.

Finally, EE strongly objects to the lack of regulatory certainty created by Ofcom's proposed approach on the interaction of these proposals with GC9.6 regarding material detriment. EE remains of the view that Ofcom must clearly exempt the initial setting of the AC, which no OCP would need to do absent the regulatory obligations proposed to be imposed by Ofcom, as a result of this consultation, from the application of GC 9.6. To fail to do so would essentially create a double jeopardy for OCPs.

EE's concerns regarding the legality of Ofcom's proposals

Legality of Ofcom's freephone proposals

1. Origination charge must allow efficient cost recovery

It is perhaps a point so fundamental as to go without saying, but the first step in any analysis of the legality of Ofcom's freephone proposals must necessarily be to ensure that these proposals comply with Ofcom's general duties under section 3 of the Act. This means that they must not only further the interests of citizens and consumers (s 3(1)) but must also have regard to the desirability of encouraging investment and innovation in relevant markets (s 3(4)), as well as promoting competition (ss 3(1)(b) and 3(4)(b)).

Ofcom has duly reflected these important legal obligations in principle 1 of its framework for assessing what are likely to be fair and reasonable freephone origination charges, by requiring that "*OCPs should not be denied the opportunity to recover their efficient costs of originating calls to a free to caller range*". Ofcom has also reflected the same wording in principle 1 of its analytical framework for determining the IAR for freephone origination charges (§12.16).

However, EE does not consider that Ofcom has applied these principles so as to ensure that Ofcom's proposals will not harm the investment and innovation incentives of OCPs. Specifically, EE notes that Ofcom has determined that:

- The IAR for mobile origination charges should lie between 0.8ppm and 3.3ppm and that the fair and reasonable range for these origination charges should lie between 1.3pm and 3ppm.
- The full LRIC+ cost of originating calls to freephone numbers (including 100% of A&R costs) is circa 5.5ppm (Table A26.5).
- OCPs should recover their A&R costs from the origination of mobile calls, rather than through termination charges.

In this context, EE considers that the origination charge ranges selected by Ofcom are **materially too low**, and that they will therefore cause Ofcom to fail to meet its objectives of encouraging investment and innovation by UK mobile OCPs. EE sets out below its views as to the adjustments it believes need to be made to these ranges.

Furthermore, EE notes that the MMP option for the freephone ranges that Ofcom has also considered *would* allow OCPs to recover these costs in full (§A26.76). EE appreciates that at some point under the free-to-caller option for the freephone ranges Ofcom may need to consider a trade-off between the impact of the proposed origination charges on the investment and innovation incentives of OCPs against those of SPs. However, the MMP option requires no such trade-off. For this reason as well as those set out below, EE considers that the MMP option better meets Ofcom's statutory objectives than the free-to-caller option.

2. Mandated free to caller option offers less net benefits to consumers than the maximum mobile price range option

Ofcom's cost benefit assessment for the mandated free-to-caller and MMP options for the 080 and 116 ranges is finely balanced. However, EE considers that the mandated free-to-caller option is likely to offer less net benefits to consumers than the MMP option when considered in the light of changes to Ofcom's analysis in its latest consultation.

EE notes that the costs of implementing MMP remain very low at **£0.2m to £3.2m,** whereas Ofcom's recent inclusion of migration costs and misdialling costs have significantly raised the costs of implementing the free-to-caller option (to between **£8.8m to £57.5m).**[3]

As the implementation costs have now increased so markedly for the free-to-caller option, this places more reliance on the relative benefits of this option. However Ofcom continues to argue against quantification of any such benefits (such as measuring reductions in price misperception). The reasons for this are unclear, especially when it is considered that this is central to the approach to estimating benefits for the unbundled tariff regime. Ofcom is also required to estimate any consumer benefits.

In any event, in terms of qualitative benefits, EE considers that the MMP option has the same or greater benefits than the free-to caller option. In particular, EE notes that:

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[3] These implementation costs arise when considering the IAR in relation to origination charges and costs.

- Ofcom cannot confidently claim the free-to-caller option is qualitatively better at achieving consumer price awareness than the MMP option unless it quantifies the estimated reduction in price misperceptions for both options.
- Making the 080 range free-to-caller pushes retail prices below cost, which does not promote allocative or dynamic efficiency: MMP better promotes efficiency.
- SPs prefer MMP over free-to-caller at average call origination charges as low as 1.5ppm.
- Like the free-to-caller option, MMP would also improve the brand reputation of the 080 range because it would enable SPs to advertise a single low mobile price nationally.
- There are so few socially important services that are not already zero rated that the mandated free-to-caller option is unlikely to make a material difference to promoting this particular stated aim (particularly when it is considered that this option may also cause the exit from the market of some current socially important SPs).[4]

As a result of its materially higher likely costs and very similar potential qualitative benefits, EE considers that the mandated free-to-caller option is likely to offer lower net benefits to consumers than the MMP option.

EE's detailed analysis of the CBA of the freephone options is set out at Annex A of this response.

Legality of Ofcom's proposal to unbundle the 09 and 118 ranges

1. 09 and 118 unbundling proposals fail the consumer protection requirement

EE welcomes Ofcom's amended approach of separately assessing the net consumer benefits of its unbundling proposals in respect of each of the 084/087 ("08x"), 09 and 118 ranges. Clearly, any final legal instruments adopted by Ofcom will involve discrete decisions as to whether or not to extend these intrusive retail pricing restrictions to each number range. In order to be legally valid, it is therefore imperative that each decision is independently justifiable "*for the purpose of* protecting *consumers*" (s 58(1)(aa)).

For the reasons set out below and in Annex B to this response, EE believes that separately breaking out the potential benefits and costs of unbundling each of the 09 and 118 ranges has made it manifest that, based on the evidence currently before Ofcom, it is neither necessary nor proportionate to require these ranges to be unbundled for the purposes of protecting consumers.

[4] See §A29.116-A29.143 of Ofcom's final policy position.

These results accordingly call into serious question the legal validity of Ofcom's final policy position supporting the extension of the unbundling regime to the 09 and 118 ranges.

2. Benefits of unbundling the 09 range likely to be outweighed by the costs

EE considers that the CBA for unbundling the 09 number range does not robustly support Ofcom's proposed approach. In fact, EE considers that the limited benefits likely to be generated by Ofcom's proposals will easily be outweighed by the likely costs.

Of the three market failures identified by Ofcom, only one of these is relevant to unbundling prices for the 09 number range (the vertical externality). Even here, the effect is largely mitigated by high revenue retention on the 09 number range by SPs as well as the growth in alternative means of accessing services that give SPs full control over the retail price (e.g. mobile short codes, Premium SMS and mobile apps).

Ofcom has also failed to identify a compelling theory of harm with little, if any, evidence of any of: price misperception, lack of trust or confidence, or suppressed demand. Many of the criteria applied by Ofcom lack supporting evidence or are simply not applicable to the 09 number range.

Ofcom's method for estimating the costs and benefits of unbundling the 09 range has serious weaknesses:

- Under Ofcom's Effect 1 (which measures price misperception), Ofcom concludes that the most likely scenario is that there is no price misperception. However Ofcom does not rule out the potential for price misperception in the form of 09 price underestimation. Where Ofcom models price misperception, Ofcom's estimation method overstates the size of this beneficial effect by using price elasticity of demand and shape of demand assumptions which are inconsistent with Ofcom's own published analysis. Ofcom's assumption of declining demand of 7.5 % is also inconsistent with third party analysis of the scale of decline in traffic on the 09 range.[5]
- The available survey evidence clearly contradicts Ofcom's Effect 2 (an alleged lack of trust and confidence leading to suppressed demand). EE accordingly considers that these benefits must be struck out of Ofcom's CBA analysis relating to unbundling calls to 09 numbers.
- Ofcom has either understated or erroneously excluded many costs that are clearly incremental to unbundling calls to 09 numbers. For example, by mandating a single AC for 08 and 09, Ofcom's unbundling proposals present an inherent commercial exposure to bad debt risk in relation to calls to 09 numbers (since the proposals as they stand remove any commercial flexibility to set cost reflective ACs for 09 numbers to cover this cost). This is a significant incremental cost to the 09 unbundling proposal.[6]

[5] 2011 PP+ Report.

[6] Obviously, if this restriction was removed (as EE believes it should be) this would go some way to lowering the incremental cost of unbundling the 09 range. EE's detailed comments on

- EE considers that there is now irrefutable evidence of alternate means for accessing equivalent services which are steadily overtaking the revenues of traditional voice 09 services. Premium SMS, mobile voice short codes, mobile apps and internet services increasingly reflect consumers' preferred means of accessing information and entertainment services. In some cases, these alternatives are free or offer simpler pricing messages than could ever be achieved under unbundling (e.g. the per call charge structures on mobile short codes). In essence, as observed in the 2011 Phonepay Plus ("PP+") market study, the 09 market is "dwindling". The proportionality and net consumer welfare benefit of imposing costly, heavy handed and untested regulatory measures in such a dwindling market when there are clear market based solutions that are in fact better at responding to Ofcom's alleged market imperfections is highly questionable.

Properly taking these issues into account, EE considers that the benefits of Ofcom's proposal for 09 numbers are likely to be outweighed by the costs to the point where EE firmly believes that Ofcom should refrain from unbundling the 09 range.

For EE's detailed analysis see Annex B of this response.

3. Benefits of unbundling the 118 range likely to be outweighed by the costs

Ofcom has gathered only an extremely limited amount of evidence regarding the potential benefits of unbundling the 118 range. Based on the scant evidence Ofcom has put together in support of its proposals, EE considers that the costs of unbundling the 118 number range are likely to outweigh the consumer benefits.

Ofcom claims that two types of market failure are present on the 118 number range: a lack price awareness and a vertical externality.

However, Ofcom's evidence on lack of price awareness is weak and is based on a table in its 2010 consultation which simply illustrates a list of OCPs offering different 118 charging structures and price levels. The existence of different prices in itself says nothing about price awareness. Furthermore, Ofcom's proposals involve no necessary change to the current range of SCs available for 118 services – hence any lack of price awareness that is generated by this price diversity is likely to endure even after the implementation of unbundling.

In addition, the vertical externality effect is largely mitigated by high revenue retention on the number range by directory enquiry ("DQ") operators (meaning that DQ SPs in a large part can and do control the level of the end-price for their services paid by consumers) , as well as the growth in alternative means of accessing the underlying service involved which give DQ operators or consumers more control over the retail price (e.g. text directory, the "118 app" services and Google or other search engines).

Ofcom's proposed intra-tariff restrictions on the AC are set out below in section 5.1 of this response.

Ofcom has also failed to identify a compelling theory of harm with little, if any, evidence of each of: price misperception, lack of trust or confidence, or suppressed demand. Many other criteria applied by Ofcom lack supporting evidence or are simply not applicable to the 118 number range.

Ofcom has not undertaken a separate detailed assessment of the CBA for unbundling calls to 118 numbers, which is a material failing on Ofcom's part. For this reason EE has, in this response, applied the CBA framework set out by Ofcom for the 09 range to demonstrate that the (limited) benefits of the unbundling proposal for 118 that Ofcom has suggested are likely to be outweighed by the costs.

EE considers that, as for 09, there are many new services which are available for accessing DQ-type information and services which represent far better long term solutions to any alleged market imperfections than Ofcom's approach which has not been substantiated and will be intrusive and costly. These services are also, in any event, causing a highly perceptible decline in the volume of 118 calls and revenues generated from these services, with every indication suggesting that such declines are only likely to increase in the period to 2015 and beyond. Together, all of these factors suggest that Ofcom's objectives of maximising net customer welfare are most likely to be achieved by Ofcom refraining from further intervention on the 118 range, and simply letting the market take its natural path of technological evolution towards more evolved solutions that better meet the requirements of both consumers and SPs.

For EE's detailed analysis see Annex B of this response.

Legality of Ofcom's proposal to unbundle the 08x ranges

Although Ofcom has made some quantitative adjustments to its CBA for unbundling the 08x ranges, Ofcom's final policy position contains no fundamental changes from its April 2012 consultation on simplifying non-geographic numbers (the "April 2012 Consultation") in relation to the anticipated consumer benefits and costs. EE's concerns expressed in response to the April 2012 Consultation therefore remain and EE maintains them. Furthermore, the following points arising from Ofcom's final policy position tip the balance even further in favour of a finding that Ofcom's proposals lack the necessary proportionality to be legally valid.

EE considers that the changes made to Ofcom's assessment of the costs of unbundling the 08x ranges in its final policy position (e.g. regarding billing costs) are subject to a number of weaknesses which cause Ofcom to understate the true implementation costs likely to be incurred by the industry. In particular:

- EE notes that in both the fixed and mobile sectors, network operators who provide managed end to end services to fixed OCPs and MVNOs will have to provide billing platform, support and format solutions to these operators under Ofcom's tariff unbundling regime. Ofcom's CBA does not appear to adequately factor in the costs of these wholesale level billing changes. Given the prevalence of this commercial model, EE strongly objects to the reduction in the number of OCPs modelled to have complex billing costs from 20 down to between 4 and 10.

- In its recent decision in the disputes relating to BT's NCCN 1101 (introducing additional tiered termination rates for the 08x ranges)[7] Ofcom emphasised the benefits of a linear approach to estimating demand response. EE considers that Ofcom should apply this for its base case analysis of the benefits likely to result from unbundling the 08x ranges and notes that it will imply a significantly larger reduction in price misperception to offset unbundling implementation costs than the current modelling by Ofcom.[8]

EE also considers that many of the alternative means for accessing 09 and 118 services are becoming increasingly prevalent even for 08x services. For example, banks and utilities are increasingly offering consumers web chat type solutions whereby you can message a company representative about a bill or statement and enquire through real time chat services. EE therefore strongly disagrees with Ofcom's assumptions that there are no viable alternatives to the real time interaction offered by 08x services. Particularly in the present climate of economic austerity in the UK, but also given the general commercial drive towards greater economic efficiency, EE considers that it is *more* rather than less likely that British businesses will continue to offer and to encourage their customers to use cheaper technological customer service / interaction alternatives to 08x services over the coming years. In addition, Ofcom's CBA fails to factor in any impact from the impending government legislative changes requiring post sales helplines to be charged at no more than a basic rate. If the government maintains its current proposals to ban the use of any revenue share ranges for these services, the impact on 08x volumes and revenues could be both material and substantial. Such considerations throw into serious question Ofcom's arbitrary new assumptions in its CBA that the rate of decline in 08x volumes and revenues seen in recent years will slow down after 2015.

EE therefore continues to believe that the benefits of implementing unbundling on the 08x ranges are at a very great risk of being outweighed by the costs, and that Ofcom should accordingly take less intrusive measures to achieve its consumer protection objectives.

Implementation concerns with Ofcom's freephone proposals

Proposed Access Condition

1. Ofcom has chosen a sub-optimal legal solution

Ofcom has rejected the option of not setting an access condition and relying on dispute resolution alone (§14.2, §A30.14). EE agrees that it would be inefficient and create too much regulatory uncertainty as well as a higher risk of consumer

[7] http://stakeholders.ofcom.org.uk/binaries/consultations/provisional-conclusions/statement/040413.pdf

[8] See Table A11.7.

harm if Ofcom were to rely upon an unguided process of industry negotiation and subsequent dispute resolution alone to set freephone origination charges.

Ofcom has also rejected the option of conducting a formal wholesale review (§14.2, §§A30.6-30.10). For the reasons set out in EE's response to Ofcom's April 2012 Consultation, EE remains of the view that this approach is flawed. In that response, EE set out the reasons why EE continues to believe that each TCP has a monopoly in relation to the termination of 080 and 116 calls on its network, in the same way that each fixed TCP has been found to have a monopoly in relation to the termination of geographic calls on its network and each mobile TCP found to have a monopoly for the termination of wholesale mobile calls on its network.

EE does not agree with Ofcom's conclusions that the existence of some countervailing buyer power on the part of certain larger OCPs such as BT would prevent Ofcom from being able to impose SMP regulation on a consistent basis across the market of TCPs (cf. §A30.9). For example, in Ofcom's most recent Statement on Wholesale Mobile Call Termination Ofcom also found that: "*while we noted that some originating CPs (such as the national MCPs) have sought to reduce MTRs charged by MCPs with fewer subscribers, by applying pressure as relatively large buyers of MCT, this did not appear to have constrained price-setting behaviour appreciably*" (§4.20).[9] Exactly the same situation has been seen in relation to the failed attempts by all of the mobile OCPs to negotiate to reduce the unfair and unreasonable tiered 080 termination rates introduced by a range of both large and smaller fixed TCPs.

The obvious and clear benefit that would result from Ofcom deciding to do a wholesale market review and reaching a formal conclusion that all TCPs have a monopoly on the termination of 080 and 116 calls on their networks is that this would enable Ofcom to impose SMP conditions on the supply of this service, including a charge control. EE considers that the setting of a charge control on the supply of 080 and 116 termination on at least the largest TCPs currently in the market would far more efficiently and effectively achieve the wholesale outcomes that Ofcom is trying to achieve in an unsatisfactory and roundabout manner through the currently proposed process of multiple bi-lateral negotiations and inevitable disputes.[10] Equally importantly, this approach would allow Ofcom to consider the appropriate level of the origination charge from an SMP vantage point, rather than the current much more complex and less appropriate non-SMP analytical framework that Ofcom has been forced to adopt when considering this issue to date in its tiered termination rate dispute decisions. Specifically, it would allow Ofcom to focus on the core issue of what the fair and reasonable charge is as between the TCP and the OCP (bearing in mind the TCP's position of SMP) – in contrast to placing an undue amount of weight on the highly uncertain and ultimately peripheral issue of what impact the charge may or may not have on the TCP's SP customers as is the case under Ofcom's current proposed analytical framework. We also note the clear

[9] http://stakeholders.ofcom.org.uk/binaries/consultations/mtr/statement/MCT_statement.pdf. See also Ofcom's analysis at §§4.68 to 4.93 of this Consultation.

[10] EE notes in this regard the comments made by Mr Markham Sivak at Ofcom at a recent NGCS forum meeting that he "wished" he could simply just set the level of the freephone origination charge.

policy position that Ofcom should be utilising its competition powers wherever possible in preference to other, less effective, powers and would urge it to re-consider its abdication of such powers in this area.

2. The scope of the draft condition is impracticably and inappropriately too narrow

EE is very concerned that the definition of “Origination Services” set out in the draft access condition is too narrow:

First, EE notes that this definition is so narrow as to be essentially unworkable in practice. In many cases it will just not be possible for either the OCP or TCP to know whether or not a call has been originated by a consumer – e.g. SME customers on standard consumer tariffs; employees on corporate tariffs who use their work telephone to make personal calls. Accordingly, EE considers it would be in violation of section 47 of the Act (which requires all such access conditions to be both proportionate and transparent) for Ofcom to set an access condition which will only legally apply on a call by call basis depending on whether or not the caller is making the call for purposes which are outside of his or her trade, business or profession. At a minimum, EE therefore considers that this definition needs to be amended so that it would be along the lines of “*the origination of calls to Free-to-caller Numbers by callers on tariffs designed for the use of Consumers….*”

However, EE considers that even this expanded scope of the access condition would be inappropriately narrow. Specifically, EE does not believe that the access condition should be limited at all to 080 and 116 calls made by consumers / callers on consumer tariffs. Rather, EE considers that the access condition should be extended so that it applies to the origination of *any* call to an 080 or 116 number which is free to the caller. This is for the following reasons:

- Fundamentally, whether or not the free-to-caller calls are made by business or consumer customers makes no relevant difference to (i) the need for the access condition or (ii) the interpretation of the obligations imposed by the access condition. All of the conclusions reached by Ofcom at §§14.50 to 14.53 still apply. Similarly, each of Ofcom’s IAR and base case ranges already assume that all traffic will be free-to-caller, not just consumer calls.
- The working assumption behind Ofcom’s freephone proposals is that all types of freephone calls, including both business and residential freephone calls are likely to be free-to-caller after the implementation of Ofcom’s proposals.[11] Currently, a very material proportion of 080 calls are made by business customers.[12] To the extent that Ofcom’s working assumption of the extension of free-to-caller arrangements to these customers proves to be accurate, it will be equally as important for Ofcom in furtherance of its duties under section 3 of the Act to minimise regulatory uncertainty, unnecessary blocking of calls and disputes by setting an access condition in relation to business calls in the same manner as for consumer calls.

[11] See §12.115; and footnotes 98 and 109.

[12] See footnote 97. In EE’s case, currently approximately [✂] of its 080 calls are made by customers on business tariffs.

- Unlike the maximum tariff principles that Ofcom is proposing to implement via amendments to the GCs and the Numbering Plan, Ofcom's powers to set access conditions under section 73 of the Act are not limited to those designed for the protection of consumers as defined in the Framework Directive. There is accordingly no legal reason why Ofcom cannot exercise its powers under section 73 to set an access condition for the purposes of ensuring access to 080 and 116 numbers by both business and consumer customers.
- Without the extension of the access condition to calls by customers on business tariffs, there is a very high risk that difficulties in reaching agreement on origination charges for these calls will pose a barrier to the implementation of free-to-caller arrangements for these customers. EE does not consider that such an outcome would be consistent with Ofcom's statutory duties to maximise benefits for all citizens and consumers.

3. Practical implementation process is inadequately thought through

EE supports Ofcom's policy position to impose the access condition only on TCPs and agrees with the reasons that Ofcom has set out for taking this position (§14.67).

EE also supports Ofcom's decision to remove the previously proposed obligation upon TCPs to notify SPs of their proposed origination charges prior to any agreement on these charges having been reached with OCPs (§§14.71-14.72).

EE is also in agreement with Ofcom's proposal to require TCPs to notify their proposed origination charges within one month of the access condition being set (§14.73), assuming that Ofcom's 080 and 116 dispute resolution guidelines are also in place by this time. Clearly, time will be of the essence for all stakeholders in reaching a position where there is commercial and legal certainty regarding the level of these origination charges.

However EE is concerned that the bilateral negotiation and dispute resolution process that Ofcom envisages taking place following notification by the TCPs has been inadequately thought through, and as a result is likely to be unduly duplicative, costly, slow, inefficient and susceptible to creating competitive distortions and outcomes which are not in the best interests of consumers.

In particular, as Ofcom has noted in its previous consultations, the vast majority of 080 and 116 TCPs and OCPs are not directly interconnected with each other. Accordingly, it is imperative that the proposed access condition functions effectively and efficiently in situations where the TCP and OCP are only indirectly interconnected via a transit operator. Unfortunately, this does not appear to be the case. For example:

- Draft access condition 1.1 requires each OCP to directly request in writing from each TCP (whether or not the OCP is directly interconnected with that TCP) the purchase of 080 and 116 origination services from the OCP before the TCP's obligation to purchase those services on fair and reasonable terms becomes effective. This means that each OCP will potentially have to separately write to some 120 TCPs as listed in Schedule 1 to the draft access condition, plus continuously monitor whether any new such TCPs have come into the market and separately write to them as well as and when they do so. In turn, each TCP will have to individually respond to each OCP from whom it receives such a written request. EE considers that this process is unduly administratively burdensome and definitely not proportionate. In part, the purpose of transit arrangements is to reduce such administrative transaction costs and Ofcom's access condition needs to reflect this.

- Draft access condition 2 only requires TCPs to notify OCPs of their proposed origination charges within the stipulated one month time-frame in the very few cases where the TCP has a pre-existing agreement in place with the OCP for the direct purchase of such services. This means that in the vast majority of cases OCPs would need to request access under draft access condition 1 without the benefit of having this information. It also creates a risk that, depending on the TCP's individual circumstances, the obligation to purchase these services "as soon as reasonably practicable" might still mean that the information about the proposed charges is not provided for a considerably longer time period than the one month applicable where the parties have a pre-existing agreement. This creates both a great deal of commercial uncertainty for OCPs, significant market distortion and the potential for significant delays in reaching any final agreement on charges.

In a transit situation, it might potentially be said that these steps would be unnecessary where the transit operator has already requested such access and agreed on rates in its capacity as OCP and/or agreed to provide such access and agreed on rates in its capacity as TCP. However, there are three key problems with this suggestion:

- First, although the legal drafting of the proposed access condition is highly ambiguous[13], it seems that the terms of draft access condition 1 are not intended to apply to TCPs and OCPs when acting in their capacity as transit providers.[14] On the basis that this understanding is correct, OCPs and TCPs who are not directly interconnected will have absolutely no legal certainty that the rates that they have negotiated with their transit provider in its capacity as TCP/OCP will apply when their traffic is passed by the transit provider to other OCPs/TCPs. Accordingly, without engaging in further direct communications and negotiations with individual TCPs, OCPs will have no certainty whether or not it will prove to be economically viable to originate significant proportions of their current 080 and 116 traffic. Similarly, TCPs who do not engage in further direct communications and negotiations with OCPs will not have any certainty regarding the origination charges that they will need to pass on to their SP customers for significant proportions of the 080 and 116 calls made to these SPs.

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[13] In that the definition of "Terminating Communications Provider" adopted is simply any person specified in schedule 1 regardless of whether or not that person is acting in its capacity as TCP, transit provider or otherwise and the definition of "Originating Communications Provider" is similarly wide in including any electronic communications network provider regardless of whether or not that provider is acting in its capacity as OCP, transit provider or otherwise.

[14] See §§A30.87-A30.90 and in particular §A30.90 which anticipates that a transit provider may refuse to negotiate and would only have a commercial incentive rather than a legal obligation to agree to fair and reasonable terms.

- Second, even if draft access condition 1 was to be amended / interpreted broadly so as to require TCPs to pay fair and reasonable origination charges for any 080 and 116 traffic terminated on their network, whether received directly or via a transit operator, it is unclear whether / how the transit operator would negotiate these origination charges for its transit customers. A transit operator who only operated a fixed network could not, for example, be expected to have a full understanding of the costs of origination for its mobile transit customers, nor indeed for its fixed transit customers - who may potentially face different network and non-network costs.
- Third, and most importantly, there is almost no scope for alignment between the interests of transit operators and their transit customers in such negotiations:
  - As Ofcom has acknowledged, TCP transit providers will have an interest in increasing the costs of their rival TCPs by increasing origination charges (§A30.90).
  - EE considers that the tiered termination rates that many fixed TCPs have sought to implement in relation to 080 calls invalidate Ofcom's assumption that "menu costs" are likely to limit these concerns (cf. §3.51). Menu costs are those associated with administering different prices and especially changes in prices or structure of prices. The fact that costs are incurred when prices need to be changed will indeed reduce the frequency with which operators tend to change prices, but does not imply that operators and service providers will prefer a smaller number of overall prices. The costs of setting appropriate prices will involve significant analysis and initial systems work – warranted by the importance of the associated revenue streams. Such initial costs are significant regardless of the overall number of prices involved. Menu costs may drive less frequent *changing* of these prices rather than any reduction in the *overall initial number*: Ofcom has not provided any evidence or argument that a smaller number of prices will lead to a significant reduction in cost, compared to the potential revenue gains which could be made by greater pricing differentiation.
  - EE notes that all TCP transit providers will have an interest in reducing the origination charges payable to OCPs (except in the case of any self originated traffic). Contrary to Ofcom's conclusions,[15] EE does not believe that competition for transit business will address these concerns. For example, as all of the current major transit providers have a substantial 080 hosting business, they will have a common interest in pushing the charges payable for mobile origination down as low as possible, creating a substantial risk that mobile OCPs will be unable to create any significant transit competition in this regard.

EE is also concerned that Ofcom's anticipated closed bi-lateral negotiation process creates significant scope for competitive distortion to be created by large vertically integrated OCP/TCPs, especially those who are also converged

15 See §A30.90 and §A30.51.

fixed and mobile operators – such as CWW/Vodafone.[16.] For example, it is quite feasible that CWW/Vodafone may agree on blended fixed and mobile origination charges which involve relatively high mobile origination charges to support Vodafone's retail mobile business and relatively low fixed origination charges which would still keep average charges to CWW's SP customers at acceptable levels, but insist on a lower mobile origination charge in relation to third party originated mobile traffic. Similarly BT may seek to negotiate fixed origination charges that are relatively low for traffic originated from other fixed networks, but insist on relatively high origination charges for traffic originated from its fixed network. EE does not consider that the proposed limitation on the notification obligation in draft access condition 2 to OCPs with whom a TCP is already directly interconnected will make any material difference to this situation (cf. §§A30.87-A.30.90), given the multiple OCP/TCP/transit provider roles performed by each of the largest TCPs.

One way that EE can see to reduce many of these concerns would be to amend the draft access condition so that TCPs are obliged to notify *Ofcom* of their proposed origination charges, rather than the OCPs with whom they have an existing agreement to purchase origination services. In the case of all TCPs specified in Schedule 1 to the access condition this notification would be required within 1 month of the date of the access condition as currently proposed. In the case of TCPs who subsequently enter the market[17], this should be within 1 month of allocation of the relevant 080 / 116 range to the TCP.

In terms of the content of the notification, in order to ensure full market transparency and minimise both transaction costs and the risks of competitive distortion resulting from information asymmetries, EE suggests that this should include:

a) The TCP's "reference" fixed origination charge proposal;
b) The TCP's "reference" mobile origination charge proposal; and
c) Any proposals applicable in respect of specific OCPs which differ from the "reference" proposals.

Ofcom should then publish on its website a version of Schedule 1 to the draft access condition specifying each of these rates against each TCP as soon as the relevant information is received by Ofcom.

Following this, rather than requiring each OCP to request each TCP to individually purchase its origination services, there should be an option for OCPs to simply notify Ofcom that they wish (directly or indirectly) to sell their origination services to *all 080/116 TCPs* listed in Schedule 1 / subsequently entering the market, which notification Ofcom could publish and thus pass on to the TCPs. On the basis that all TCPs would be obliged purchase these services on fair and reasonable terms EE imagines that this would be the most

16 These concerns echo those already received by Ofcom in response to its April 2012 consultation – see e.g. §§A30.33; A30.51

17 This will require an amendment to the current definition of "Terminating Communications Provider" used in the draft access condition. However EE believes that this definition needs to be amended in any event so as to avoid unduly discriminating between existing and new TCPs, unless Ofcom is proposing to keep Schedule 1 continuously updated, in which case no amendment would be required.

popular option for most OCPs. However it would still be open for them to individually request purchases from a more limited sub-set of TCPs if they so chose.

Following this, it would then be expected that OCPs would seek to enter into bi-lateral negotiations with a number of “lead” TCPs who currently terminate 080 and 116 traffic considered to be of particular importance to the OCP (e.g. those terminating large traffic volumes and any others who host SPs that are of particular importance to the OCP’s customers). Whilst any commercial agreement / dispute finding in relation to these “lead” TCPs would not necessarily bind other TCPs, it may be hoped that such agreements / dispute findings would at least set a compelling precedent.[18]

In relation to this negotiation / dispute resolution process, EE considers that Ofcom should give some further thought to the timetable according to which Ofcom expects this process to take place. Obviously, Ofcom’s intention in requiring early notification of proposed origination charges by TCPs is so that the negotiation / dispute resolution process can start and ideally finish as early as possible into Ofcom’s proposed 18 month implementation period (§A30.15; §A30.38). However, as the experience with BT’s 080 tiered termination rates has demonstrated (with these charges first sought to be imposed in 2009 and the legal proceedings in relation to these charges still not expected to be concluded until at least 2014), such matters can take an extensive amount of time and effort to resolve. Whilst it would not necessarily need to be legally binding, EE therefore considers that it may be helpful for Ofcom to supplement the access condition with some guidance as to the timetable according to which Ofcom would hope to see these negotiations / dispute resolution / notification to SPs etc unfold within the proposed 18 month implementation period.

EE would also like some clarity on what Ofcom expects OCPs to do in relation to the origination of 080 and 116 calls in the event that no legally binding decision is in place (whether by way of contractual agreement or dispute decision) by the time the 18 month implementation period expires. At this stage, the only fair and reasonable solution that EE can see would be for Ofcom to permit the OCP to continue charging its retail customers for the origination of such calls until the necessary origination charge is agreed / determined.[19]

Obviously, these revised arrangements would involve some additional work on the part of Ofcom as compared with the current draft access condition. However, EE does not consider that this would be significantly greater than the work that Ofcom would need to do to monitor compliance with the access condition and achieve the consumer protection objectives behind the proposal

18 Of course, as noted above, the imposition of an SMP charge control obligation on these TCPs would, however, be a far superior solution from the perspective of efficiency and legal certainty.

19 The only other option EE can foresee is for OCPs to potentially block access. Ofcom claims that call blocking is not a reasonable response to resolve issues relating to wholesale pricing (§A30.85). However it cannot be the case that OCPs are obliged to originate calls to a number range in respect of which they are not guaranteed to be able to cover their costs of origination. Otherwise, Ofcom would in fact be imposing a defacto access obligation on all OCPs, which likely to violate Ofcom’s duties under section 3 of the Act.

in any event. At the same time, EE considers that such revisions are likely to materially reduce transaction and information asymmetry costs and improve the likelihood of the industry being able to arrive at a single origination payment for each of fixed and mobile origination calls in a timely manner, as is the current majority industry preference (§A30.51).

4. Implementation costs and complexity severely underestimated

EE is concerned that Ofcom has severely underestimated the communications, negotiations and dispute resolution costs of its proposals. In particular:

- EE notes that Ofcom has failed to quantify the costs likely to be involved of TCPs "communicating" with OCPs (§A30.91). By "communicating", EE understands that Ofcom actually means: communicating, negotiating, endeavouring to resolve any dispute commercially, filing a dispute with Ofcom / defending the dispute, engaging with Ofcom in relation to the dispute and (almost inevitably) then appealing the dispute finding to the Competition Appeal Tribunal ("CAT") and potentially beyond.[20] Given Ofcom's vast experience with such matters, in particular in relation to two tiered termination rate disputes concerning the rates payable in relation to termination of 080 calls, EE finds Ofcom's claims that it would be too complex for Ofcom to cost these activities[21] uncompelling. At the very least, Ofcom can start by quantifying its own staff and litigation costs on relation to the 080 ladder charge disputes. In relation to time costs for all parties, Ofcom could at least use as a conservative starting point its consumer time cost estimates of £5.97 per hour or £0.01 per minute (§A.10.196). Based on EE's own experience of trying to reach agreement on 080 termination charges with BT and for all of the reasons set out above as to why it is likely to be necessary for there to be a number of direct communications and negotiations between OCPs and TCPs who are not directly interconnected, EE also finds the factors listed in §A10.260 highly uncompelling evidence that these costs are "unlikely to be material" (§A10.261). For example, based purely on time costs alone, conservative estimates involving the minimum activities listed in §A10.258 (i.e. without assuming involvement in the essentially inevitable dispute proceedings before Ofcom) and also assuming the small number of negotiating parties considered in §A10.260, EE can already see the relevant costs for the industry hitting the several hundred thousands of pounds mark,if not more.
- Ofcom considers that it is likely that there will ultimately either be a single fixed and mobile origination charge, or a very small number (§A30.51). EE is not convinced that this will prove to be the case given (i) the very divergent interests of the different stakeholders; (ii) the currently fairly wide 1.7ppm range of potentially fair and reasonable origination charges listed in Ofcom's draft 080 and 116 Dispute Resolution Guidance (the "Draft 080 DRG"); (iii) the potential importance in terms of business impact for the various stakeholders of differences in charges of just 0.5ppm; and (iv)

[20] §A10.259 appears to reflect this understanding.

[21] See §§A30.91; A10.260.

current divergent ladder pricing. In the event that a large range of origination charges does emerge, EE disagrees with Ofcom that the associated wholesale billing and related staff time costs are unlikely to be material (§A30.52). As discussed in greater detail below in relation to Ofcom's Draft 080 DRG, in order to try to reduce the likelihood of costs associated with multiple origination charges, EE would like to see Ofcom publish both a tighter range of fair and reasonable charges[22] and much more specific guidance as to the precise circumstances in which Ofcom would consider origination charges at particular points within this range as likely to be fair and reasonable (e.g. in a similar manner as Ofcom has done with its dispute resolution guidance on mobile call termination rates).

5. The drafting of the draft access condition needs tightening

In terms of the legal drafting of the draft access condition, EE has the following comments:

- Access Condition 1.1 – EE appreciates that it is standard wording used in many SMP conditions imposed by Ofcom, but in the present context it is unclear to EE what is a "reasonable request" in writing for a TCP to purchase origination. In particular, EE would like to understand when an OCP request might be considered unreasonable. EE considers that it would be helpful for Ofcom to at least give some elaboration on this, otherwise there is a risk of TCPs abusing this wording to reject requests.
- It is slightly unclear at what date the phrase "has an agreement" in draft Access Condition 2.1 is to be assessed. This is explained at footnote 475 in Annex 30, but would be better clarified in the wording of the Access Condition itself. More importantly, as noted above, EE considers that the Access Condition is deficient in failing to stipulate any relevant notification obligations in relation to TCPs who enter into agreements with OCPs subsequent to the Access Condition coming into effect.
- Whilst the list of current 080 and 116 TCPs in Schedule 1 to the draft Access Condition is helpful, EE considers that the definition of "Terminating Communications Provider" in the draft Access Condition should be amended so that it is both more fit for purpose and more future proof. Currently, draft Access Condition 1 is binding upon any subsidiary, holding company or subsidiary of a holding company of any of the companies listed in Schedule 1, even if the business of those companies has nothing to do with the telecoms industry or the UK. Presumably, a request to purchase 080 and 116 origination services made to such a company would be considered unreasonable under draft Access Condition 1.1. However, EE does not consider that such companies should be obliged to even receive and consider such requests. At the same time, as noted above, there is a risk that Schedule 1 could become rapidly out of date, unless Ofcom keeps it constantly updated with all new 080 and 116 TCPs and deletes any TCPs that exit the market. Fundamentally, there would seem to be no valid

[22] That is, within a range starting at not lower than 2.4ppm at the bottom end (see, in particular, section 4.2 of this response, at pp 28 to 30).

reason for Ofcom applying different obligations to different 080 and 116 TCPs based purely on the date on which they commence business, hence EE believes that Ofcom would need to keep this list updated. To address both of these concerns, EE would recommend that the definition of Terminating Communications Provider" is amended so that it reads something like "*A Communications Provider who conveys a call to a Free-to-Caller Number from an Assumed Handover Point to the point of termination*". For clarity, Schedule 1 could continue to list those providers that Ofcom considers to be Terminating Communications Providers as at the effective date of the access condition, but it would be the definition rather than the list that would be definitive in the event of any discrepancy.

- As noted above, EE does not believe that the definition of "Origination Services" should be limited to calls made by consumers.

6. Access condition could potentially be discriminatory

Section 47(2) of the Act requires an access condition not to unduly discriminate against particular persons / classes of persons. Depending on the level of origination charges recommended by Ofcom in its final 080 and 116 dispute resolution guidance and as ultimately determined by Ofcom in the event of any dispute, EE considers that the access condition could fall foul of this legal obligation. In particular, EE considers that this would be the case if Ofcom maintained its current position as set out in the Draft 080 DRG that fixed OCPs would be able to recover their full LRIC+ costs (excluding A&R costs), but mobile OCPs would only permitted to recover a portion of these costs. This point is discussed further in the section of EE's response dealing with Ofcom's proposed "fair and reasonable" ranges of origination charges for 080.[23]

The proposed level of free phone origination costs

As set out in its July 2012 Response[24], EE continues to believe that Ofcom has materially underestimated the appropriate level of costs which should be recovered from a freephone origination charge levied by mobile OCPs. EE fully agrees with the basic principle that operators should be able to recover their efficiently incurred costs of origination. As such, we agree that Ofcom's "Principle 1" is the right starting point. Where EE disagrees with the approach set out in Ofcom's final policy position is in relation to how Ofcom has applied this principle. The remainder of this sub-section sets out EE's concerns with how Ofcom has derived the ranges for appropriate origination costs used both to identify the potential impacts of the proposed policy changes (the IAR) and as the starting point for establishing what a fair and reasonable charge would be under Ofcom's proposed new freephone regime (the base case range). In summary:

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[23] See section 4.3 at pp 34 to 46.

[24] "Everything Everywhere Limited – Response to Ofcom's second consultation on simplifying non-geographic numbers", dated 11 July 2012.

- The ranges used for Ofcom's analysis should be based on LRIC+ measures and the alternative cost benchmarks which Ofcom cites (pure LRIC and the LRIC differential) are below efficiently incurred costs;
- EE continues to believe that the cost ranges (based on LRIC+) should include at least some allocation of A&R costs, because SPs also benefit from such efficiently incurred costs and Ofcom has not substantiated its claim that recovery of these costs through origination charges would lead to them being at an inefficient level (which underpins Ofcom's decision not include them);
- Even if Ofcom continues to calculate its ranges using the same cost benchmarks (i.e. from pure LRIC to LRIC+ excluding any A&R costs), there are a number of elements of the calculation of these costs which are out of date or incorrect which need to be updated and which could materially increase Ofcom's figures;
- As a result, EE believes that the correct cost estimation involves a range which should be no less than 2.8ppm to 6.0ppm.

EE discusses each of these points in turn below.

1. Ofcom's ranges should exclusively be based on allowing recovery of LRIC+ costs

In setting both its base case range (on which Ofcom places greater weight and which appears to be the range Ofcom intends to focus upon in determining whether freephone origination charges are fair and reasonable) and the wider IAR, Ofcom has used a range of different cost benchmarks.

When setting these ranges it is clearly vital that there is no danger of rates being below pure LRIC (i.e. those costs which are only incurred because a service is provided excluding all costs which are common with other services), as this would lead to OCPs losing money on a per call basis by not even covering the capacity costs of carrying those calls. Ofcom suggests that any rate above the pure LRIC level can be considered to satisfy the cost recovery principle – as it will make at least some contribution to common costs.[25] EE disagrees and does not consider that the pure LRIC level of costs can be considered as the minimum level which satisfies cost recovery.

First, in the call termination context, pure LRIC rates were set on the basis that common costs could be recovered from other services without (In Ofcom's view) significant adverse impacts.[26] Ofcom has not undertaken analysis which demonstrates that any common costs which cannot be recovered from freephone origination are more efficiently recovered from other services. Increases in the prices of other mobile products, as a result of being required to recover a greater proportion of common costs, would represent a distortion to competition and allocative inefficiency.

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25 See §12.29.

26 See especially section 7 (including the conclusion at paragraphs 7.212-7.215) of "Wholesale Mobile Voice Call Termination: Statement" published 15 March 2011.

Second, such common costs need to be recovered from somewhere. The increasing scope of consumer protection measures and direct charge controls (across international roaming and mobile call termination) is reducing the flexibility of mobile operators to recover such costs from alternative revenue sources. Ofcom should not, and has no justification for, further restricting mobile operators' ability to recover their costs without any findings of SMP. Depressing prices below levels which allow a reasonable contribution to all relevant costs (i.e. including a contribution to common costs) requires specific justification. This should only be done in the context of a charge control where a full case can be made for not allowing appropriate cost recovery. Otherwise Ofcom should place most weight on, if not exclusively consider, wholesale prices which allow a fair and reasonable contribution to common costs and as well as direct costs. This is the LRIC+ level of costs (i.e. pure LRIC plus an appropriate allocation of all costs associated with the service which are common with other services). Ofcom in this regard needs to have regard to its statutory duties as discussed above.

Third, Ofcom's approach is short term. Ofcom is correct that economic theory suggests that an operator would continue to provide a service if it recovered at least its pure incremental cost (i.e. more than the marginal cost of providing the service such that it is providing some contribution, however small, to common costs). But this is only in the relatively short term. In the longer term, especially to the extent that common costs can be varied, operators will have the incentive to reduce the output of services which provide little contribution to common costs overall and concentrate on products with a higher contribution. Ofcom's CBA for unbundling is conducted assuming a 10 year post implementation period. Adopting a consistent approach for the freephone ranges suggests that it is important that Ofcom does consider longer term incentives.

Fourth, the LRIC differential approach (which we understand to be the pure LRIC of originating mobile calls added to the **absolute** amount of common cost contribution contained within a **fixed** LRIC+ measure) suffers from many of the same issues. It still represents a cost measure *below* the mobile LRIC+ measure and therefore does not lead to a reasonable contribution to **mobile** common costs. Any approach which led to mobile origination charges being constrained to this level (while fixed origination charges would be able to recover up to the full fixed LRIC+ level) would not be technologically neutral: by definition this leads to mobile originators recovering a lower **proportion** of their common costs than fixed operators. By not allowing a reasonable contribution to mobile common costs, this measure (albeit in a slightly less extreme way than the use of mobile pure LRIC) would be subject to all the same criticisms set out above. Ofcom's use of this new analysis in its final policy position is also entirely lacking in any objective justification and EE accordingly strongly recommends that it is given no weight in Ofcom's final legal instruments.

In summary, EE considers that the appropriate ranges of potential prices which should be considered for both the IAR and the base case range should be limited to those that meet the threshold requirement of allowing OCPs to recover their LRIC+ costs.

2. Ofcom’s estimate of LRIC+ costs should include some contribution to A&R costs

Any such range of LRIC+ measures should also include cost measures which include some recovery of A&R costs. Ofcom has explicitly excluded any recovery of these A&R costs from the LRIC+ estimates it has made for these purposes. In contrast, EE considers that these estimates should represent the *lower bound* and that the upper bound of Ofcom’s ranges should include measures which include some recovery of A&R costs. There are a number of reasons why Ofcom’s approach (of completely excluding these costs) is inappropriate:

- **Cost causation**: these costs create the customer base which enables SPs to receive calls. To say that A&R costs are only “caused” by callers ignores the fact that telecommunications is a two way process. At the extreme, if callers had nobody to call then they would not wish to take any service and therefore would not cause any A&R costs. Both sides to the call benefit from a larger base of customers – the essence of the telecoms positive network externality – and therefore both calling and called parties in some sense both cause and benefit from A&R costs.
- **Cost minimisation**: Ofcom argues that if some of these costs are recovered from SPs then this will blunt the cost minimisation incentive for OCPs. This ignores the fact that Ofcom expects these charges to be set through commercial negotiations with TCPs who each possess a monopoly on the termination of such calls on their network, under the shadow of a potential dispute resolution process. The characterisation of mobile OCPs simply being able to pass through these costs to SPs - and thereby reduce downward pressure on these costs – is incorrect. It also needs to be recognised that the overall level of CARS costs is determined in a highly competitive overall mobile sector. Any danger of cost minimisation incentives being materially blunted is therefore remote.
- **Distribution of benefits**:
  - Ofcom argues that there are parallels between the discussion of the network externality impact of recovering A&R costs through an origination charge and the “network externality surcharge” (“NES”)[27] previously applied to mobile termination rates. However, the arguments deployed by the Competition Commission (“CC”) in removing the NES from regulated termination rates do not directly read across in this situation. First, the NES was originally concerned with contributing to the *marginal* increase of the overall mobile subscriber base (as Ofcom makes clear in §12.36). EE considers that the debate here is rather about recovery of *overall* mobile costs (where in an overall dwindling non-geographic call market A&R costs are efficiently

[27] As Ofcom notes in §12.37, this was the uplift applied to mobile termination rates to reflect the externality benefit of increasing the overall number of mobile subscribers.

incurred in order to *maintain* the existing mobile subscriber base and compete) rather than a "surcharge" calculated purely in relation to the benefits of *additional* mobile subscribers. This is therefore a conceptually different issue, which relates to whether SPs benefit from these costs being incurred. Ofcom asserts that recovery of a proportion of these costs from SPs would lead to them being incurred inefficiently (leading to "unnecessary and inefficient upgrading and switching"[28]). The basis for this assertion is unclear and it is unsubstantiated. In particular, it is unclear on what basis Ofcom considers that A&R costs are inefficient, as Ofcom has not provided any evidence on this point. If such costs are in fact *efficient*, restraining the ability of mobile OCPs to recover these efficient costs will cause mobile OCPs to have to reduce these costs below efficient levels, which is likely to be detrimental to consumers.

- Furthermore, the fact that Ofcom's market research indicates that on average SPs are willing to pay up to 5.8ppm for mobile call origination charges also suggests that SPs do see tangible benefits accruing to them through mobile operators' A&R spend.[29] Rational SPs would not have this willingness to pay unless they saw a benefit to paying charges at this level. It is particularly notable that this level these charges would enable OCPs to recover Ofcom's full 5.5ppm estimate of LRIC+ costs including a 100% contribution to A&R costs[30]. EE considers that the fact that SPs are willing to pay charges at these levels makes it incumbent on Ofcom to revisit the ability of OCPs to recover a substantial proportion if not 100% of their A&R costs from the 080 origination charge. Ofcom cannot simply exclude these costs overall from its consideration of the relevant costs ranges. In contrast, Ofcom appears to contend that there is not enough granularity in the cost information collected for the mobile call termination modelling process to allow an analysis of what proportion of these costs should be recovered from these origination charges. At most, EE considers that this is an argument for updating Ofcom's information base and further analysis rather than simply dismissing this cost category overall on the basis that an out of date evidence base collected for a different purpose is insufficient.

All of the above factors suggest that a substantial allowance for overall A&R costs (if not 100%) should be considered within the range set for LRIC+ costs which can be recovered.

On the basis of the figures included in Ofcom's final policy position[31], EE therefore considers that the range of what constitutes efficient costs permitted to be recovered from mobile origination charges for 080 calls should lie between 2.4ppm (Ofcom's estimation of LRIC+ with no allocation for CARS

28 Second bullet of §12.38 of Ofcom's final policy position.
29 See §A27.95 of Ofcom's final policy position.
30 See Table A26.5.
31 *Ibid.*

costs) and 5.5 ppm (Ofcom's estimation of LRIC+ all CARS costs, including 100% of A&R costs).

3. A number of Ofcom's cost calculation elements are out of date or incorrect and need to be updated

Furthermore, those figures as they are presented in Ofcom's final policy position are subject to a number of deficiencies which mean they underestimate the relevant cost measures. Even if Ofcom continues, in EE's view erroneously, to base its ranges on the same below LRIC+ cost benchmarks, the calculation of their level needs to be updated to take account of these factors.

First, Ofcom has based its cost estimates on the mobile call termination cost modelling which was undertaken in 2008/09 prices. As such, Ofcom has needed to apply inflation to express these cost measures in 2014/15 prices. Ofcom has calculated the relevant inflation factor to be 1.197. This is materially below the appropriate inflation factor for the following reasons.

- In order to be fair and reasonable and comply with Ofcom's statutory duties, Ofcom should use the best available and most up-to-date inflation data. Since the publication of Ofcom's policy position, more recent relevant inflation figures have been published (for March 2013). These figures are significantly above the 2.5% assumption which Ofcom has used for future years and. This increases the 1.197 inflation factor to 1.206.
- In relation to mobile call termination Ofcom used an assumption of 2.5% for future years' inflation. However, there is a good reason for departing from this approach here: in the mobile call termination context this **assumption** was simply used to give an indication of future years' rates (as under the charge control actual rates are determined by out-turn inflation).[32] What is required here both for the purposes of indicating fair and reasonable origination rates and for the purposes of undertaking the impact assessment of the proposed policy changes is a **forecast** of relevant inflation, such that the cost benchmarks are based on the best available view of actual inflation. 2.5% is far from a robust forecast of inflation over the relevant period. Independent inflation forecasts would suggest a materially higher rate which Ofcom should use here. Based on a forecast of 3.0%[33] inflation for 2013, this further increases the inflation factor to 1.212.
- Finally, Ofcom is establishing prices for 2014/15. The mobile call termination model estimates costs based in prices at the end of the year 2008/09. Ofcom has only inflated costs to the end of the prior year (2013/14). A consistent approach would therefore further inflate

32 This is apart from the technical point that future inflation was needed to apply the geometric conversion factor to ensure that the X factor could be expected to reduce charges to the right cost level. However, this does not materially change the fact that future rates were not set on the basis of this assumed inflation but rather on the basis of actual inflation.

33 Based on the most recent average of independent forecasts published by HM Treasury, See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/199018/201305_-_Forecasts_for_the_UK_economy.pdf.

these costs to end of the relevant year (2014/15). Assuming a forecast of inflation of 3.2% for 2014[34] therefore leads to a more appropriate inflation factor of 1.251.

Second, Ofcom has excluded billing costs from its estimates of origination costs. This is not appropriate. A large proportion of the relevant billing costs would still be incurred. The calls still need to be metered and a wholesale billing system is still required in order to accurately and appropriately bill the terminating providers as well as wholesale MVNO customers. The mere fact that the relevant number of minutes would no longer be identified on a customer's bill is not, as Ofcom appears to consider, a reason why these costs cease to exist. Even if completely suppressed from the consumer's printed bill many, if not most, of the "behind the scenes" billing costs would still need to be incurred potentially even on the retail billing systems. Therefore Ofcom should include at a least a proportion of billing costs in the cost estimates.

Third, Ofcom has included an allowance for common costs no longer recovered from call termination given the move to pure LRIC in both fixed and mobile figures. However, the approach taken to calculating this allowance is inconsistent. In the fixed context, origination charges are allowed to recover **all** of the common costs previously recovered from call termination. The figures which Ofcom has used for fixed call origination are taken straight from the Fixed Narrowband Market Review where it is clearly stated that this is the methodology used.[35] In contrast, Ofcom's final policy position states that in calculating the mobile origination costs, these common costs have been spread "across all services" implying that not all of these costs have been allocated to origination as with fixed.[36] This difference in approach is therefore not technology neutral and materially disadvantages mobile OCPs. Ofcom should use a consistent approach across both the fixed and mobile sectors. This is potentially a material impact, as EE roughly estimates that using the same approach for mobile as has been used for fixed would increase the mobile LRIC figures by in the region of 0.2ppm.[37]

Fourth, Ofcom's estimates of the appropriate cost benchmarks do take account of customer care costs, with the range taking account of different levels of recovery of the "other CARS costs" category used in the mobile call termination cost modelling work. EE agrees that this is appropriate and required, but considers that the estimates of CARS costs used are significantly out of date. As set out in EE's previous response, the level of CARS costs has increased materially since the mobile call termination analysis was undertaken[38] and therefore EE does not consider that the figures Ofcom has used remain appropriate. The reasons that Ofcom has set out for not updating the figures in relation to these costs do not bear up to scrutiny:

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34 *Ibid.* Using same source as used above for 2013.

35 As set out in paragraph A12.210 of "Review of the fixed narrowband services markets", consultation published on 5 February 2013.

36 See §A26.63.

37 Based on the latest version (Release 4) of the MCT LRIC Cost Model, available from http://www.ofcom.org.uk/static/wmvct-model/model-2011.html.

38 See EE's comments on Annex 22 (under the response to Consultation Question 16.2) on page 49 of its July 2012 Response.

- First, Ofcom states it would be disproportionate to recalculate these costs.[39] However Ofcom's overall cost estimates are being used to justify a significant and potentially disruptive change and moreover as essentially a price cap on the wholesale charges of non-SMP communications providers. Given EE's view that the CARS element of the costs has increased, this means that Ofcom is basing this significant change on a material underestimate of the impact. It is also unclear how this will be taken into account in any dispute resolution process which could involve disputes over significant amounts of money. Given that these are potentially material impacts and the CARS costs which Ofcom is presently using will be even more out of date by the time it comes to any dispute resolution proceedings, Ofcom may need to revisit these costs in that context. It will lead to a more consistent outcome and beless burdensome on industry as a whole if Ofcom considers these costs as part of its consultation process on its final policy position, rather than in the tightly time constrained context of individual disputes. Indeed differences of view on the level of these costs;the fact that Ofcom has not engaged in further consultation on these levels and consequently the fact that Ofcom has failed to provide clear and unambiguous guidance as to the level which may be recovered could make disputes over origination charges more likely.
- Second, Ofcom also argue that if they updated CARS costs then that would imply a need to update all of the mobile call termination cost modelling work. This argument fails to take account of the reality of how these figures were gathered and the scrutiny to which they have been subjected. The network cost figures were considered more recently as part of the CC proceedings in some detail. Further the mobile call termination market review overall did not apply the same level of scrutiny to CARS costs, which were not being recovered from call termination. In contrast, there is no significant evidence that the network cost estimates need the same amount of scrutiny, nor reason to believe that they may have changed significantly. In these circumstances, the fact that there is good evidence that CARS costs have significantly changed (as provided by EE in its previous response) means that it would in no way be inappropriate for Ofcom to update this element of its cost estimates in isolation.
- Third, Ofcom suggests that a full cost modelling exercise is not appropriate or proportionate in the present context, where no charge control is being set. However, the mere fact that these cost figures are not part of a market review does not mean that Ofcom is able to use less robust figures. Ofcom's review of non-geographic numbers has already been over three years in the making and taken a significant amount of time and combined industry effort. It is accordingly both necessary and entirely appropriate that the assumptions underlying Ofcom's extensive analysis are robust. Further, as noted above, in effect, Ofcom's figures will (and are intended by Ofcom so as to limit the potential impact on SPs and thus costs of its proposals to) represent a *de facto* price cap on the level of origination charges that OCPs can recover. Proportionality would suggest that it is the

[39] See §A26.49.

scale of the impact on the industry which should be considered here and not simply the legal instrument which is being used. The potential impact on the industry is extremely significant, notwithstanding that Ofcom is not (presently) proposing to impose a formal charge control on TCPs - [✂]

[40] [✂]

- Finally, Ofcom also suggests that no further evidence was provided by consultees on the level of CARS costs.[41] This ignores the fact that EE provided estimates in its previous response to show that the overall CARS costs used from the mobile call termination market review were significantly less than current total CARS costs. Ofcom appears to be envisaging that it would have needed more detailed breakdowns of these costs to be convinced. However, EE is not aware of Ofcom having provided any detail of how it would want these costs to be broken down or even, prior to this Consultation, the types of CARS costs in principle it was including (i.e. "customer care" costs). In such a situation, it was incumbent on Ofcom to seek relevant information from the operators as part of its lengthy consultations rather than to expect operator to second guess what was required and supply it in response to consultations.

4. Conclusions on costs

Overall therefore, EE considers that the appropriate range of potential efficiently incurred costs should lie between the different elements of LRIC+ (recovering different levels of CARS costs up to and including recovery of 100% of A&R costs), appropriately adjusted up for the factors described above in relation to inflation, billing costs, common costs no longer recovered from call termination and the level of "customer care" costs.

As set out in Table A26.5, Ofcom presents a LRIC+ range of between 2.4ppm and 5.5ppm (depending on what CARS costs are included). Taking into account the above adjustments, EE considers that this range should be increased to **at least 2.8ppm to 6.0ppm**. This range uses the updated inflation approach described above, includes billing costs in all of the LRIC+ estimates (and not just at the top of the range) and uses the same approach to "unrecovered common costs" for mobile as is used for the equivalent fixed costs in the Narrowband Market Review.[42] As stated above, EE also considers that the overall level of CARS costs should also be revisited and revised upwards. Based on the 3.12ppm of overall CARS costs which EE set out in its July 2012 response, and making reasonable assumptions for illustrative purposes, this could further increase the "LRIC+ (all 'other CARS')" measure from 3.74ppm to around 3.9-4.0ppm. It would also imply the top of the range

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40 [✂]

[✂]

41 See §A26.50.

(including all CARS costs) would increase from around 6.0ppm to around 7.0ppm.

In the light of the above, it is clear that Ofcom's current base case range does not allow appropriate cost recovery, is not therefore an appropriate basis for the IAR and would not lead to a fair or reasonable outcome were it to be applied by Ofcom in a dispute resolution context, and must therefore be revised.

Assumptions behind the "fair and reasonable" ranges of origination charges for 080

The previous sub-section set out EE's views on the underlying mobile origination costs which Ofcom should take into account in setting the proposed "fair and reasonable" ranges of charges, in order to ensure that mobile OCPs are able to recover their efficiently incurred costs (Ofcom's "Principle 1" in its final policy position). This section turns to Ofcom's approach in using those cost ranges to consider what a fair and reasonable charge should be (broadly the analysis covered under Ofcom's "Principle 2" in its final policy position).

Principle 2 trades off different potential impacts on consumers and impacts on competition to reach a view on the appropriate level of the origination charges. Ofcom undertakes this in two steps:

- step 1 being a trade off between service availability (in relation to 080 services) and the tariff package effect ("TPE"); and
- step 2 considers an assessment of "the relative prices between fixed and mobile origination charges".

Ofcom's basic approach in applying steps 1 and 2 of its Principle 2 assumes that it is necessarily economically efficient for more 080 calls to be made and more SPs to use 080 numbers. This approach fails to take account of other, potentially more economically efficient, ways of accessing the underlying services (for example through web pages or apps). It also fails to take due account of the fact that, in cases where the net benefits to the customer benefits are the same or only very marginally higher from making an 080 call from a landline or a mobile, it is more efficient for the customer to make the call from a landline, as the costs incurred in fixed origination are substantially lower than mobile origination. The assessment of impact on other mobile services of charging below LRIC+ is also simplistic and based solely on the overall revenue impact on mobile OCPs under a range of assumptions rather than considering the impact on structures of charges.

In Ofcom's analysis under its step 1, this trade off is considered in terms of balancing the following competing factors:

1. higher mobile OCP origination charges leading to lower mobile retail prices more generally through the TPE;

[42] Using the steps set out in Paragraph A12.210 of Ofcom's "Review of fixed narrowband services", published 5 February 2013.

2. higher origination charges increasing the likelihood that SPs will cease to provide services using 080 (willingness to exit);
3. the idea that the risk around reductions in 080 services is greater than the risk around a negative impact from the TPE and that this asymmetry supports limiting the overall level of mobile origination charges; and
4. the existence of a positive caller externality means that optimal charges will be below SPs' willingness to pay.

EE has previously set out its views on the first two of these factors in its previous consultation response and continues to have concerns with Ofcom's approach to estimating the TPE impact and the impact of charging arrangements on whether SPs exit.[43] Ofcom specifically asks for views on the third and fourth of the factors above. The remainder of this section covers EE's views on these points (in conjunction with the answers to consultation Questions 12.3 and 12.4 below) as well as our views on Ofcom's application of the second step under Principle 2 (i.e. the balance between fixed and mobile charges).

Asymmetric risk

In the fourth element of step 1, Ofcom places emphasis on the uncertainty around its market research of potential SP responses, compared to Ofcom's asserted confidence that the TPE "will not be greater than the 100% we have assumed to arrive at the estimates shown above".[44] As a result of this, Ofcom suggests that risks associated with "too low" origination charges are outweighed by the risks of "too high" charges and that this supports limiting the level of origination charges.

This approach raises a number of concerns both conceptually and practically in terms of how Ofcom has applied this.

At a conceptual level, Ofcom's approach fails to recognise that the risk in relation to impact on service availability is in fact symmetric (i.e. it could be both more or less than Ofcom has assumed based on its market research). None of the uncertainties which Ofcom identify around the extent to which its market research will capture actual SP behaviour lead necessarily to a greater rather than lesser impact. The asymmetric risk Ofcom identifies is therefore in some sense artificial, by only considering the risk in one direction compared to the risks around the TPE. The risk of SP exit from the 080 range being lower than anticipated by Ofcom becomes particularly important at the point at which Ofcom starts suggesting that OCPs should be able to recover any less than their full LRIC+ 100% of A&R costs from the origination charge as a result of the impact of the charge on this SP behaviour – which is a point crossed in Ofcom's current proposals.

[43] See, for example, the section on Consultation Question 16.2 in EE's July 2012 Response. EE also sets out further reasons as to why it remains sceptical of Ofcom's reliance on SPs' willingness to exit, effectively ignoring willingness to pay, below in relation to its response on the caller externality (see pp 38 to 42).

[44] See §12.103.

In relation to the risk on the TPE, Ofcom avers that this can only be one way given that a 100% TPE is being considered. Ofcom therefore characterises the estimates of the size of this effect effectively as a ceiling and appears to be suggesting that the actual impact must strictly lie at or below the level of its estimates. This ignores the fact that the size of Ofcom's estimates of the TPE depends very heavily on a number of assumptions (as explicitly acknowledged in Annex 28). For example, the level of origination costs and percentage of calls which switch from fixed to mobile are both input assumptions which have an absolutely critical impact on the estimated levels of the TPE. These assumptions are clearly subject to symmetric risks of being either estimated too low or too high[45] and are far less certain than Ofcom is implying in its consideration of asymmetric risks as between service availability and the TPE. Ofcom has not taken into account the potential adverse impact of a TPE greater than it has estimated and there are also risks associated with the incidence and competitive impact of any such greater negative effect, which could mean the overall impact on consumers is more adverse than would be suggested by simple financial measures of its size in revenue terms as assessed in Annex 28.

Another conceptual dimension ignored in Ofcom's final policy position is the basic point discussed above that Ofcom has assumed that all 080 service reduction is unequivocally bad. This does not take into account that alternative ways of contacting SPs or accessing the underlying services could be more efficient / beneficial for consumers (e.g. using mobile apps, websites, or Instant Messaging). Setting origination charges to reflect the appropriate level of underlying costs (including a reasonable contribution to common costs as discussed in the section above) will provide efficient incentives to all parties. This will lead to allocative efficiency. Ofcom's approach under this asymmetry of risk element of step 1 essentially distorts the wider markets, *inter alia* reducing incentives for SPs to innovate.

From a theoretical perspective, EE therefore considers that there is absolutely no justification for Ofcom's view that it should "err on the side of caution" in "limiting the increase in SP[s'] average out-payments to below 1ppm".[46]

Neither does EE agree with the practical analysis undertaken by Ofcom on asymmetric risks in the event that the call origination charge is set "too high". For the reasons set out below in relation to discussion on the caller externality, EE remains sceptical of Ofcom's reliance on willingness to exit, effectively ignoring willingness to pay, of SPs. Taking account of the revealed willingness to pay in Ofcom's market research would lead to a significantly higher potential overall out-payment being considered reasonable. Ofcom should at least take this into account.

The discussion of the conceptual weaknesses in Ofcom's approach above also suggests that Ofcom needs to distinguish between cessation of service and migration of service away from 080. It is economically more efficient that those

[45] Although as set out elsewhere in this response, EE considers that as presently estimated the risk is tilted very heavily on the side of Ofcom costs having been estimated too low and substitution to mobile 080 calls too high.

[46] See §12.104.

080 operators who do not share other SPs' willingness to pay for free-to-caller calls from mobiles to migrate to other number ranges than to expect mobile originators to subsidise their continued presence in the market. Ofcom's arguments around the alleged asymmetry in risk effectively push mobile origination payments below LRIC+. This can be considered as a cross subsidy from other mobile services to 080 services – for example 084 and 087 services. In practice what this factor is implying is that the risk that there could be a reduction on 080 services should be given more weight than the risk that there could be a reduction in other services (e.g. the exit from the market of marginal 084 or 087 SPs if OCPs need to increase the AC for these calls to recover their 080 origination costs, leading to a reduction in 084/087 call volumes; recovery of 080 costs by way of reduced mobile OCP spend on innovative new features and services etc). It is entirely unclear why this should be the case (the justification given by Ofcom being simply uncertainty around the evidence base on which the policy is being derived).

The context of there being no SMP finding in relation to origination services and that mobile operators are no longer able to recover common costs from termination should also be taken into due account in Ofcom's analysis. In these circumstances, it is entirely fair and reasonable that mobile OCPs are able to charge at least their full LRIC+ costs of originating 080 calls. Ofcom's own research shows that many SPs are willing to pay such a rate. For these SPs, the benefit to customers and thus to their own business case makes this worthwhile - i.e. this is the rate which promotes overall allocative and dynamic efficiency providing all sides of the market with sensible and appropriate incentives.

In applying the asymmetric risk criterion, Ofcom is essentially just assuming that the only risk or unknown in its analysis is that there may be a *greater* negative impact on willingness to exit than its analysis has shown. As noted above, this ignores the potential for there to be a *smaller* impact on SP exit than Ofcom's research suggests. In addition, it underestimates the residual benefits to consumers that would still flow as a result of a number of the mitigation strategies available to SPs who are unwilling or unable to pay the full 080 mobile call origination cost:

- For example, Ofcom has noted that SPs may be able to manage their costs by activities such as playing pre-recorded announcements for mobile customers directing them to *alternative means of communication*. In the event that this alternative means of communication is a zero rated mobile voice short code, a free to call skype number or free to use web chat or online booking service, by way of just some examples, there may be essentially no loss in net benefit to the consumer (especially once awareness of these alternative means of communication is raised). Indeed, it is entirely conceivable that increasing use of functions such as online booking and purchase systems rather than 080 phone calls reduces costs and improves outcomes for both consumers and SPs, enhancing overall consumer welfare.

- Even in the case where SPs chose to migrate to other chargeable number ranges, it is only the difference between the cost of calling the alternative number range and the calls being free to caller which is relevant – and this may be negligible.[47] It is not clear where the overall potential for an asymmetric negative impact on consumers arises here, as if services are valued sufficiently to pay the additional costs consumers will do so. Those who do not simply do not value the service at that level and in such a situation the mere deficiencies of Ofcom's evidence base are not sufficient justification for biasing the result towards a cross subsidy from other services. Such a cross subsidy would, by definition, be benefitting only the least valued 080 services.

EE therefore considers that Ofcom's approach to asymmetry is highly flawed, by inappropriately weighting willingness to exit as entirely negative in terms of net consumer benefit and equivalent to removal of the service overall.

Ultimately, as noted above in section 3.1 (see pp 9 to 11) of this response and as set out in EE's response to the April 2012 Consultation, the best way for Ofcom to ensure that it can address the heterogeneous needs of different current freephone SPs and does not create any unnecessary distortions or net consumer detriment by setting the 080 origination charge either too high or too low is to select the MMP option for the 080 range – which will ensure that all 080 SPs can remain in the market and that there is no subsidy required by MNOs and their customers of other services – and to introduce a new 0500 free to caller range to which SPs who are prepared to pay the full origination charges can migrate.

Caller externality

EE does not agree that a caller externality for calls to 080 and 116 limits the SP out-payment to below 1ppm. Ofcom states:

> *"The existence of a positive caller externality (if there is a less than complete internalisation by SPs) may therefore imply that the optimal origination charge for consumers is below SPs <u>willingness to pay</u>."*[48]

Ofcom's argument involves four elements:

1. That there is a positive caller externality;
2. That the existence of this externality would justify a legally binding dispute determination by Ofcom requiring OCPs to recover less than their full LRIC+ 100% A&R costs of 080 origination in order to limit the extent of the externality;
3. That the level of under-recovery by OCPs in element 2 needs to result in SPs on average paying less for mobile 080 origination than they are on average willing to pay; and
4. As a net result of the first three elements, mobile OCPs need to subsidise 080 SPs to the extent that the subsidy achieves a situation where the average net-out-payment by SPs is below 1ppm.

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[47] EE notes Ofcom considers that the average cost of calling 03 numbers is relatively low, for example. See §A28.56.

[48] See §12.108.

For the reasons set out below, EE considers that, to the extent that such an externality exists, no such subsidy is necessary in order to address it.

Element 1 – whether and to what extent such an externality is likely to exist

The existence of such a caller externality relies on SPs not taking account of the benefits to callers of the SP staying on a free to call number range.[49] Ofcom briefly acknowledges that this externality will at least in part be internalised (i.e. SPs will take at least **some** account of this benefit). Given that all SPs currently have to pay something to a TCP to host their 080 number and to receive calls, logically it must be the case that SPs do to some extent consider the benefits to calling customers of the SP incurring these costs – at least when they first take out the number and rationally at various points after this when considering whether or not to stay on that number range and to continue to incur those costs. Essentially, the benefit to consumers is the benefit to the SP (their business case) for considering such numbers. In essence a SP will choose a free to caller number range where it considers there is some benefit to stimulating calls to it in this way.

Situations where an SP will decide to choose an 080 number include, when:

- offering a charitable service and the SP wants to make it as easy and cheap as possible to provide their charitable assistance to their target callers;
- offering a government service and the SP wants to make it as easy and cheap as possible to provide their assistance to their target callers;
- offering a free to call sales enquiry line to make it as easy and cheap as possible to call to generate sales of a SP's profitable product / service; and
- offering a free to call customer service line which is as cheap and easy as possible to call to create a good customer service experience, which will assist a SP to retain happy customers and gain more customers to whom they sell their profitable product / service.

In each of these cases there is clearly a significant benefit to the SP as well as the consumer from using the SP's free to caller number and therefore it is not obvious what is leading to the source of the alleged caller externality.[50]

While, under the new regime, it will cost the SP more to receive calls from mobiles than from landlines, the customer will not be aware of this because all calls are free. However the SP and the customer should ultimately value the ability to make the calls from mobiles about the same. An SP who tries to take measures to limit calls from mobiles (e.g. playing a pre-recorded announcement asking mobile customers to dial another number) can expect to see a drop off in the number of calls made from mobiles. It would then be a simple matter of whether this drop off costs the SP more than the cost of not taking actions to limit calls from mobiles. This is efficient. If the ability to call from a mobile is vital / very important to those customers, then the SP will see a drop-off in total

[49] See §12.106.

[50] EE notes that, while making no firm conclusions, the Competition Commission (CC) found no evidence of uninternalised caller externalities See CC Final Determination of 9 February 2012 in cases 1180-1183/3/3/11 at paragraphs 2.137ff. Indeed this determination (at paragraph 2.414) reported Ofcom's view that uninternalized call externalities were not "an important feature of the UK market".

calls. If the ability to call from a mobile is a "nice to have" but not a "must have" - as customers can as easily / almost as easily call from a landline - then the SP will not see a significant drop-off. The drop-off in calls can be expected to have a direct impact on the SP's business case (reducing the benefits outlined above from having a free to caller number in the first place). As such, EE considers that incentives will in fact be appropriately aligned and that there is only a very weak case for any externality impact.

Elements 2 – 3 – requirement for / net benefit of OCP subsidy

As a result of this alleged externality, Ofcom claims that the prices paid by SPs for 080 call origination should be below the private value market clearing rate (i.e. where willingness to pay equals full origination costs) to further stimulate output.

There are a number of fatal flaws in Ofcom's analysis, as follows:

- It fails to take into account the alternative more beneficial or more efficient ways of contacting the SP which may be available or incentivised if SPs are required to bear the full cost of mobile origination. Ofcom's approach is also a one sided analysis in that it proposes to constrain the level of the origination charge without also considering the impact which such an effective cross subsidy has on the services which will fund this cross subsidy. By constraining the amount of cost which mobile OCPs can recover from 080 calls in this way, Ofcom has not off-set the alleged benefits of reducing the risk of this caller externality against the costs in terms of distortion to mobile OCPs' incentives and other prices. [51] Accordingly, it is not at all clear that, even if there is such an externality, Ofcom's approach is the least cost, least intrusive and most efficient way of dealing with it.
- Ofcom has not set out why, for example, it considers that it is most efficient for the cost of subsidising this externality to borne solely by originating and not also by terminating operators. According to the 2009 flow of funds study, almost half of the charges paid by SPs in respect of 080 calls are retained by TCPs. In a situation where TCPs will derive an equal or greater financial benefit from the mobile origination of 080 calls than mobile OCPs under the new free-to-caller regime, there is a strong argument that TCPs, rather than OCPs, should bear the cost of any subsidy required to be given to SPs to protect consumer interests.

Element 4 - average net-out-payment by SPs needs to be below 1ppm

The level of the average out-payments, to which Ofcom considers these factors point, is 1ppm. Even if Ofcom continues to consider that these factors are relevant, then EE also has concerns about the weight which is being placed on this 1ppm figure. Specifically, EE considers that this figure is nowhere near as objective and obvious from Ofcom's market research as suggested in Ofcom's final policy position.

[51] See the discussion on these points above in relation to asymmetric risk Section 4.3 at pp 35 to 38.

The 1ppm benchmark is based on the survey evidence[52] of SPs' willingness to *exit.*[53] EE considers that this is not the appropriate benchmark for assessing (relative) optimal prices. Given that the externality and optimal charge is relative to the willingness to *pay*, Ofcom should use the evidence on SPs' willingness to pay responses rather than their willingness to exit responses to inform its assessment in relation to asymmetry of risk and any caller externality. Ofcom's market research shows that SPs are willing to *pay* an average 5.8ppm[54] for call origination (given this is an average, the payment for mobiles would be in fact higher). Accordingly, even if the risk asymmetry or caller externality factors were relevant then, they would potentially support an average call origination charge payment up to 5.8ppm. This figure is higher than Ofcom's estimate of the full LRIC+ costs including 100% of A&R costs (at 5.5ppm), and approaches EE's current assessment of these costs (at somewhere in excess of 6ppm) and accordingly affords no justification for preventing mobile OCPs from being able to recover at least Ofcom's current 5.5ppm assessment of these costs.

EE also considers that the willingness to exit responses in Ofcom's survey of SPs must be interpreted with caution. When consumers are asked if they would switch provider in response to an increase in price, respondents to such hypothetical questions tend to overstate switching intentions relative to the actual switching which is subsequently observed in practice. Similarly if you ask a group of SPs above what charges they will choose to exit, these stated intentions will almost certainly overstate actual future exit.

EE notes that both Ofcom and the CC rejected EE's evidence of customer switching in response to pay-as-you-go handset price increases and pence per minute call charge increases for similar reasons in the context of the mobile call termination market review.[55]

There are several ways in which Ofcom could in practice take account of the likely overstatement of willingness to exit. For example:

SPs reported they were "fairly likely" or "very likely" to exit. Those that stated "fairly likely" could arguably be given less weight on the basis they are the more marginal SPs to hypothetically exit. The impact of this would be to suggest that the percentage of willingness to exit would be 8% (at 0.5ppm), 11% (at 1ppm) 18% (at 1.5ppm) and 24% (at 2ppm).[56] Note 24% is below the 28% reported for all who reported they may be likely to exit at 1.5ppm (from where the additional 1ppm is derived). Given this result, 2ppm should be the revised upper bound charge suggested by examining willingness to exit and not 1.5ppm, (i.e. an extra **1.5ppm** on top of the existing 0.5ppm paid) if correcting for overstated hypothetical preference to exit.

Even based on Ofcom's adopted approach assessing willingness to exit, the 1ppm figure selected by Ofcom appears essentially arbitrary. In a large part, it is a function of the lack of granularity in the questions asked in the market

52 See Table 12.1.
53 Willingness to exit may still be the appropriate measure for estimating migration costs.
54 See §A27.95.
55 CC Final Determination of 9 February 2012, §2.685, §§2.689-2.691.
56 See Table 12.1.

research when SPs were asked about willingness to exit. Given the relative size of cost ranges for the 080 origination charge which Ofcom has derived, the half penny increments by which SP responses have been assessed are very crude. What is more, the basis on which Ofcom chooses 1ppm is not particularly robust, even given the lack of granularity of the market research. There is no particular magic about the 18% of SPs being likely to exit at average out-payments of 1.5ppm compared to the 24% who are considered likely to exit at rates half a penny higher. Ofcom has not made an objective case as to why this level of SPs exiting is the relevant bright line test.

In relation to cost measures Ofcom uses a complex and broadly theoretically legitimate process to set the ranges to assess impacts. Yet the crude and arbitrary measure of the average level of out-payments at which SPs' are likely to exit is equally important under Ofcom's methodology to the ultimate outcome. This measure is also, by Ofcom own admission and as discussed above, subject to at least as much uncertainty and risk as the cost estimates. As such EE considers that it is simply not acceptable for Ofcom to use a single bright line measure, which has little underlying justification, for this crucial step in its analysis.

The balance between fixed and mobile origination charges

The final step in determining appropriate ranges for fair and reasonable origination charges under Ofcom's methodology involves consideration of the relative prices between fixed and mobile origination charges. Given the "target" average out-payment to which Ofcom considers SPs should be subject (EE's concerns about which are outlined above), Ofcom then uses a range of potential fixed to mobile substitution, applies this to the cost ranges to derive ranges of potential charges and then considers the implications of the resulting charges on competition and SPs' incentives.

Below we consider each of these steps in the analysis in turn.

(i) Range of potential fixed to mobile substitution

First, in this final policy position, Ofcom has made a material adjustment to the overall level of fixed to mobile substitution assumed (within a range) as compared with the assumptions set out in Ofcom's April 2012 Consultation. This has a significant impact on Ofcom's calculations. EE is disappointed that Ofcom has not seen fit to ask a specific consultation question on this material and important change to its previous proposals. Nevertheless, EE considers that a number of points need to be made about the revised range:

- The increased bottom end of the range (from 40% to 45%) appears to be heavily influenced by recent information about the volume of calls to the Department of Work and Pensions ("DWP") originating from each of the fixed and mobile sectors. As such, Ofcom appears to be placing a lot of weight on most recent DWP data (which Ofcom claims is "stabilising" around the range of 45%-50% of calls being mobile originated). It is not clear from Figure 12.2 that this is a long term trend or that a small number of recent observations can be given this much weight (or represent a statistically significant departure from the longer term average which is clearly below this range).

- The volatility of calls to the DWP numbers is further underpinned by EE's recent experience where there was a significant drop in the overall number of calls due to the DWP removing a particular service (a crisis loans helpline, responsibility for providing services in this area was devolved to local authorities resulting in the removal of this service). This individual DWP number accounted for nearly [✂] **% of all freephone traffic on EE's network** and has consequently led to [✂] [✂]. This also underlines the fact that many of the DWP services will be focused on vulnerable consumers, who are more likely to be mobile-only, and therefore DWP mobile origination proportions are likely to overstate the average for the wider population.
- The top end of Ofcom's range appears to have no more justification than that there is anecdotal evidence that for some services (based on evidence from another jurisdiction) calls from mobile may exceed this higher level of 60%. This is clearly not sufficient and there is little justification for assuming that there will be a higher propensity to call 080 numbers from mobiles than the overall proportion of voice traffic represented by mobile. Indeed, Ofcom's logic suggests that the reverse is true under a system where SPs' pay origination charges and may actively limit the volume of calls from mobiles in various ways.
- The only other implied justification for a higher top end to the range is that overall the proportion of voice traffic carried over mobile has grown in recent years. Even if this is taken into account 60% is still far too high a top end given that Ofcom considers mobile traffic is growing at a rate of 0.5% a year. Even if this trend were to continue unabated, this would lead to a top end of the range for residential customers (the appropriate benchmark as these are the customer to whom these policy changes apply) of mobile originated calls of 47% by 2015 – well below Ofcom's arbitrary 60%.
- Taking all of these factors into account, Ofcom's range of 45%-60% mobile originated calls is built on very shaky foundations and is overly optimistic. Given the possibility of a **lower** propensity to call free to caller numbers from mobile, EE considers that the bottom end of the range should be below 40% and that there is no justification for assuming that mobile originated free phone calls will be above the overall share mobile has of residential voice calls: suggesting an upper end of the range around 47% at best.

In addition, EE notes that Ofcom has not taken account of any transition period in reaching the level of fixed to mobile substitution which is being predicted. Ofcom's assessment of the fair and reasonable range effectively assumes that mobile originated calls will jump immediately to the 45% to 60% range. However, in practice this increase in the proportion of freephone calls which is mobile originated will take time as consumers become used to the change in the overall pricing structure and adapt their behaviour accordingly. In the context of introducing guidance for assessing a fair and reasonable range of charges, Ofcom should therefore explicitly accept that charges could reasonably be reduced in stages taking account of the likely time taken to reach the overall proportion of mobile originated volumes assumed.

EE notes that in its CBA for unbundling, Ofcom has assumed in its base case scenario that only 50% of the benefits of unbundling are realised in year 1, 75% in year 2 and then 100% thereafter.[57] EE considers that would be a reasonable and consistent assumption to also apply here.

In particular, EE notes that during the period when mobile originated volumes are lower than Ofcom's assumed long term levels, lower mobile origination charges will be of less benefit to SPs (in terms of SPs overall average out-payments) while the full impact of the reduction in OCP 080 revenues will have an adverse impact through the TPE. This asymmetric short term impact provides a further justification for any guidelines for assessing fair and reasonable charges explicitly to take account of the time which will be taken for the share of mobile originated calls to increase.

(ii) Cost ranges

Combining the impact of all of the concerns that EE has raised regarding the assumptions underlying Ofcom's ranges requires consequential amendments to be made to Tables 12.5 to 12.9 in Ofcom's final policy position as follows:

- Table 12.5 would need to be amended so that:
  - The starting point is LRIC+ (no 'other CARS') for both fixed and mobile origination, rather than LRIC – i.e. 2.4ppm for mobile[58] and 0.3 for fixed;[59] and
  - The given level of fixed to mobile substitution is the new lower end of this range (i.e. below 40% rather than the 45% figure Ofcom has used). Furthermore, the assessment should be split out for years 1, 2 and 3 onwards so that the level is ½ of this in year 1 (20%), ¾ of this in year 2 (30%) and the full 40% from year 3 onwards.
- Table 12.6 would need to be amended[60] so that:
  - The assumed share of mobile originated calls ranges was from below 40% to 47% (say increases in steps of 2% from 39% to 47%). Furthermore, the assessment should be split out for years 1, 2 and 3 onwards so that the each level in the range is set at ½ of these figures this in year 1, ¾ of this in year 2 and 100% from year 3 onwards; and
  - The target average SP out-payment was set at 2ppm, reflecting a more realistic estimate of SP willingness exit, given the uncertainties surrounding the survey results.
- Table 12.7 would need to be amended[61] so that:
  - The assumed share of mobile originated calls ranges was from below 40% to 47% (say increases in steps of 2% from 39% to 47%); and
  - The target average SP out-payment was set at 5.8ppm, reflecting the more appropriate measure of SP willingness to pay, rather than willingness to exit.

[57] §11.122.
[58] Table A26.5.
[59] Table A26.4.
[60] There would be no need to change the assumed level of fixed origination payments, as the current range already allows recovery of LRIC+ all other CARS costs - see Table A26.4.
[61] There would be no need to change the assumed level of fixed origination payments, as the current range already allows recovery of LRIC+ all other CARS costs - see Table A26.4.

- Consequent adjustments would need to be made to Tables 12.8 and 12.9.

Table 12.7 in Ofcom's final policy position gives a range of fair and reasonable mobile origination rates between 2.10ppm and 2.97ppm. These adjustments would allow for recovery of materially higher mobile origination rates as being fair and reasonable. This would significantly increase the above range, likely making it more consistent with the range of LRIC+ measures discussed above.

Thus, even if Ofcom considers it needs to continue to take into account an estimation of SP willingness to exit / pay, under reasonable alternative and better assumptions this basic approach can still provide a range of fair and reasonable rates which are more in line with mobile LRIC+ cost estimates: which EE continues to believe is the more appropriate and efficient approach.

(iii) Impact on competition and SP incentives

The final step in Ofcom's analysis relates to the competitive implications of differentials between the fixed and mobile origination rates.

Here Ofcom places weight on its LRIC differential cost measure which allows the same **absolute** ppm common cost recovery as between fixed and mobile rates. For the reasons explained above[62], EE considers this to be an entirely arbitrary and invalid benchmark, which consequently invalidates Ofcom's derived conclusion that there is the potential for an inefficient "negative impact" on SPs' incentives in relation to mobile originated calls as a result of setting mobile origination rates above this LRIC differential. Ofcom accepts that higher mobile origination charges are acceptable from an overall net welfare perspective, notwithstanding that these higher charges may incentivise some SPs to engage in mobile cost avoidance strategies, so long as the higher charges reflect efficient costs. If recovery of 100% of LRIC + other CARS costs by fixed operators is considered efficient, *ipso facto* recovery of 100% of LRIC + other CARS by mobile operators must be considered to be equally efficient. Accordingly the entire LRIC differential assessment falls away as being invalid.

Ofcom also suggests that at the same time such rates would place mobile operators at a competitive advantage compared to fixed operators. Although Ofcom considers that fixed and mobile sectors are in different markets, it suggests that there would be some competitive interaction which would be distorted. These two impacts are completely contradictory and Ofcom cannot base a decision on mobile operators recovering more of their efficiently incurred costs leading to both SPs reducing the amount of mobile originated freephone traffic at the same time as enabling mobile operators to increase this traffic at the expense of fixed OCPs. More fundamentally, the assumption that mobile operators are recovering "more" of their efficiently incurred costs than fixed operators is based on an arbitrary and invalid absolute ppm assessment of the amount of these costs. If it costs £1 to make a product and you allow the supplier to recover £0.90 of its costs and it costs £0.10 to make another product and you allow the supplier of that product to recover £0.09 of its costs, then each supplier will be treated fairly in being allowed to recover 90% of its costs. It is of absolutely no relevance that in absolute terms one supplier is allowed to

[62] See the discussion above on why Ofcom's ranges should be based exclusively on LRIC+ measures in Section 4.2 at pp 25 to 34.

recover £0.90 and the other only one tenth of that at £0.09 – this is simply to do with the unrelated and different cost structures of the supply of the two products.

Further, as discussed above, it is not clear why the SPs' cost mitigation strategies discussed in §§ 2.141 to 12.154 of Ofcom's final policy position would inevitably be negative impacts which harm consumers for all the reasons discussed above in relation to the caller externality. Rather than incentives promoting adverse impacts these are better considered as setting appropriate incentives on SPs.

Proposed "fair and reasonable" ranges of origination charges for 116

Ofcom's proposed conclusion in its Draft 080 DRG that origination charges for calls to 116 numbers are likely to be fair and reasonable if (i) maintained at existing levels (approximately 0.5ppm for both fixed and mobile origination) or (ii) set at pure LRIC levels (which would mean a lower rate than the existing rate for fixed origination and a higher rate than the existing rate for mobile origination)[63] appears to be a relatively pragmatic and appropriate conclusion. However, this view is subject to three important provisos:

a) That the current "extreme social value" purpose of the range remains unchanged (Draft 080 DRG, §3.58), as do Ofcom's current strict 116 allocation conditions (§12.194);
b) That volumes on the range remain relatively low, thus limiting the financial impact of at or below LRIC origination charges on OCPs (Draft 080 DRG, §3.61); and
c) EE's comments above on what the LRIC mobile origination costs for calls to 080 and 116 numbers actually are (i.e. based on updated LRIC+ ranges with a lower bound of at least 2.4/2.5ppm rather than 0.8ppm-0.9ppm as currently assumed by Ofcom) – such costs would need to be taken into account if the overall volumes associated with these number ranges were to change significantly.

Draft 080 and 116 dispute resolution guidance

1. Ofcom's three principles need to be amended

Ofcom's Draft 080 DRG is based on the phrasing of the three principles that Ofcom originally consulted on in April 2012, before the Court of Appeal handed down its decision in *Telefonica v Ofcom* [2012] EWCA Civ 1002 (the "Court of Appeal 08x Judgment") in July 2012, overturning the judgment of the Competition Appeal Tribunal ("CAT") in *BT v Ofcom* [2011] CAT 24 (the "CAT 08x Judgment"). The Draft 080 DRG is deficient in not even noting that the CAT 08x Judgment has now been overturned.

63 Draft 080 DRG, §3.69

In the light of the Court of Appeal 08x Judgment, EE considers that the phrasing of the three principles in the Draft 080 DRG should reflect the test as most recently set out in Ofcom's April 2013 *Determination to resolve disputes concerning BT's tiered termination charges in NCCNs 1101, 1107 and 1046* (the "Recent Determination")[64], which was modified by Ofcom to reflect the decision of the Court of Appeal. Adopting this test does not change principles 1 or 3 in the Draft 080 DRG, but it does involve some important adjustments to principle 2. In particular, principle 2 as phrased in the Recent Determination puts the requirement that the charges should be beneficial to consumers first and foremost, overarching all other considerations forming a part of principle 2. EE considers that this is particularly appropriate in the present context, given the stated consumer protection justification underpinning Ofcom's reforms. It is obviously also important from the perspective of ensuring that Ofcom complies with its obligations of regulatory consistency.

If Ofcom were to align the wording of principle 2 with the test as applied in the Recent Determination then, in the present context, EE considers that it should be rephrased to read along the following lines:

> *"Principle 2 – The charges should be beneficial to consumers. This is assessed by considering the following factors:*
>
> *1. **Direct effect**: direct impact of the proposed origination charges on OCPs' and TCPs' prices for freephone services;*
>
> *2. **Tariff Package effect**: impact of the proposed origination charges on OCPs' prices for other services;*
>
> *3. **Indirect effect**: impact of the proposed origination charges on SP revenue, and through the impact on SP services, on callers; and*
>
> *4. **Competition effect**: impact of the proposed origination charges on competition, whether beneficial or detrimental"*

Under this new wording, principles 2(2) and 2(3) are essentially the same as expressed in principle 2 in the Draft 080 DRG. However principle 2(1) – direct effect – is new. Principle 2(4) – competition effect – is also amended, so that there is a more rounded assessment of the impact on competition in line with the guidance given in the Court of Appeal 08x Judgment. EE elaborates further on these changes below.

Direct Effect

The direct effect is the first element considered under principle 2 as applied by Ofcom in its Recent Determination. In contrast, the Draft 080 DRG do not currently consider the direct effect at all. EE considers that this is a material failing in the Draft 080 DRG.

Clearly the origination charge will not impact on the retail price for 080 and 116 calls charged by OCPs, as this will stay at zero by virtue of Ofcom's regulatory requirements. However, the level of the origination charge *will* have a direct effect on the prices charged by TCPs to their SP customers for the termination

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64 http://stakeholders.ofcom.org.uk/binaries/consultations/provisional-conclusions/statement/040413.pdf

and hosting of calls to 080 and 116 numbers. Presently the Draft 080 DRG are deficient in simply assuming that any increase in the current level of origination charges paid by TCPs to OCPs will be passed straight through to SPs, without examining whether or not this is in fact likely to be the case.

In the 2009 Flow of Funds Study, it was found that SPs paid a net total of GBP120 million to communications providers in 2009 in relation to 080 calls. TCPs were found to have retained GBP57 million (**48%**) of these revenues, with the rest flowing to OCPs barring a retention of less than GBP2 million by transit providers (p. 44). These statistics suggest that current net levels of out-payments to OCPs for 080 origination could effectively be doubled, without there being any necessary impact on the charges paid by SPs at all – simply with a large dent in current TCP profits.

The ability of TCPs to and likelihood that TCPs will bear at least some such highly relevant to Ofcom's fairness and reasonableness assessment because it:

- has a knock on effect on the likely extent of the indirect effect;
- is obviously also important in relation to fairness if and when Ofcom comes to a point of considering whether or not OCPs should be forced to recover any less than their full LRIC+ A&R costs of origination in order to limit the indirect effect; and
- is likely to be relevant to Ofcom's positive caller externality analysis (see §§3.21-3.23 of the Draft 080 DRG) as the decision-maker in the first case is actually the TCP, and only then the SP.

Competition Effect

EE considers that the competition impact aspect of principle 2 as phrased in the Draft 080 DRG is deficient in only considering ways in which the level of the origination charge may *distort* competition, without considering the ways in which it might also *promote* competition, to the benefit of consumers. In particular EE notes that the current phrasing is closer to the CAT's test, which was rejected in the Court of Appeal 08x Judgment. EE considers that there are a number of ways in which a higher level of origination charges may promote competition that are not currently assessed by Ofcom in its principle 2 analyses in the Draft 080 DRG. For example, if mobile OCPs can recover origination charges which make a contribution to their A&R costs, then this could increase their incentives to promote 080 calls from mobiles to customers. This activity may in turn enhance the competitiveness of 080 SPs who have a service model that is particularly benefited by calls originated from mobiles – such as those looking to generate sales leads from customers on the move.

2. Reference to Ofcom's six principles of pricing and cost recovery is unnecessary

EE considers that the exercise of trying to fit Ofcom's six principles of pricing and cost recovery into the three principles that Ofcom has undertaken in the Draft 080 DRG adds a seemingly unnecessary and undesirable additional layer of complexity (see §§A1.14 to A1.16). There is for example overlap with the distribution of benefits principle being considered in both principle 1 and principle 2. Clearly cost minimisation can also be said to be something that benefits consumers and thus as something that should be considered as a part of principle 2 as well as (potentially) under principle 1 as Ofcom has proposed.

In fact, the only one of these principles that it might be helpful for Ofcom to supplement its 3 principles test with is that of reciprocity, and Ofcom has claimed that this principle is not relevant at all as call origination is not necessarily a reciprocal service (§A1.16). Although it can just as easily be considered under the competition effect in principle 2, EE considers that the principle of reciprocity (i.e. that where services are provided reciprocally, charges should also be reciprocal) is likely to be relevant when considering the levels of charges proposed by large vertically integrated operators such as BT and CWW/Vodafone in their respective capacity as OCP/TCP.

In terms of regulatory consistency, EE also notes that Ofcom did not find it necessary to refer directly to the six principles of pricing and cost recovery in its Recent Determination.

EE therefore recommends that §§A1.14 to A1.16 are simply deleted from the Draft 080 DRG.

3. The guidelines are insufficiently specific to be fit for purpose

EE considers that the Draft 080 DRG should:

- Set a narrower range of fair and reasonable charges than is currently specified i.e. one based on allowing mobile originators to recover LRIC+ figures and taking account of other adjustments to Ofcom's methodology as argued above which would lead to mobile charges being no lower than 2.4ppm (based on Ofcom's figures before any corrections), with fixed charges starting at 0.3ppm.
- Make it clear that it would only be in exceptional circumstances that Ofcom would be likely to consider charges outside of this range to be fair and reasonable, and to specify precisely what those exceptional circumstances are likely to be.

In this respect, EE considers that Ofcom's MTR dispute guidance provides much clearer and more specific guidance to the industry than the Draft 080 DRG. For example, the MTR dispute guidance states as follows (emphasis added):

> *"Our starting point in determining a dispute will be that **smaller MCPs should receive the benchmark MTR (subject to the specific exception in relation to 100% OTT MCPs, described below)**. We recognise that it might be appropriate to depart from this starting point based on the specific facts of a particular case, **and would consider any cost or other evidence, presented or available to us** in the context of determining a particular dispute, which suggests that the benchmark MTR is not fair and reasonable in the circumstances (for example, where a smaller MCP's **costs are demonstrably and substantially below those of a national MCP**)" (3.3.2, see also A1.15)….*
>
> *"…generally we consider it unlikely that a MTR at a level higher than the benchmark MTR will be fair and reasonable, as the benchmark MTR has been based on the modelled costs of an average efficient national MCP… we have included in our final guidance a section which sets out the circumstances in which we might conclude that a*

MTR above the benchmark MTR is fair and reasonable for a smaller MCP. We would expect the terminating smaller MCP (which is subject to Condition M1) ***to be able to demonstrate that****, in complying with that condition:*

3.10.1 charging a MTR equal to the benchmark MTR ***would deny it recovery of its actual costs of providing MCT****;*

3.10.2 its actual ***costs of providing MCT are efficiently incurred****; and*

3.10.3 charging a higher MTR than the benchmark MTR ***would be offset by consumer benefits, which might include lower overall end-to-end costs*** *(not just in particular cases but in general for calls to the terminating MCP's network) or other benefits to calling parties related, for example, to the quality of the service provided" (3.10, see also A1.22)*

"…we accept that the ***FTR is an imperfect proxy, but consider it to be a pragmatic starting point*** *for setting fair and reasonable MTRs for an 100% OTT MCP in a four month dispute resolution process" (3.16), see also A1.20)*

As a consequence of its clarity and specificity, the MTR dispute guidance has been successful in achieving Ofcom's objective of reducing the number of disputes referred to it on this issue. In contrast, EE fears that there the 080 DRG in their current form will do little to assist TCPs and OCPs to reach commercial agreement without lengthy delays and further Ofcom intervention.

In terms of some ways in which the Draft 080 DRG can be improved in this regard, EE notes that:

- At §§2.5-2.6 of Draft 080 DRG Ofcom states that in considering any dispute, in addition to its guidelines, it will nevertheless consider any cost or other evidence presented by the parties and consider the specific facts and circumstances of that dispute. It would be helpful for Ofcom to be more specific on what kinds of evidence it currently considers might cause it to consider as fair and reasonable a charge outside its nominated range.
- The Draft 080 DRG do not give any guidance as to *how* Ofcom is likely to assess the likely proportion of calls that are originated from fixed and mobile lines. Given the importance of this issue to Ofcom's current views on the range of fair and reasonable origination charges, EE considers that Ofcom should be much more specific on this issue. For example, Ofcom should clarify:
  - Whether Ofcom is likely to assess this question across all 080 number ranges and all OCPs as a whole, or differently for individual ranges / according to individual OCP; and
  - How Ofcom will decide on a proportion of mobile originated calls when there are a range of theoretically plausible possibilities and no conclusive evidence in this regard (as will necessarily be the case prior to the implementation of the reforms). For example, EE considers that in such a case it is appropriate for Ofcom to err on the side of deciding that there will be less rather than more fixed to mobile substitution (i.e. closer to current levels) at least initially, with a party able to reopen this

if the evidence subsequently proves this assumption to have been materially incorrect.

- The Draft 080 Guidance in Annex 1 doesn't have any numbers in it! The point of the guidance is to be clear and helpful to industry and help avoid the need to raise disputes. Obviously Ofcom cannot fetter its discretion, but it seems entirely unhelpful for Ofcom's policy position / statement / consultation to take a clear stance on Ofcom's views on the fair and reasonable range and then for the actual guidance note to be phrased in an almost entirely open ended manner. EE considers that Ofcom should plainly set out its position in the actual guidance, rather than requiring industry to piece together potentially three separate statements on the issue. Ofcom's MTR dispute guidance is much simpler and clearer in this respect. Ofcom should seek to replicate the same clear and practical guidance as to what level of origination charge it considers reasonable and precisely which matters and what evidence to support this would need to be established to justify a departure from this level.

Concerns regarding particular aspects of Ofcom's unbundling proposals

EE has set out above why it does not believe that Ofcom should proceed with its unbundling proposals at all. However, assuming that Ofcom disregards these submissions and is minded to mandate unbundling, then EE sets out below some specific concerns that it has with particular aspects of Ofcom's current proposals and draft legal instruments.

Intra tariff package AC restriction is legally invalid

1. Intra tariff package AC restriction is not needed to protect consumers from harm

EE responds in this section to Ofcom's policy position in favour of legally preventing retail OCPs from being able to vary the AC within a retail tariff package.

This proposal takes legal effect through a proposed new General Condition ("GC") 17.25, which states that the AC must not vary within a customer's tariff package by reference to the unbundled tariff number that is called.

Accordingly, in order to be legally valid, this new GC must be justified as necessary and appropriate "*for the purpose of protecting consumers*" (s58(1)(aa)). Clearly, this aspect of Ofcom's proposals is one of the most intrusive and potentially distortive, as it involves a direct incursion into the retail pricing freedom of non-SMP OCPs. Ofcom accepts that "*retail price regulation is intrusive and that it should only be imposed where strictly necessary*" (§6.13). Ofcom also accepts that it is subject to "*a requirement for proportionality and targeting intervention only at cases where action is needed (sections 3(3) and 47(2) of the Act*" (§6.13).

However, in reaching its decision to impose the strictures of a single AC across all 08x, 09 and 118 calls, Ofcom appears to have failed to apply the required legal test of “strict necessity”. Critically, Ofcom has decided to impose this obligation in spite of its finding that “*two ACs might still improve price awareness relative to the status quo*” (§9.16).

EE considers this to be a fundamental flaw that undermines the legal validity of Ofcom’s proposed new GC. As modelled by Ofcom[65], Ofcom’s proposals will involve a radical restriction on the revenue and margin that retail OCPs can generate from the supply of 09 and 118 calls. The only prospect for such a restriction to be considered legally valid in the absence of any SMP finding is if it were to be established as integral for the protection of consumers from harm. Ofcom has failed to demonstrate this. Specifically:

- A separate 09/118 AC would still address the vertical externality issues that Ofcom has identified (§4.56).
- Ofcom now places only limited weight on the need to correct horizontal externalities in relation to the 09 and 118 ranges (§4.55). However, to the extent that these externalities may exist, a separate 09/118 AC would still address them.
- Ofcom’s updated view is that the price awareness of 09 users is actually relatively accurate, and that the awareness levels of non-users should be given limited weight, as most consumers who don’t use 09 numbers simply see no need to do so (§A11.77; §A11.81; §A11.92). Ofcom has gathered extremely limited empirical evidence regarding the price awareness levels of 118 calls. However, Ofcom has determined that, due to the nature of demand for these calls (with consumers naturally incentivised to keep calls as short as possible and to call only when necessary) the consumer harm from low price awareness / bill shock is likely to be very low (§9.94; §A22.92). Accordingly, lack of price awareness should either be regarded as a non-issue on the 09 and 118 ranges, or at most one causing very limited consumer harm. Furthermore, Ofcom has concluded that having a separate 09/118 AC does still have the potential to protect consumers from this form of harm (§9.16).

In this context, the extremely intrusive step of mandating a single AC can in no way be seen to be essential or strictly necessary to protect consumers from harm. That being the case, EE considers it to be imperative that Ofcom reconsiders its position and amends its proposals so as to withdraw the obligation that there can only be a single AC across all 08x, 09 and 118 numbers. Absent the legal basis for imposing this GC, pushing ahead with Ofcom’s proposals is likely only to cause unnecessary cost and delay to the implementation of any of Ofcom’s unbundling proposals as a result of unnecessary litigation, when it is clear from the outset that the consumer benefit from this particular aspect of the proposals is in fact negligible.

Further, another material issue which arises when considering separate AC charges is the approach taken to inclusion of charges within bundle. Given the bad debt and fraud risks, as well as the commercial impact, it is highly unlikely

65 See Table A20.1.

that OCPs will be able to include the AC for 118 and 09 number ranges in bundle. If Ofcom's approach means that the AC must be treated the same for all non geographic ranges, then this will block the ability of OCPs to include ACs for 08x number ranges in bundle as well. This creates a perverse adverse impact for consumers by not allowing tariffs which would enable the more popular non geographic number ranges to be included in the standard bundles of minutes. Overall this will reduce consumers' trust in the non geographic number "brand" and reduce the extent to which consumers feel comfortable calling these numbers (especially from mobiles where in bundle calling has become the norm for most number ranges). As such, EE considers it is vital that OCPs are able to include the AC for 08x numbers within bundle while at the same time having a different treatment for 118 and 09 number ranges. This is highly unlikely to create any consumer confusion as the market research clearly shows that consumers are able to distinguish different numbers to the second digit.

In the light of the fundamental flaws in these proposals, it is not ultimately to the point whether the benefits of a single intra-tariff package AC are likely to outweigh the costs, and/or whether the net benefits of this calculation are likely to outweigh the net benefits of allowing separate 08x and 118/09 ACs.[66] Doubtless there are many regulatory initiatives that Ofcom could undertake which will show greater likely potential consumer benefits than costs. However Ofcom has consistently stated that it acts according to best regulatory practices which involve a *bias against intervention*, consistent with Ofcom's legal obligations under s 3(3) of the Act. Accordingly, if a proposal fails the "strict necessity" test (as the mandating of a single AC across all 09, 118 and 08x numbers does), the only proper course for Ofcom to take is to abstain from regulatory intervention, unless and until evidence comes to light which establishes that the position has changed.

Nevertheless, EE also sets out below why EE believes that the cost benefit analysis that Ofcom has conducted is also flawed, and why EE believes that costs of mandating a single AC within tariff packages are likely to outweigh the benefits.

2. Costs of intra-tariff package AC restriction outweigh the benefits

Ofcom's framework for analysis is both deficient and defective

Ofcom states that its decision on this issue "*primarily involves considering the price awareness and efficient prices criteria*" (§9.13). For the reasons set out below, EE considers that the analytical framework adopted by Ofcom regarding the extremely important issue of whether or not to mandate a single AC per tariff package is both deficient and defective.

a) Ofcom has overestimated the likely price awareness benefits of a single AC

[66] cf. Ofcom's flawed analysis at §9.16 which places very strong weight on Ofcom's belief that a single AC is likely to be more effective in enhancing consumer price awareness than separate 08x and 09/118 ACs.

Ofcom has rightly acknowledged that consumers are already familiar with prices varying between tariff packages (§9.9). Similarly, Table A11.13 makes it clear that customers are already familiar with prices varying between 087/4 calls and 09 calls, with a significantly higher price expected for 09 calls from both fixed lines and mobiles, and Ofcom acknowledges this at §9.16. Ofcom also concedes that the 118 range has a distinct identity (§9.16), which is reinforced by strong marketing and brand promotion (§A22.88). Clearly it is Ofcom's intention to reinforce this distinct identity (along with the distinct identity of the 09 premium rate range) under Ofcom's proposed new numbering guide (see Figure 1.1). Ofcom also considers that it is plausible that consumers are capable of distinguishing 118 calls from 08x calls (§9.16). Given that Ofcom has no evidence to the contrary (§9.16), and that Ofcom does have evidence that customers are able to distinguish ranges to the first two digits, as well as the brand awareness of particular 118 directory enquiry services such as the Number's 118118 service and BT's 118500 service, EE considers that this can be the only fair and reasonable assumption.

Ofcom has accordingly (rightly) concluded that the price awareness benefits which might result from restricting OCPs' pricing freedom to a single AC *between* their tariff packages is likely to be limited (§9.9).

In contrast, for no clear or objective reason that EE can discern, Ofcom appears to have reached the complete opposite conclusion in relation to the price awareness benefits of restricting OCPs' pricing freedom to a single AC *within* each tariff package. EE considers that Ofcom is mistaken. First, in relation to its belief that any significant such price awareness benefits are likely to materialise, and secondly as to the overriding importance that Ofcom appears to have placed on these benefits.

EE notes that Ofcom does not appear to have any *empirical evidence* to substantiate its view that the price awareness benefits of restricting the AC within a tariff package are likely to be any greater than restricting it between tariff packages.[67]

Secondly, EE fails to see that there is any *logical distinction* which can be drawn between the two scenarios. Customers see two sets of services (one tariff package versus another; 08x calls versus 09/118 calls) as being distinct. Customers expect to pay different prices for those two distinct sets of services. *Ipso facto*, there is not likely to be a great deal of customer benefit to be gained in forcing OCPs to price either one of these distinct sets of services identically.

Whilst Ofcom and industry participants understand that 08x, 09 and 118 numbers all fall within the concept of a non-geographic number (along of course

[67] The mere fact that two stakeholders have expressed unsubstantiated opinions that they consider prohibiting a variation of the AC to be necessary to ensure the success of the unbundled tariff is clearly insufficient evidence for Ofcom to rely upon (cf. §9.14). In relation to BT's further point that a single intra-tariff AC for 08x, 09 and 118 calls will allow OCPs to treat the AC in a similar manner to geographic calls (§A20.24) EE considers that this presumes that consumers have a concept of "non-geographic calls" encompassing these ranges that EE simply does not believe the average consumer actually has. Fundamentally these ranges lack a commonality of purpose from a consumer facing perspective and EE therefore does not believe that it is realistic to expect consumers to recognise them as having a collective identity in the same way as the geographic number ranges.

with 03, 080, 116, 070/076 and 0500 numbers), it is far less clear that consumers drawn any such connection. To the extent customers consider that 084/087 numbers have a distinct national/local call identity, 09 numbers a distinct premium rate identity and 118 numbers a distinct directory inquiries identity it is by no means a given that just because a customer calls 08x numbers relatively frequently that he or she will realise that the same AC he or she usually pays in relation to these calls will also apply on the odd occasion that he or she calls a directory inquiry number or uses a premium rate 09 number.[68] For the average pay-as-you-go ("PAYG") mobile customer, EE considers it extremely unlikely to make any difference to the customer's level of price awareness that the ACs for these calls happen to be the same. For those pay-monthly ("PAYM") mobile customers and fixed customers who do chose to download and review their monthly bills[69] it is possible that a single reference to the 08x, 09 and 118 AC may increase awareness that the same AC applies to 09 and 118 numbers that the customer very rarely calls as to the 08x numbers that the customer calls more frequently. However, it is also possible that listing the two ACs (08x and 09/118) directly after each other on the same bill would achieve the same, or almost the same, outcome.[70]

Accordingly, EE considers highly questionable Ofcom's conclusion that it is "*significantly more likely with a single [intra-tariff] AC*" (§9.16) that customers will be able to remember at least the broad magnitude of the AC.

d) Ofcom's analysis of the costs of imposing a single intra-tariff package AC is manifestly deficient

Ofcom has (rightly) concluded that restricting OCPs' pricing freedom to a single AC across all tariff packages "*carries a significant risk of material disadvantage in terms of efficient prices and regulatory burden, which outweigh the limited consumer benefits*" (§9.9). Ofcom has reached a directly contrary conclusion in relation to restricting OCPs' pricing freedom to a single AC within each tariff package, but has failed to justify this conclusion with sufficient contrary evidence or analysis.

In part, this is because Ofcom has failed to apply its test consistently across the two issues (i) varying the AC between tariff packages and (ii) varying the test within a tariff package:

In relation to *inter-tariff* AC variations, Ofcom has, rightly, assumed that the market is best placed to determine the efficient level of the AC for each tariff package, given that the retail mobile and fixed markets are competitive. Ofcom has then weighed the risk of causing a distortion to this efficient, market driven, level of pricing against the price awareness improvement benefits of mandating that the AC must be the same across all tariff packages – which Ofcom has found to be limited.

In relation to *intra-tariff* AC variations, Ofcom has applied an incorrectly distorted/biased version of this test. Ofcom should have considered whether

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68 cf. §9.16.

69 The vast majority of EE's fixed and PAYM mobile customers these days receive online rather than paper bills.

70 Ofcom's comments at §A20.14 are also pertinent here.

the (limited and unproven) price awareness benefits of this restriction were likely to outweigh the risks of distortion to efficient market driven pricing. That is to say, Ofcom should have taken as its non-interventionist base case the situation where OCPs would be permitted the flexibility to set separate 08x and 09/118 ACs, in line with the differences between the current OCP margins on these two categories of non-geographic calls reflecting the fact that 08x calls are typically currently charged in the market by OCPs (and TCPs) as low margin/cost and high volume/duration calls, whereas 09 and 118 calls are typically currently charged by OCPs (and TCPs) as high margin/cost and low volume/duration calls.[71]

Instead, Ofcom has turned the test on its head and (wrongly) assumed that it's artificially created and mandated scenario of having a single AC across all 08x, 09 and 118 calls is the "risk-free neutral" base case. Ofcom's test has then required it to be established that the current natural market driven style setting of the AC (i.e. where the AC is set at different levels for high volume 08x calls and low volume 118 and 09 calls) has benefits for consumers that outweigh the "risk" that this market reflective manner of setting the AC will not bring as many pricing transparency benefits to consumers as Ofcom hopes that a single AC will do. In effect, OCPs have been required to demonstrate the consumer benefits of market driven retail pricing in a competitive market environment (which in the case of varying the AC between tariff packages Ofcom has (rightly) regarded as self evident) over a regulatory artifice which has had the odds falsely stacked in its favour as a result of Ofcom's flawed presumption that this is a neutral and costless base case.[72]

EE considers that the above flaws in Ofcom's analytical process fundamentally undermine the conclusions that Ofcom has reached regarding the relevant costs and benefits of mandating a single intra-tariff package AC.

In particular EE considers that the twisted way in which Ofcom has applied this test has caused it to:

- Place undue and inappropriate weight on whether or not and, if so, to what extent levels of bad debt differ between the 08x, 09 and 118 ranges (see e.g. §§9.19-9.22). Certainly there is evidence that there are higher levels of bad debt in relation to 09 calls than to 08x calls (whether as a result of non-payment of bills in the case of fixed and PAYM mobile customers or in the case of refunds due following established fraudulent activity in the case of all customers).[73] However, as SSE has explained to Ofcom[74], there are much wider legitimate commercial reasons why, in a competitive retail market environment, OCPs have typically chosen to recover higher ppm margins on the higher SP charged and lower volume 118 and 09 calls than

[71] As well as, at least in the case of 09 calls, also being a category of calls that carries a higher bad debt risk than 08x calls. However, this is really a subsidiary point and has been elevated to a level of undue significance in Ofcom's analysis.

[72] See e.g. Ofcom's conclusion at §9.18.

[73] EE fundamentally disagrees with Ofcom's conclusion that this risk is unlikely to increase as a result of Ofcom's unbundling proposals (§A20.87). *Inter alia*, the large increase in the SC caps on the 09 range that Ofcom is proposing is likely to materially increase OCPs' exposure to bad debt and fraud on this range.

[74] §A20.90.

on the lower SP priced and higher volume 08x calls. In addition to being a market driven practice in this case, recovery of margins on a cost plus percentage basis is the way in which Ofcom currently designs all of its charge controls for SMP products. EE therefore considers that it is highly inconsistent for Ofcom to suggest that this manner of fixed and common cost / reasonable rate of return recovery is somehow inappropriately inefficient in the present case (cf. §A20.40; §A20.49).[75] In the absence of any suggestion that current non-SMP OCP credit management practices are causing any relevant form of consumer harm, EE also considers it highly inappropriate and *ultra vires* for Ofcom to be considering imposing retail tariff principles that are directed towards this end (§A20.40; §A20.46; §A20.65).

- Inadequately assess the impact of Ofcom's proposals on pricing efficiency. In this regard, Ofcom has described its test as follows: "*The impact on pricing efficiency depends on the extent to which a single AC leads to higher prices for 084/087 calls*" (§9.23) and has concluded that "*a separate AC for 09/118 calls could result in a more efficient outcome than a single AC….however any such efficiency benefits may not be material, particularly given the greater competition we expect between OCPs under the unbundled tariff*" (§9.24) Ultimately, Ofcom has concluded that there is a "*risk that a single [intra-tariff] AC could lead to less efficient pricing*", which Ofcom considers to be outweighed by its perceived price awareness benefits of the proposal (§9.25). In contrast, EE considers that Ofcom's analysis on pricing efficiency should begin with the non-interventionist presumption that the competitive retail market is best placed to determine the efficient level and form of the AC and that any restrictions placed on this freedom by Ofcom carry a high risk of regulatory failure (i.e. that the efficient functioning of the market will be unduly distorted and inefficient pricing thereby result). As imposing an intra-tariff package restriction on the AC places a greater restriction on OCPs' retail pricing flexibility than allowing the AC to be linked to the number dialled, Ofcom should then consider all potential costs of this restriction. Certainly one such cost is that this may lead to the AC for 08x numbers being set at an inefficiently high level, in order to cover the higher costs and higher revenue previously recovered from 09 and 118 calls. However, another very important and very likely cost is the TPE impact of this proposal. Specifically, Ofcom needs to consider the scenario where the high volume / low margin nature of 08x calls does not allow the market to set a blended AC which enables to OCPs to fully recover their previous higher margins on 118 and 09 calls. In this case there will be an important indirect flow through effect on all consumers in the form of the TPE. Ofcom should acknowledge and quantify this potential cost. In both cases, EE considers that Ofcom should quantify these costs in terms of <u>aggregate impact on net consumer welfare</u>. EE considers that this aggregate cost to consumers is likely to reach many tens of millions of pounds per annum. Phrasing this cost as a "mere" likely

[75] To the extent that Ofcom believes these margins are higher than efficient levels due to a lack of price awareness, see EE's comments above under sub-heading (a)

0.5/1.3ppm / 17%/8% increase in the 08x AC as Ofcom has done[76] tends to understate the cost of this risk and may have misled Ofcom into believing that it can easily be outweighed by the (unproven and likely very limited) price awareness benefits of mandating a single intra-tariff AC (§A.20.89).

- Fail to adequately reflect in its analysis the fact that the evidence on consumer price awareness on the 09 and 118 ranges gives no basis for Ofcom's concerns that the current higher levels of OCP margins on 09 and 118 calls exploit a lack of consumer price awareness on these ranges (§A20.73; §A20.76). Ofcom has concluded that having two ACs would not reflect consumer preferences because differences in elasticities would not be fully reflected as a result of the reduced price awareness caused by having two ACs (§A20.76). This conclusion is first likely to be factually flawed for the reasons set out under sub-heading (a) above. Furthermore it is flawed because it gives no weight to Ofcom's new findings that price awareness on the 09 range is not necessarily poor and that callers may be relatively price aware (§A20.20). As set out in Table A20.1, these relatively price aware 09 callers are currently prepared to purchase 09 calls at OCP margins which are some two to five times higher than the margins recovered from 08x calls. This being the case, Ofcom should allow OCPs to reflect consumer preferences (reflected in relevant elasticity and volume differences) in the way that they set the AC. Clearly, it may be that additional transparency of the margins retained by OCPs through the 09 AC changes current consumer preferences and elasticities. However this is something that Ofcom should leave the market to determine.

e) Risk that two ACs could undermine the success of unbundling is unfounded

Given that the communications plan for Ofcom's as yet unfinalised proposals is still at the inception stages, EE considers it highly premature for Ofcom to have reached a conclusion that having a single intra-tariff AC "*is a key factor*" in ensuring the efficiency of Ofcom's communications activities (§9.17).

Leaving aside the timing of this inappropriate pre-judgement, EE notes that Ofcom's proposed numbering guide doesn't even refer to the existence of the AC in relation to the 09 and 118 number ranges. Presumably, this is because these number ranges already have clear and distinct brand identities and it is potentially likely to cause more customer confusion rather than less for the numbering guide to refer to the common AC with the 08x ranges, which Ofcom is trying to separately and distinctly identify. Beyond this, EE is confident that Ofcom and the industry would be able to find a way to describe an unbundling concept where the AC was linked to the number dialled in no less an efficient way than where the AC for the otherwise unconnected 08x. 09 and 118 ranges are identical per tariff package. Certainly, to place any weight on a contrary conclusion at this early stage of industry discussions on the matter is misguided.

Similarly, given that Ofcom's proposed SP advertising obligations will require references to the AC to immediately follow the SP's reference to the number

[76] §A20.61

being dialled, EE fails to see how the inclusion of a single extra word (084/087/09/118) to the phrase “your company’s access charge” makes this message in any way materially more complex.[77]

It is also clear that the extensive publication obligations that Ofcom is proposing to impose on OCPs in relation to the AC that, whether there are one or two ACs, in neither case will it be possible for OCPs to “obfuscate” their charges (cf. §A20.25). Similarly, given these publication obligations (and the corresponding obligations on SPs to make reference to the AC when they advertise the relevant number) EE can see no valid basis for Ofcom’s concern that consumers would not be able to recognise that the AC may be higher for 09/118 calls than for 08x calls (§A20.31).

Lastly, while EE does appreciate Ofcom’s goal of keeping the message conveyed to consumers as simple as possible (§A20.35), EE considers that Ofcom needs to be very careful not to give a “straw that broke the camel’s back” status to this particular nuance to the consumer message. Ofcom is already currently expecting consumers to be able to accept that, whilst they are also non-geographic numbers, the AC will not apply to 03, 080, 118, 070/076 or 0500 calls. In this context, whilst it may be said that it is one less thing for the consumer to remember if the AC is the same for all 08x, 09 and 118 calls, it could equally be said that the fact that the AC is the same for these dissimilar and distinct number ranges is actually just one more not clearly logical rule that the customer *does* need to remember.

Accordingly, EE believes that Ofcom’s conclusions regarding the “risk” that allowing separate 08x and 09/118 ACs will undermine the success of the unbundling proposal are unfounded.

Proposed changes to the General Conditions

1. High level comments

Before discussing the details of the proposed changes to General Conditions (GCs), EE would like to make a few high level comments on the proposed changes:

- The number of changes made to the GCs throughout the years has a led to a decrease in transparency, a duplication of obligations, use of terms with different definitions depending on the GC and cross-referencing, leading to an unwieldy and complex set of regulations which impacts the understanding and therefore the ease of compliance. On several occasions EE has urged Ofcom to review the GCs. Ofcom committed to this review in its annual plan a number of years ago, but EE is disappointed to see that this commitment has disappeared from Ofcom’s plan.

[77] cf. §9.18. EE cannot at this stage envisage a situation where an SP is likely to be advertising an 08x number at the same time as an 09/118 number, however in such cases it would seem that the current more generic reference to “your company’s access charge” would suffice.

Considering the number of proposed changes to a significant number of GCs, EE believes such a review is now more than overdue.

- The new regime will, as set out by Ofcom, only apply to customers who fall within the definition of a “consumer”. Ofcom proposes to retain the existing obligations regarding non-geographical numbers for business customers. EE considers this to be disproportionately burdensome. The GCs contain a number of existing obligations around information provision and transparency, for instance GC9.2 and GC10. EE considers these obligations to be sufficient for business customers.
- EE considers the use of definitions throughout the GCs, Numbering Plan and Premium Rate Services (“PRS”) Condition confusing. The GCs start off with a list of definitions, separate definitions are then added in individual GCs, definitions used in one GC refer to definitions in other GCs. Where definitions are not specified, the definitions in the Act have to be used. For ease of compliance, EE would prefer to be able to read each GC in isolation, even if this would result in duplication of definitions across all GCs.

2. Comments on proposed changes to individual GCs

Ofcom proposes to add ‘Transparency’, to GC14. GC14 contains obligations regarding Codes of Practice and Dispute Resolution. The GCs already contain a specific GC regarding Transparency, GC10 ‘Transparency and Publication of Information’. EE considers the new proposed obligations under GC14 would sit better in GC10. This would also remove the need for duplicating transparency requirements in two GCs and would ensure the transparency obligations remain transparent.

As set out in our high level comments, GC 14 gets unwieldy because the current obligations will remain in place for business customers and new obligations are proposed to come into force for consumers. The general transparency obligations in GC10 should be sufficient for business customers.

In terms of comments on the new proposed individual GCs in GC 14, EE notes as follows:

- We have commented on the difference in applicability to consumers and business customers above in our general comments. The overlap, as defined in 14.7 unnecessarily complicates regulation, makes the regulation untransparent, inconsistent and hard to comply with.
- EE believes that the obligations proposed in GCs 14.8-14.10 are unnecessarily detailed and prescriptive and considers Ofcom could rely on the existing transparency obligations instead – in particular that already specified in GC10.2(d). We believe the AC is no different from any other types of usage charge and therefore do not think it warrants separate treatment:
    - In our plans we already make clear which services are included in a bundle. Giving the same prominence to ACs as to bundles, as proposed in 14.8, implies that these two are equally important to customers. Clearly, customers would attach more importance to the components and charge of an overall bundle compared to a stand-alone AC. This obligation is overly prescriptive and does not appear to

reflect customer's perceptions regarding the value of bundles and services.
  - It is clearly in OCPs' interests to provide customers with accurate and comprehensive information about their price plans and tariffs and information on bundles and tariffs is readily available. It is unnecessary to spell this out in detail, as is proposed in 14.9.
  - There is also a real question as to the amount of information customers can absorb and process. Ofcom's approach appears to be adding more information to an already long list, rather than assessing which information is relevant to a customer at which point in their contract, and what the best way would be to provide this information. On a number of occasions we have asked Ofcom to develop a more holistic approach to consumer information, which would address this type of concern.
- Apart from the level of prescription and detail in GC 14.8 and 14.9, we question how the obligation in GC 14.10 can be implemented in practice. GC 14.10 provides that when an OCP mentions any call pricing, it should include a link to information on its website containing the AC. Consequently, were the OCP to try to promote its non-geographic call pricing on a banner, it would have to also include a web link to the precise location on its website where its ACs can be found – which would be highly impracticable. For example, below we have included the web link to EE's Home Broadband price guide: http://e-gain.s3.amazonaws.com/external/content/Ts%20and%20Cs/EE%20Broadband%20Price%20Guide.pdf.pdf. As can be seen, these web links can be quite long and take up a significant of space. More importantly, we question whether including such a link would really benefit customers at that point in time. We are interested to find out Ofcom's thoughts on the practical implications of this obligation and the assumed benefits of this obligation. We believe that it is sufficient to publish ACs alongside other usage charges and publish them with the same prominence.
- Ofcom proposes to retain the obligation in Annex 1 to GC14, 3.3(ii) on Communications Providers to provide information about the tariffs that apply on their network for calls to any PRS number range. Since the central database with the SCs sits with Ofcom, EE believes this obligation should be amended and OCPs should simply refer customers to the Ofcom SC database instead.
- Ofcom appears to have included the proposed new obligation in GC 14.11 because GC23 and GC24 do not cover all services. GC23 excludes PAYG and and SIM only customers, GC24 only applies to switching fixed line providers rather than those taking out a new line. Rather than amending the relevant GCs, Ofcom proposes a roundabout solution of adding a new obligation in a different GC, which will apply in all cases. EE believes this obligation is unwieldy, unnecessary and disproportionate. There are, for example, very good reasons why Ofcom has determined that the general point of sale information requirements in GC 23 should not apply to PAYG customers (who can simply pick up a PAYG phone essentially "off-the-shelf" from a variety of different retail outlets). There is simply no logical reason for elevating the importance of the AC above this other key contractual information such that it is the only information that a mobile OCP would have to ensure is provided to PAYG customers at point of sale.

In this respect EE would again reiterate the point around Ofcom's statutory obligations to ensure that all amendments to the GCs are proportionate and objectively justified.

- EE questions the rationale of describing in a very detailed way the mechanism of bundle charging in the proposed new GC 17.29. Bundles are well known in the market, they have been around for a long time, OCPs are best placed to explain the workings to customers and they do not require separate specification. There is no such detailed specification on other services that are included in a bundle. We believe this obligation is unnecessary, disproportionate and confusing and suggest it be removed.
- EE has significant concerns regarding the opaque wording of the proposed new GC 17.32, as set out below in section 5.7 of this response (see pp 69 to 70).
- EE questions the need for the proposed amendments to GC 23.5, in particular taking into account the extent to which customers are likely to actually take the AC into account when entering into a contract – which Ofcom accepts is not high. It seems disproportionate to single out the AC, whereas other charges have been grouped under 'key charges'. Ofcom could just have updated the guidance on this GC by specifying that the AC is considered to be a key charge customers take into account when entering into a contract (if there is any evidence supporting this assertion, which we doubt). We would like to make the same comment regarding the proposed changes to GC24.
- EE questions whether the AC and SC definitions that Ofcom has proposed in GC 17.33 will work for non-network SPs or resellers. These parties will not convey a call themselves but rely on their wholesale providers to do so. We also wonder whether the last part of the definition of AC adds anything to the rest of the definition: '*for the purpose of calculating the amount payable by a Consumer for making such a call.*

3. Proposed changes to the Numbering Plan

In our high level comments we mentioned the definitions and the cross-referencing issues which affect all of the legal instruments mentioned in Annexes 14-16 in Ofcom's final policy position. In terms of interpretation difficulty, there are a number of different definitions of Subscriber, Consumer, Customer and Domestic Customer in the Act, in the GCs and in the Numbering Plan. This makes it hard to identify which obligations apply to which group of customers, and where possible overlaps and gaps are. As part of a review of the GCs we ask Ofcom to harmonise these definitions as much as possible.

Interaction of Ofcom's reform proposals with GC 9.6 regarding material detriment

In its response to OCPs' concerns about the interaction between the implementation of the unbundled tariff and the application of GC9.6 Ofcom sets out the following:

> *A25.148The application of GC9.6 to modifications to contract terms which a CP may make in implementing the unbundled tariff will depend on a variety of factors. It is not possible at this stage to*

identify with any certainty those factors nor to provide definitive guidance as to whether or not the interaction of these factors will be likely to give rise to material detriment so as to trigger the subscriber's right of withdrawal under this condition… it will be for CPs themselves to determine on a case by case basis the extent to which GC9.6 is engaged by changes they make to the contract terms of their subscribers.

Nevertheless, as a matter of "broad principle", Ofcom goes on to set out that where a price rise is attributable to the level of the SC, it does not consider that generally there will be a modification likely to be of material detriment to the consumer. EE welcomes this clarification, which EE considers is the only sensible position that Ofcom could reach on this matter.

However, as regards the AC, Ofcom states that it considers that whether or not a churn risk will be triggered under GC 9.6 may depend on the individual circumstances of the customer. In particular in relation to the setting of the initial level of the AC for each tariff package at the commencement of implementation of the unbundling proposals – which OCPs will have no choice but to do if Ofcom mandates this, EE considers that this stance by Ofcom is unfair and inappropriate, [✂]

[✂]

Finally, Ofcom states that it will consider whether additional clarification on how GC9.6 might apply to the introduction of the unbundled tariff should be given.

EE's main issue with Ofcom's approach is the lack of regulatory certainty it provides. Ofcom's comments on the applicability of its proposed new unbundled structure to a proposed revised GC9.6 does not provide industry with the required certainty in this area. Ofcom comments that it will depend on consumer's individual circumstances whether the implementation of a new AC could lead to material detriment. Whereas OCPs currently use this approach in relation to any standard price changes, clearly, in this new context, where the level of AC is unknown and also to some extent beyond the OCPs control due to the strictures of the single intra-tariff and ppm charging regulatory requirements, the uncertainty [✂]

[✂] is high.

Exposing OCPs to this unnecessary uncertainty and risk undoubtedly increases the cost of implementing unbundling for OCPs, whereas this cost has not been included in Ofcom's cost-benefit analysis and which could, on an aggregate level, have a significant impact on the net benefits.

Taking into account these considerations, EE earnestly urges Ofcom to provide regulatory certainty in this area, and to exempt at least the setting of the initial level of the AC from the application of GC9.6, in whatever form GC 9.6 may ultimately take. We do not believe additional clarification as part of the statement on the GC9 consultation would have any benefits: the uncertainty as to the level of the AC would remain, and with that the impact on overall costs.

Proposed Numbering Condition binding non-providers

EE is concerned that the phrase "*advertises, promotes or procures the advertisement or promotion of any Unbundled Tariff Number*" in proposed condition 1.1 is still relatively undefined.

In particular, EE would like to see it made clear whether there are any circumstances in which an SP might publish an unbundled tariff number without this being regarded as the promotion or advertisement of the number (e.g. on business cards, stationary, email footers, in non-classified directories etc).

Ofcom appears to have an implicit understanding in this regard that the same advertising and promotion services will be regulated as under the current CAP *UK Code of Non-broadcast Advertising, Sales Promotion and Direct Marketing* (§A24.76 and footnote 779). In the interests of transparency and clarity, EE believes that the proposed new numbering condition should make this link express.

Billing impact of Ofcom's proposals

EE does not agree with Ofcom's analysis of billing costs either for the 084/087 number ranges nor for the incremental costs of unbundling 09 and 118. In particular, EE remains concerned that the billing cost estimates are incomplete and material underestimates (ignoring important costs).

First, it is not possible meaningfully to comment on the billing cost estimates in Ofcom's final policy position when the estimated costs for CPs with high, medium or low complexity are not separately published. In contrast the April 2012 consultation provided the average one-off and on-going costs for CPs with complex and less complex billing systems, enabling some comparison between different OCP type billing costs. In the absence of similar disaggregated comparator OCP costs it is difficult for EE to comment on the modelled cost for an OCP requiring complex billing changes relative to EE's own expected costs of implementation.

EE notes that part of the rationale for the revision to the estimated annual billing costs is that Ofcom had identified that the annual implementation costs doubled from £50k to £100k when the number of SC price points exceeded 100. In addition, EE notes that the annual costs would also be sensitive to the **frequency** in the change in SC price points – which is a matter that currently remains undefined by Ofcom and highly uncertain.

For instance, EE has noted in its CBA for unbundling the 09 range that Ofcom anticipates significant new entry on the 09 number range to be incentivised by the additional headroom offered under the higher proposed maximum SC caps on the 09 number range. As a result, prices are likely to change more frequently under the new SC caps on 09 because of the following factors:

- diversity of discretionary 09 services reflecting a wide variety of preferences;
- disruptive price discovery generated by new PRS entrants as they "learn by doing" and iterate to price points that maximise profit. This is likely to

generate higher ongoing billing costs if manual processes are relied on to facilitate this process;

- costs of correcting any billing errors or handling call centre queries from customers suffering confusion where new entrant 09 prices are changing frequently; and
- where prices for existing 09 services are opportunistically raised in response to the introduction of the new caps.

For this reason, EE is particularly concerned about the annual costs of managing *changing* price points on the 09 number range (see EE's analysis of the CBA for the 09 and 118 unbundling proposals).

Second, Ofcom argues that the 4 to 10 OCPs modelled with complex billing systems will take account of some MVNOs' billing costs (as well as MNOs and large fixed OCPs' billing costs). EE stresses that network operators will need to provide end-to-end tariff unbundling solutions for many, if not all, fixed OCP reseller and MVNO customers. Ofcom's approach does not properly take this into account. Such changes will place significant pressure on network operators to develop unbundled tariff billing solutions for their retail customers - at a time when mobile and fixed wholesale network operators must also implement tariff unbundling.

Given that implementation must be completed by all OCPs at the same time, this will create timing constraints and could require additional resource to implement a solution for all fixed OCP reseller and MVNO customers. The 18 month implementation period will therefore be challenging and these timing issues could be exacerbated as a result.

For instance, incremental resource required for implementing unbundling for fixed and mobile network operators will be considerable. This will include both direct incremental costs (i.e. additional full time equivalent resource to develop MNO/FNO and separate MVNO/fixed OCP reseller solutions).

If MVNOs wish to have different approaches to implementing tariff unbundling than those of their wholesale provider (e.g. application of unbundling to business tariffs, on decimal pence rounding and specific presentation of the AC on the printed bill) the costs may not simply be incremental to the billing solution for the wholesale network provider, but rather require a separate bottom-up solution with the associated additional costs. These standalone solutions could significantly add to overall industry costs.

This is not a factor for EE alone and all fixed and mobile wholesale network operators will face this same billing system re-build cost issue for their fixed OCP reseller and MVNO customers.

For this reason, EE considers that Ofcom has underestimated the number of OCPs requiring complex billing changes and the number of such OCPs assumed in its analysis should be increased to cover fixed OCP resellers and MVNOs that rely on the same wholesale network operators for their billing solution.

Third, whilst it is not strictly a billing cost, EE also notes that the rigidities of the AC structure will expose wholesale customers such as fixed resellers and MVNOs to a greater risk of cost under-recovery on 08x, 09 and 118 calls than currently. Currently, where the wholesale charges to such customers reflect a mark-up that is proportionate to the termination rate, the wholesale customers can reflect these differing mark-ups through retail prices to their end-customers that similarly differ in absolute terms so as to cover the relevant individual costs of each different type of call. Under unbundling, this will not be possible. Instead, the wholesale customers will have to seek to recover an average of all of these wholesale mark-ups by inflating their ACs accordingly. There is consequently a materially higher risk that misestimates could cause such costs to be under-recovered. Ofcom should reflect this risk as a cost in its CBA.

Fourth, EE notes some stakeholders have argued that legacy billing systems should be viewed as inefficient and that these costs should not be allowed by Ofcom when estimating billing costs. Ofcom argues that estimated implementation costs for OCPs with legacy billing systems may overstate costs but that (a) Ofcom takes them at face value (b) benefits more than outweigh the higher legacy cost.

EE strongly objects to any suggestion that legacy billing systems costs are inefficient or overstate the efficient costs. If Ofcom was to fail to give full weight to these costs in its CBA this would be discriminatory against businesses undergoing unprecedented and ongoing integration of the legacy retail and network elements (e.g. Vodafone and C&W; and BSkyB and O2 fixed; as well as EE's legacy networks).

EE notes that if Ofcom was setting a price control in response to an SMP finding, Ofcom may wish to consider only statically efficient costs in a bottom up cost model to estimate average hypothetical efficient costs within a mature regulated market. However Ofcom is not in this case setting prices to try to mitigate the impact of SMP. The market for retail mobile services is not such a market. Competitive forces are driving static and dynamic efficiencies - not an Ofcom efficiency model. For this reason Ofcom must accept those costs bases which have developed under competitive markets

Fifth, EE notes that billing costs may be dwarfed by call centre queries arising from unbundled 08 and 09 AC bill formats and final charges set by SPs. Given the likely entry on 09 range, EE expects consumer queries to call centres may increase significantly. One way to estimate these costs would be to consider how much time it would take consumers to make enquiries about their bills where the new format was confusing (e.g. where the SC price points were changing frequently) and the value of their time spent on the call. Ofcom should also examine the costs borne by OCPs, where call centre traffic is tied up with responding to consumer confusion over their bills. This could include direct costs to the OCP and indirect costs such as the opportunity cost of not being able to provide business as usual customer support or degrading the quality of that support. The 09 number range would be key in any such analysis given the likely entry and price disruption.

Proposed SC caps

EE is concerned that Ofcom has chosen to set maximum SC caps for 09 numbers under Option 2 (£3 per minute and £5 per call charge). EE is also concerned that Ofcom has decided not to set any maximum SC caps for 118 services.

EE continues to disagree with much of Ofcom's analysis for the same reasons set out in EE's response to Ofcom's initial consultation on the 09 and 118 SC caps. In addition, EE sets out below areas where EE feels that Ofcom's analysis as expressed in its final policy position is particularly unsubstantiated:

Insufficient evidence of unmet demand

- Under the criterion of "efficient prices", Ofcom notes that one SP expressly wanted to use 09 services for charity donations (offered on mobile short codes at £5 and above).[78] Ofcom argues on the basis of this anecdotal and limited evidence that it is now confident that there is unmet demand for services above the level of the current cap. EE considers it lacking in proper objective justification for Ofcom to set the benchmark maximum SC for the entire 09 number range under Option 2 on the basis of alleged unmet demand by one SP, when Option 1 could have permitted higher SCs than offered today without the heightened risk of bill shock, fraud and bad debt (see below).
- EE's 09 and 118 consumer survey[79] results also indicate that only 1% of consumers that make donations do so via mobile voice short codes. Ofcom is therefore effectively relying on a single SP's stated preference to set 09 charges at the higher donation charge level on mobile voice short codes, and when only 1% of consumers make donations in this way. Given these charge levels sit significantly above the levels currently used by EE, EE does not consider this is a reasonable or proportionate approach to setting the level of maximum SC charges on 09.

Risk of clustering at the cap remains a concern

In response to EE's previous submissions on this point[80], Ofcom argues that current SC prices do not cluster at, or exceed, the proposed maximum caps. This was not EE's argument and misses the point entirely. EE's argument is that caps only become focal points for clustering *after* they are introduced not *before*. Ofcom does not respond to EE's evidence of price clustering under retail roaming caps (which provides a better comparator where charges were set after regulation is imposed).[81]

Risks of fraud and bad debt created by Ofcom's proposals are materially understated

Under its criterion "Consumer exposure to fraud and bill shock", Ofcom appears to continue to misunderstand the nature of a key type of fraud on 09. While customers may be subject to fraud, EE was also making the point that EE *as a company* is subject to fraud under these ranges. This will not necessarily

[78] §A22.149

[79] EE, The 09 and 118 consumer survey, conducted in May 2013. The reponse is to the question "Here is a list of other ways of accessing these [09] services. Which, if any, have you used in the past 6 months? Please select all that apply". Overall number of survey respondents was 1209

[80] "Everything Everywhere's response to Ofcom's Consultation on maximum Service Charges for 09 and 118 services in the unbundled tariff regime", 19 September 2012, page 7.

[81] §A22.155

feature in consumer complaint statistics (on which Ofcom relies to conclude the risk of fraud is low in relation to the 09 range).[82]

Under the criterion “Bad debt” EE continues to view Option 2 as representing an unacceptable risk of bad debt for the 09 number range and, combined with the policy to mandate the same AC for 08 and 09 number ranges, will further increase commercial exposure to bad debt risk.[83] Ofcom argues that the risks of bad debt are mitigated by low volumes of calls to 09 numbers, and that no evidence was provided by CPs in any case.[84] However, other stakeholders such as the citizens advice bureau have indicated that they receive many complaints about bill shock and that Ofcom’s Option 2 proposals will exacerbate this problem. EE considers that this in turn is likely to lead to a higher risk of bad debt – OCPs are required to make higher levels of consequent “good will” refunds to customers exposed to these problems. EE therefore argues that this feature of the proposals (combined with the intra-tariff single AC obligation) substantially raises the incremental costs of unbundling 09.

Caps are required on the SC for 118 to promote accessibility

Under the criterion “access to DQ services at an affordable price”, the majority of respondents sought maximum SC caps on 118. Ofcom argues in response that there is minimal historic or current evidence of bill shock or fraud, and that bad debt is lower on 118 than other ranges. However this is not really to the point.

In 2009, 118 calls represented close to £301 million in revenues.[85] Since then, the level of revenues generated by 118 voice calls has declined materially – by circa 14% from 2010-2011[86] - as customers increasingly use cheaper alternatives to these services. If Ofcom’s objective was truly to enhance consumer welfare by stimulating increased demand for 118 calls then setting a sensible level of SC cap in line with that set for the 09 range is the obvious and most direct way to do this.

Furthermore, given the low overall volumes of 118 calls (circa 1% of call volumes in 2009), it is inappropriate for Ofcom to rely on statistics showing low absolute levels of complaints on the 118 number range regarding matters such as bill shock and any comparative analysis needs to be done on a % of complaints as % of calls basis.

Lack of caps increases incremental costs of unbundling the 118 range

Lastly, EE notes that by not applying maximum SC caps on the 118 range Ofcom will thereby raise the incremental billing costs of unbundling 118 – as more SC price points are likely to be needed to be accommodated, as well as potentially increasing the incremental fraud and bad debt risk.

82 §A22.150
83 §A22.120
84 §A22.122
85 Analysys Mason Flow of Funds Report December 2010.
86 2011 PP+ Report, page 22. .

Unworkable ambiguity regarding setting of price points

EE is very concerned that the proposed wording of the new GC 17.32 is unworkably opaque. Specifically, it is not at all clear how the obligation to maintain billing system price points which "*reflect on a fair and reasonable basis the rates proposed by other providers in respect of their SCs, taking account of the volume and range of such proposals"* should be interpreted in practice.

It would, for example, appear to be highly misleading for customers if an 09 SP were to advertise that calls to its 09 number cost £1.25 ppm, when customers of one or more OCPs were in fact going to be charged £1.50ppm because those OCPs had not (yet) built in a £1.25 price point and £1.50ppm was the closest price point. By the same token, it would clearly be unreasonable to expect OCPs to be able to simply build in new price points / re-map an 09 number to a new price point overnight. It would also clearly be unreasonable to expect OCPs to dedicate resources to such tasks 365 days a year.

The success of Ofcom's unbundling proposals depends on there being a common set of SC price points available from *all* OCPs (§A21.150). It is simply not enough for these price points to "coalesce to a substantial degree" (§A21.158). EE therefore cannot understand how Ofcom considers it workable for its proposed legal instruments to fail to directly reflect this requirement.

EE remains of the view that the finally agreed initial 80 SC price points should be reflected in the Numbering Plan. EE disagrees that this would mean that Ofcom would need to issue a consultation every time a TCP/SP wanted to change an existing SC price point (cf. §A21.161). The mere decision of an SP to move from one of the 80 pre-agreed SC price points to another would require no changes to the Numbering Plan. The only time a consultation would be required would be if it was considered that one of the pre-agreed SC price points needed to be deleted and replaced with another (as well as in relation to the levels of the final 20 SC price points). Given the important balancing considerations that are in play between the interests of OCPs, TCPs and SPs (see §§A21.152 to A21.159), EE considers that this obligation on the part of Ofcom would be entirely appropriate to ensure that such decisions maximise the best interests of consumers and that this approach would not unduly restrict pricing innovation. In the long run, it is also likely to be far more efficient than yet another use of Ofcom's dispute resolution powers to resolve any disagreements – which Ofcom sadly seems to already be contemplating as a potential outcome of its current bi-lateral negotiation proposals (§A21.195).

EE appreciates that more work will need to be done by industry, in collaboration with Ofcom, in order to try to reach agreement on what the initial 80 price points will be; to ensure that all existing 08x, 09 and 118 numbers are mapped to these price points in all retail and wholesale OCP billing systems; and to try to reach agreement on a sensible process for mapping new 08x, 09 and 118 ranges to the right price points as well as accommodating any proposed changes to previously agreed price points for existing 08x, 09 and 118 numbers.

In this regard, the bi-lateral TCP/OCP negotiation process that Ofcom seems to currently envisage (§A21.155; §A21.163) would appear to be unworkably complex and burdensome and discloses more than anything else Ofcom's lack of evolved thinking in this area. Clearly, further work will need to be completed to arrive at sensible arrangements that are capable of being efficiently implemented without the need to incur huge industry time and resource costs that Ofcom has not factored in to its cost benefit analysis.

In advance of this, EE considers that it is premature and ultimately non-transparent and in violation of s 47(2)(d) of the Act for Ofcom to seek to impose any generic and non-specific obligations on OCPs in this regard as per the current proposed terms of GC 17.32.

Ban on bespoke SCs

EE wholeheartedly agrees with Ofcom's proposals to modify GC 17 by adding GC 17.26(a) so as to prohibit the existence of bespoke SCs and remove the scope for TCPs to set variable termination rates (§9.64). EE considers it beyond argument that allowing TCPs/SPs to vary the SC between different OCPs would fundamentally undermine the whole raison d'être of Ofcom's unbundling proposals (§A21.5).

At the same time, from a consumer benefit perspective, EE acknowledges and welcomes Ofcom's proposals to allow TCPs/SPs the flexibility to negotiate the inclusion by OCPs of particular numbers in bundles, or other discount arrangements in relation to the SC (§9.65).

Transit costs

EE supports Ofcom's final policy position in relation to transit costs as follows:

- EE agrees with the principle that the OCP should be responsible for the costs of conveyance up to the assumed handover point ("AHP") and the TCP for the conveyance costs after the AHP (§9.134).
- EE also agrees that using the near end handover ("NEHO") model for determining the AHP (leading to this being at the digital local exchange ("DLE") in the case of BT originated calls and the originating switch in the OCP's network in the case of BT terminated calls)[87] is most likely to deliver efficient outcomes (§9.136).
- EE also agrees that a TCP pays approach to transit charges is more appropriate than an OCP approach, because it is more consistent with the NEHO approach to the AHP (§9.140).

In relation to transit arrangements where BT is neither the OCP nor TCP, EE maintains its views as set out in response to the April 2012 consultation, as summarised by Ofcom at §A23.83.

In relation to Ofcom's proposal to agree to BT's suggestion that, where an OCP requires a TCP to carry calls further into the network than the AHP, the TCP should be able to levy an additional conveyance charge to address the extra costs of carrying the call beyond the AHP (§A23.87; §A23.90) EE consider.

87 §A23.2

No cap on the Access Charge

For all of the reasons set out in EE's previous consultation responses, EE supports Ofcom's decision to allow the level of the AC to be set by the market.

Responses to Ofcom consultation questions

Legal instruments (Section 6, Annexes 14 to 18)

Q6.1: Do you have any comments on the notifications in Annexes 14 to 18 and the draft modifications set out within them? Where you disagree with any of the proposed modifications, please explain why.

EE's comments on Annex 14 are set out in section 5.2 of this response (see pp 59 to 62). EE's comments on Annex 17 are set out in section 4.1 of this response (see pp 15 to 25). EE's comments on Annex 18 are set out in section 5.4 of this response (see p 64). EE does not have any comments on Annexes 15 and 16.

Assessment of costs (Annex 10)

Q10.1: Do you agree with our estimates of the billing costs for implementing the unbundled tariff? If not, please explain why and provide evidence to support your response, particularly of the level of costs you are likely to incur as a result of our approach

EE does not agree with Ofcom's analysis of billing costs either for the 084/087 number ranges or for the incremental costs of unbundling 09 and 118. In particular, EE remains concerned that the billing cost estimates are incomplete and are likely to continue to ignore some costs.

Please see EE's analysis of the billing impact of Ofcom's proposals in section 5.5 above (pp 64 to 66) and EE's analysis of Ofcom's CBA on the unbundling of 09 and118 at Annex B.

Q10.2: Do you agree with our estimates of the level of misdialling costs for calls to SPs who may migrate as a result of making 080 free-to-caller? If not please explain why and provide evidence.

EE welcomes the correction of Ofcom's error in the April 2012 Consultation of omitting these costs from its CBA. EE has the following comments on Ofcom's new estimates:

- The out-payment assumptions in §10.188 and §A10.190 should be updated consistently with the adjustments that EE is proposing to the level of fair and reasonable origination charges in relation to the IAR and base case scenario range.
- We do not agree that the above (adjusted) out-payment assumptions would overstate the mis-dialling costs incurred by 080 SPs (cf. §10.192). Currently, Ofcom's cost analysis only covers a very limited sub-set of these

costs – the origination charges payable to the OCP. In particular, EE considers that Ofcom's estimate of the cost to SPs of misdialling should include not only the costs of paying charges for the origination, but also must include all costs payable by the 080 SP to their hosting TCP in relation to these calls (i.e. for termination and hosting and any call management services), as well as an estimate of negative business impact where the SP decides not to maintain the number (at all or only for a strictly limited period), such as the costs of lost sales / negative customer experiences.

- EE does not agree that Ofcom should have restricted its cost assessment to calls made only by consumers (and not business callers), for the reasons set out in Annex A to this response.

Q10.3: Do you agree with our estimates of the level of consumer time costs as a result of making 080 free-to-caller? If not please explain why and provide evidence.

EE welcomes the inclusion of consumer time cost estimates in Ofcom's CBA regarding its freephone proposals. However EE notes that each of the consumer time cost estimates that Ofcom has set out in Tables A10.19 to A10.22 need to be updated consistently with the adjustments that EE is proposing to the level of fair and reasonable origination charges in relation to the IAR and base case scenario range.

EE also does not agree that Ofcom should have restricted its cost assessment to calls made only by consumers (and not business callers), for the reasons set out in Annex A to this response.

Quantified benefits assessment (Annex 11)

Q11.1: Do you agree with our assessment of the impact of implementing the unbundled tariff on the 09 range is likely to be positive overall? If not please explain why.

EE does not agree with Ofcom's assessment that the impact of implementing the unbundled tariff on the 09 range is positive. Please see EE's analysis of Ofcom's CBA on the unbundling of 09 and118 at Annex B.

Framework for assessing free-to-caller origination payments (Section 12)

Q12.1: Do you agree that we should rely on our estimates of the cost of BT's call origination in the Narrowband Market Review to derive the fixed origination payments for the Impact Assessment Range for origination charges? If not, please explain why.

In principle, EE does not disagree with the approach of using consistent figures for fixed call origination between the Fixed Narrowband Market Review and for the purposes of setting fixed OCP origination charges for free phone numbers. Using inconsistent figures would be likely to introduce a distortion of its own. However, as discussed in more detail in the body of this response, it is important that there is also consistent treatment as between fixed and mobile

OCPs. One particular area where using the Fixed Narrowband Market Review figures without any adjustment means that fixed and mobile origination charges are being treated in a different way, without justification, relates to the proportion of the common costs which are no longer recovered from call termination which are allocated to origination costs.

Q12.2: Do you agree that the upper bound of non-network costs that are relevant to recovery through origination charges to 080 numbers should be LRIC+ excluding A&R, billing and bad debt costs? If not, please explain why.

The wording of this consultation question is not clear. EE assumes that Ofcom is referring to the upper bound of call origination costs which should be taken into account being LRIC+, with the non-network element of the "plus" not including A&R, billing and bad debt costs. (LRIC+ by definition includes network as well as non-network costs.) If this is correct, then EE fundamentally disagrees with this approach for the reasons set out in more detail in the main body of the response. In particular, for the reasons set out above in the body of this response:

- LRIC+ should not be an upper bound: the range of different LRIC+ estimates on different bases should **be** the relevant range which is taken into account in setting and assessing origination charges to 080 numbers;
- the estimates of LRIC+ (and indeed pure LRIC) which Ofcom has used are too low for a number of reasons, including that billing costs are still material and incurred in relation to calls to 080 numbers, even where they are suppressed from customer bills which is merely one element of those billing costs (for example, Ofcom has ignored wholesale billing costs);
- Ofcom's cost estimates are also too low due to inappropriate inflation calculations and use of out-of-date and inappropriate CARS estimates (to the extent that CARS costs are included as "customer care" costs); and
- the range which Ofcom uses should include cost estimates which appropriately include some element of A&R costs for the reasons set out in the main body of this response.

EE also notes that Ofcom has been inconsistent in its approach to allocating the common costs no longer recovered from call termination to fixed and to mobile origination charges. If the approach in relation to fixed origination charges is maintained then the mobile cost estimates are materially too low. (Alternatively, if the mobile approach of spreading these costs across all services is maintained, then the same approach should be applied to fixed origination cost estimates which would reduce them.)

Q12.3: Do you agree that the asymmetric risk of the level of payments supports limiting the increase in SP average outpayments below 1ppm? If not, please explain why.

No.

First, EE does not consider that Ofcom's market research provides a robust justification for the rather arbitrary limit on average SP outpayments of 1ppm for the reasons set in section 4.3 above.

Second, the asymmetry in risk to which Ofcom refers is illusory. The key inputs Ofcom has used in assessing the TPE are also subject to significant risk. Therefore, the fact that Ofcom has used 100% of these uncertain effects does not make them any less uncertain. In relation to the risks associated with the estimates of impacts on willingness of SPs' to exit, Ofcom has ignored the fact that these risks are symmetric: Ofcom's figures could just as easily be under or over estimates. Taking these factors together, EE does not consider that there is any justification for assuming an asymmetry in risk as between "too low" and "too high" rates.

Rather the appropriate origination rates should ensure that mobile OCPs are able to recover their reasonable and efficiently incurred costs (including some reasonable contribution to common costs – i.e. LRIC+). This should be the baseline against which impacts are assessed. See the discussion in section 4.3 of the main body of this response for EE's more detailed views on these issues.

Q12.4: Do you agree that the potential for a positive caller externality supports limiting the increase in SP average outpayments to below 1ppm? If not, please explain why.

No.

First, EE does not consider that Ofcom's market research provides a robust justification for the rather arbitrary limit on average SP outpayments of 1ppm for the reasons set in section 4.3 (pp 34 to 46) above.

Second, Ofcom has not robustly made the case that there is any relevant caller externality (which is not already internalised by the very nature of the market). See section 4.3 (pp 34 to 46) of the main body of this response.

Third, even if such a caller externality is relevant, Ofcom's approach has not properly assessed the most appropriate and efficient approach to dealing with such an externality. See section 4.3 (pp 34 to 46) of the main body of this response.

Q12.5: Do you agree that SPs are likely to resort to alternative measures to mitigate the costs of calls from mobile (e.g. routing the mobile calls to a recorded announcement) at higher mobile origination payments? Do you agree that this supports a Base case scenario range towards the LRIC differential? If not, please explain why.

EE considers that the first part of this question is focused on the wrong issue. Clearly SPs will be better placed to answer the factual issue of whether they are likely to attempt to mitigate mobile origination costs in these ways. However, the more fundamental question which Ofcom should be considering is the extent to which such behaviour is efficient. If SPs are not willing to cover the true costs of calling these numbers from mobiles then this does not represent an economically efficient way of accessing these services.

If the argument is that there are external or social benefits from ensuring that these services can be accessed from mobiles (which SPs are not prepared to cover on the basis of their own private benefit) then Ofcom has not made the case why the cross subsidy which results should be borne by mobile operators and their subscribers. This is especially true in the context where such services may be more appropriately and efficiently accessed using other means (whether from a fixed line or from alternative access methods such as through internet based services). Constraining recovery of mobile costs to the so-called LRIC differential level simply assumes that such behaviour is negative per se, which Ofcom has not demonstrated.

Further, Ofcom's proposed approach to dealing with this issue – even if it is accepted that there is a benefit to reducing the incentives on SPs to act in this way – is not appropriate. The LRIC differential is an arbitrary and illogical cost measure which constrains mobile originators to recouping only the absolute amount of common cost appropriate to fixed operators. To the extent that mobile OCPs are allowed to recover their own costs (i.e. in relation to incremental costs) there will still be a differential between mobile and fixed origination costs, which will mean that the incentive on SPs to differentiate between fixed and mobile originated calls will still exist. This could put mobile operators in a situation which is negative both from not being able to recover all of their efficiently incurred common costs as well as only recovering what common costs they can from a lower overall volumes of calls. It was in order to avoid such a discriminatory outcome that Oftel's original dispute determination allowed mobile OCPs to charge for freephone calls in order to cover their higher costs. Ofcom cannot have it both ways. If it wishes to insist that mobile OCPs must provide calls free to the caller then it must accept that this entails allowing mobile OCPs to recover their full costs of origination by way of charges imposed at the wholesale level.

It is also notable that Ofcom take account of SPs potential to reduce the calls they receive which are originated from mobile here (and also assess the potential impact this has in Annex 28 in relation to the TPE). In contrast, Ofcom ignore this reduction in overall mobile originated volumes when considering the level of fixed to mobile substitution and deriving the 45% to 60% range for such substitution.

Wholesale free-to-caller regulation (Section 14)

Q14.1: Do you agree that the notice to be given by TCPs of initial revisions to origination charges (as set out in the draft access condition):

(i) should be given to OCPs; and

(ii) should be given within one month of the condition being set?

If you do not agree, please explain why.

Broadly EE agrees with these proposals. However there are a number of important nuances to EE's views in this regard, which are set out in detail in section 4.1 of this response – see pp 15 to 25.

080 and 116 number ranges: Consultation on proposed dispute resolution guidance

Question 1: Do you have any comments on how we have applied these three Principles to generate the draft guidance in Annex 1?

Yes. These comments are set out above in section 4.5 of this response (see pp 46 to 51).

Annex A: EE's analysis of Ofcom's CBA of its freephone proposals

Introduction

Ofcom considers two options for the freephone ranges:

- **Option 1**: free-to caller: set a maximum price of zero that applies to all OCPs; and
- **Option 2**: Maximum Mobile Price ('MMP'): set a maximum price of zero for all fixed calls, and a maximum price above zero for mobile calls to 080 numbers.

For the reasons set out below, EE considers that the CBA between the mandated free-to-caller and MMP range options is finely balanced. In fact the mandated free-to-caller option is likely to offer less net benefits to consumers than then MMP range option when considered in the light of changes to Ofcom's analysis in its latest consultation.

Costs assessment

EE objected to Ofcom's April 2012 analysis on the grounds it did not sufficiently quantify the costs and benefits of mandating the free-to-caller option on 080.[88] In response to EE's comments, Ofcom has undertaken further quantification analysis, particularly on costs.

Ofcom has now quantified further costs for Option 1 and Option 2 using the IAR as follows:

- Ofcom now assumes migration away from 080 in response to making 080 free-to-caller lies within the range of **8% to 36%,** generating additional migration costs in the revised range of **£2.2m - £36m**
- Misdialling cost (where 080 SPs migrate or cease providing services) are estimated to add costs of **£3.3 - £15.5m**

In summary, Option 1 free-to-caller implementation costs are in the range of **£8.8m to £57.5m** whereas the costs of implementing Option 2 remain low at **£0.2m to £3.2m.**

In assessing these costs, Ofcom now restricts its analysis to calls made by <u>consumers</u> (and not business callers) to 080 calls (in contrast to the April 2012 proposals which included <u>business</u>) [89].

However, this approach seems entirely inconsistent with what Ofcom has done to derive the base case ranges for the fair and reasonable origination charge, where Ofcom has assumed that the freephone proposals will apply to all traffic,

88 §13.20

89 Ofcom states at 13.22 "in light of stakeholder comments, we now consider that both the free-to-caller and MMP approaches should only apply to calls made by consumers to 080 numbers. By "consumer" we mean a natural person who uses the service for purposes which are outside his or her trade, business or profession (i.e. it does not include business callers). This is a consequence of our legal powers to impose maximum prices and is explained in more detail in Section 5 and Annex 13. "

such that SPs will have to pay the higher origination charge for *all* mobile 080 traffic. Ofcom cannot have it both ways. If Ofcom assumes that its proposals will put pressure on OCPs to make all 080 traffic free to caller (as it has done for determining the base case range) then it must estimate the full costs associated with this within the CBA.

EE also considers that Ofcom needs to update its costs estimates for the free-to-caller option in line with the amendments to the IAR and base case range that EE has proposed in the main body of this response.

Overall, costs have risen significantly for the free-to-caller option while remaining very low for the MMP option. This is largely because the MMP option is far less disruptive to the 080 number range than the free-to-caller option. The free-to-caller option effectively polarises the SPs on the 080 range – many of whom express a strong willingness to exit if the free-to-caller option is implemented. MMP on the other hand appears to have support among SPs at relatively low average call origination charge levels with little evidence of the same strong willingness to exit identified under the free-to-caller option.

In summary the costs for Option 1 are significantly higher than for Option 2.

Benefits assessment

Ofcom's benefits assessment remains qualitative for both the free-to-caller and the MMP options. EE considers that this is a material weakness in Ofcom's CBA. Given the materiality of the quantitative costs of the free-to-caller option, EE considers that it is incumbent upon Ofcom in order to demonstrate the proportionality of its proposals to be able to demonstrate a likelihood of quantitative consumer benefits that outweigh these costs. EE strongly suspects that the reason Ofcom has not endeavoured to do this is because it is in fact unable to demonstrate quantitative net consumer benefits.

EE's remaining comments on the qualitative benefits assessment are made against Ofcom's four criteria:

Consumer price awareness

Ofcom argues that quantifying the benefits of Option 1 and Option 2 is not straightforward and that, in particular, Ofcom is not minded to estimate the alleviation of price misperception on 080.

EE recognises that quantifying the benefits may not be straightforward, but Ofcom should at least test whether the benefits are likely to be of an order of magnitude higher than the costs or only slightly above (or below) cost to test the robustness of the CBA.

Given that the estimation of the impact of alleviating price misperception was the main approach taken by Ofcom for assessing the benefits of improving consumer price awareness of unbundling the 084/087 and 09 ranges, EE considers that Ofcom should do the same for Option 1 and Option 2 for the 080 proposal.

Ofcom claims that its free-to-caller option will better achieve consumer price awareness than MMP, since SPs will be able to advertise a clear pricing message and because 'free' is the simplest price point. Ofcom accepts that

MMP could also help raise price awareness but argues that it may contaminate the free to caller message.

EE considers that it is highly likely that MMP will also reduce price misperception. It is also hard to see how this mobile only price could generate material price misperception and suppressed demand for fixed 080 calls given the proposed MMP price would only be around 5ppm. Accordingly, it is not clear why Ofcom has not estimated this benefit to 080 consumers as it has done for the 084/087 and 09 ranges. EE considers that Ofcom cannot confidently claim the free-to-caller option is better at achieving consumer price awareness than the MMP option unless it quantifies the estimated reduction in price misperceptions for both option. Given Ofcom already has the data necessary to estimate the benefits from its surveys this would not be a resource intensive exercise to undertake.

Efficient prices

Ofcom argues that the free-to-caller option will reduce the effect of the vertical and horizontal externality. However EE notes that this can also be achieved with a new free to caller range such as 0500 (with MMP on 080).

EE also notes that at relatively low average call origination charges more SPs prefer the MMP option to the free-to-caller option. In fact at 1.5ppm out-payment levels, only 35% of SPs want the free to caller option while 43% want the MMP option, with little evidence of the same willingness to exit identified under the free-to-caller option. Given the heterogeneity of 080 SP preferences regarding the retail price / wholesale cost blend, EE considers that the MMP option (together with the introduction of a new free-to-caller range such as on 0500) better addresses the vertical externality.

EE reiterates that by making 080 free to caller, this will force retail prices below cost which does not promote allocative efficiency. Arguably MMP better promotes efficiency by ensuring retail consumers face prices that reflect their cost of service provision. Similarly the MMP is better at promoting efficient prices because it avoids the need for the OCP subsidy of SP costs of origination that Ofcom is currently contemplating in order to mitigate any caller externality (i.e. callers valuing free mobile calls more than SPs).

Service quality, variety and innovation

Ofcom argues that the free-to-caller option will achieve better price awareness. Ofcom also claims that lower mobile 080 call prices are likely to increase demand on 080. However this qualitative assessment looks less reliable when considering the likely exit from the market by the predicted 19% of 080 SPs within the base case range and up to 38% under the IAR range.

Ofcom also argues that the free-to-caller option will improve consumer confidence in using 080 numbers and will improve the brand reputation of the number range. However, MMP would also improve the brand reputation of the 080 range because it would enable SPs to advertise a single low mobile price nationally. If it is considered that relatively high mobile prices are to blame for lack of service innovation then surely this targeted remedy is more appropriate.

Ofcom also argue that by making 080 free-to-caller, it will widen the potential for SPs to adopt innovative business models. However, EE considers that this claim seems implausible if it is the case that up to 38% of SPs will probably migrate away in response to free-to-caller being implemented. This argument also ignores other options available to facilitate SP innovation – such as zero rated mobile short codes, investment in advanced online customer service offerings etc.

EE also considers that MMP on 080 (plus a separate 0500 freephone range) may represent a better trade off between heterogeneous SPs, some of which have a high willingness to pay compared to others who have a high willingness to exit under the free-to-caller option. MMP would entail the least disruption to services on the 080 range compared to free-to-caller, because it is less polarising compared to MMP which appears to have broader support of SPs at relatively low average call origination charge levels (e.g. 1.5ppm), with little evidence of the same willingness to exit identified under the free-to-caller option.

Access to socially important services

Ofcom argues that under the free-to-caller option, 080 callers will no longer be charged for calling socially important services from mobiles. Ofcom further argues that there are some socially important services that are not offered free-to-caller (e.g. National Grid Smell Gas 0800 number and THA Public Sector Special Freephone Tariff (PSSFT) Scheme) and therefore that its proposals will assist with improving access to socially important services. Ofcom then claims many SPs are unaware they can enter into commercial deals for zero rating 080 calls.

Ofcom also rejects EE's suggested alternatives such as call back services, geographic numbers such as 03, mobile short codes or email or text services

EE still considers that a charge of 5ppm under the MMP option would not materially reduce access to socially important services, and may ensure that OCPs can continue to offer the service at no charge to the SP. This is particularly relevant given higher call origination charges under the free-to-caller option were a concern of the THA.

In any event, there are so few socially important services that are not already zero rated (only two have been identified by Ofcom) that Ofcom has failed to establish that the free-to-caller option will *materially* assist this stated aim such that it is a *proportionate* response to this issue. MMP has not been shown to reduce access relative to the free-to-caller option (in fact if it means SPs do not have to pay a call origination charge and that may promote access to these services to a greater extent than free-to-caller).

Net benefits assessment

EE considers that Ofcom's CBA for the mandated free-to-caller and MMP range options was already finely balanced in its April 2012 proposals. The mandated free-to-caller option is now likely to offer lower net benefits to consumers than the MMP option when considered against the assumptions contained within Ofcom's analysis in its latest consultation.

Because the implementation costs have now increased so markedly for free-to-caller, this places more reliance on the relative benefits of free-to-caller (as compared to the MMP option which has similar benefits but with very low costs of implementation).

Specifically, EE considers that the MMP option has the same or greater benefits than the free-to-caller option including

- Ofcom cannot confidently claim the free-to-caller option is better at achieving consumer price awareness than the MMP option unless it quantifies the estimated reduction in price misperceptions for both options.
- Making 080 free-to-caller forces retail prices below cost which does not promote allocative or dynamic efficiency. MMP better promotes efficiency.
- SPs prefer MMP over free-to-caller at average call origination charge levels as low as 1.5ppm.
- Both options would improve brand awareness for the range.
- There are so few socially important services that are not already zero rated that free-to-caller is not a proportionate way of improving access to these particular services or materially assist in doing so.

In conclusion, EE considers that the mandated free-to-caller option is likely to offer less net benefits to consumers than the MMP range option when considered in the light of changes to Ofcom's analysis in its latest consultation such as additional costs of implementation, the failure to quantify key benefits and when assessed against Ofcom's own criteria for assessing benefits.

Annex B: EE's analysis of Ofcom's CBA for unbundling the 09 and 118 ranges

Overview

This Annex sets out EE's views on why Ofcom's CBA for the unbundled tariff proposal for the 09 and 118 number ranges is fundamentally flawed. In particular, we highlight:

- the glaring lack of evidence presented for Ofcom's theory of harm in relation to calls to 09 and 118 number ranges; and
- the fact that Ofcom fails to recognise the competitive impact of alternative means of accessing entertainment and information services using mobile short codes, mobile apps and free, web based, internet services when considering the likely benefits and proportionality of its proposals.

These market led alternatives are now well established in the market and are becoming increasingly more popular than equivalent accessing of services using 09 or 118 numbers. They are also able to provide superior - and in some cases simpler - pricing messages for consumers than would be provided under Ofcom's unbundled tariff remedy.

Ofcom concedes that it has not undertaken any CBA whatsoever for its proposals for 118 numbers. EE considers this to be entirely unacceptable. Whilst volumes of calls to 118 are low, revenues generated by all industry stakeholders from calls to these numbers are still very material. It violates all of Ofcom's applicable statutory duties and powers for Ofcom to be contemplating such drastic changes to the way in which the range operates under current market driven circumstances without a) a compelling case of consumer harm authorising Ofcom to impose its proposed retail tariff restrictions and b) a robust CBA demonstrating the proportionality of these measures. Ofcom has demonstrated neither.

Put simply, Ofcom's CBA does not justify the proposed changes to pricing for the 09 and 118 number ranges. EE's analysis which highlights these failings and includes proposals for better, less expensive solutions, can be summarised as follows.

First, EE highlights the lack of evidence for market failure in relation to 09 and 118 numbers. We address:

- perceived lack of price awareness,
- the horizontal externality, and
- the vertical externality.

EE considers that the consumer survey evidence relied on by Ofcom does not support any claim that there is a lack of price awareness or horizontal externality on the 09 or 118 number ranges.

EE accepts that there may be some degree of market failure in the form of a vertical externality in relation to 09 and 118 numbers. However EE considers that the impact of this externality is limited by:

- High retention by SPs, which gives them some measure of control over the ultimate retail price; and

- Increasing usage of mobile voice short code and premium SMS alternatives, where SPs and DQ operators can directly control the retail price.

Second, we consider the lack of evidence for Ofcom's theory of harm to consumers using 09 and 118 numbers. We present our analysis using the same headings as in Section 4 of Ofcom's analysis to aid comparability with Ofcom's own analysis:

A: A reduction in demand

EE considers that the claim that there is suppressed demand on 09 and 118 is not supported by the evidence presented by Ofcom to support its final policy position.

B: Relative prices do not reflect consumer preferences;

First, Ofcom has not established that this is in fact the case. Secondly, any improvements to relative mobile and fixed OCP retail prices for calls to these numbers are likely to be limited due to the clear survey evidence that most customers are simply not interested in calling 09 and 118 numbers.

C: Loss of access to socially important services; and

There are no socially important services provided on the 09 and 118 ranges hence this criterion does not apply to the 09 and 118 number ranges.

D: Loss of service diversity and innovation resulting from SPs' lack of incentives to invest in the market.

EE notes that the evidence presented within the Flow of Funds report indicates there is no lack of incentives for investment by SPs in 09 or DQ operators in 118 services because:

- SPs on the 09 number range and DQ operators on the 118 number range are not overly revenue constrained even where they do not directly control the retail price point ;and
- SPs and DQ operators can directly control the retail price using close substitutes such as premium SMS and mobile short codes, as well as mobile apps

Third, EE identifies problems with Ofcom's approach to estimating the benefits of tariff unbundling on 09 and 118 ranges, with reference to Ofcom's Effect 1 and Effect 2 analyses.

Under Ofcom's Effect 1 (which measures price misperception), Ofcom concludes that the most likely scenario is that there is no price misperception on the 09 number range. Where Ofcom models price misperception, Ofcom's estimation method overstates the size of this beneficial effect.

In relation to Effect 2 (improvement in an alleged lack of trust and confidence leading to suppressed demand), the available survey evidence clearly contradicts the likelihood of any such effect on the 09 number range.

Ofcom makes no attempt to estimate Effect 1 or Effect 2 for the 118 number range.

Fourth, EE identifies material and significant costs of implementing tariff unbundling on the 09 and 118 number ranges which have been understated or ignored by Ofcom. These adverse impacts under the CBA include:

A: TPE as a result of OCP loss in profits;

EE argues that mandating single AC across 08x, 09 and 118 represents a further loss to OCP profits which will offset any gains from increased competition between OCPs.

B: Reduced service availability and innovation as a result of reduced SP profits

In the event that increased price awareness leads to reduced 09 demand (which is an outcome that Ofcom does not rule out), many marginal SPs on the 09 number range will migrate away to substitutes (e.g. premium SMS, mobile short codes or mobile apps) or even exit.

Similarly, many marginal DQ operators on the 118 number range may migrate to text based directory services or mobile apps or even exit the 118 range if it turns out that at least some 118 prices are currently being underestimated by consumers.

C: Incremental OCP billing costs

EE strongly objects to Ofcom's assertion that the incremental billing costs are unlikely to be material as a result of unbundling the 09 and 118 ranges. On the contrary, there are, *inter alia*, likely to be significant costs directly related to Ofcom's proposals on the single AC for 08, 09 and 118 and the new SC caps on 09 (and absence of caps on 118).

D: OCP incremental communication costs;

OCP pricing on the 09 and 118 number ranges will need to be significantly revised and this will be complex as there are a lot of 09 and 118 price points, and various bespoke pricing that OCPs have established in relation to certain numbers on these ranges (such as OCPs' own DQ services). Such costs are clearly purely incremental to the unbundling of the 09 and 118 ranges.

E: SP incremental communication costs;

All 09 SPs will need to change the way they currently advertise their prices. There must be a cost associated with this, and all of it will be incremental to unbundling 09 since there are unlikely to be many, if any, 09 SPs also providing 084/087 services (and even if they are, the services may not currently be advertised or promoted in the same publications).

Similarly DQ operators will need to change the way they advertise their prices and all of it will be incremental to unbundling the 118 range.

F: TCP cost of communicating with 09 SPs and 118 DQ operators;

EE has no evidence to suggest an alternative value to that estimated by Ofcom.

G: TCP fall in profits due to reduced volumes; and

EE strongly objects to the exclusion of this cost category given the level of TCP retention on both 09 and 118 number ranges.

The current TCP retention on 09 calls is 6% compared to OCP retention of 27%. The current TCP retention on 118 calls is 34% compared to OCP retention of 20%.

H: Migration costs.

EE argues that Ofcom should estimate migration (including possible exit from the non-geographic calls market to other technological alternatives such as premium SMS, mobile voice short codes and online service delivery) and misdialling costs for 09 and 118 number ranges in line with the approach taken on 08x. There appears to be absolutely no objective justification for Ofcom's failure to do so.

Fifth, EE summarises its assessment and makes alternative recommendations.

Each of the above assessments of Ofcom's CBA is undertaken for three separate scenarios identified for the 09 and 118 number ranges by Ofcom in their latest consultation:

- Consumers underestimate 09 and 118 prices and over-consume 09 and 118 services (Scenario A – less likely);
- Consumers accurately estimate 09 and 118 prices (Scenario B – most likely); and
- Consumers over estimate 09 and 118 prices and under consume 09 and 118 services (Scenario C – unrealistic).

The following section elaborates on the above summary.

Lack of evidence for market failures

This section highlights the lack of evidence of any market failure in relation to calls to 09 and 118 numbers.

a) Lack of price awareness

09(Scenario B)

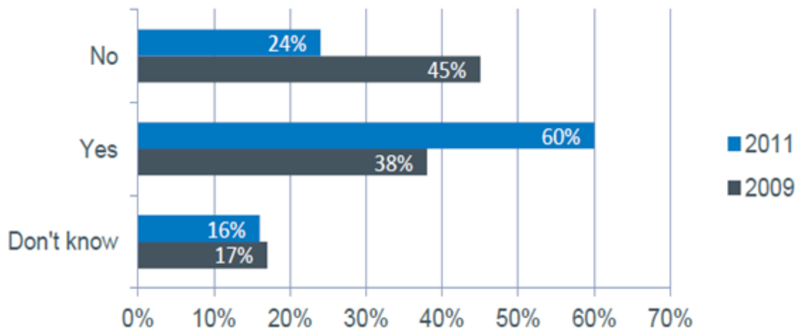
EE considers that the consumer survey evidence relied on by Ofcom does not support Ofcom's claim that there is a lack of price awareness on the 09 number range. In fact, EE can demonstrate that there is positive evidence of clarity in 09 pricing.

First, a comparison of PhonepayPlus (PP+) quantitative consumer studies between 2009 and 2011 shows a dramatic improvement in perceptions of pricing clarity on 09 from **38%** to **60%**. The report states:

> *"The majority of PRS users in our quantitative study say they are clear over how much services will cost them. This is a significant shift from consumer attitudes two years ago (see chart below).*[90]

[90] Source: PhonepayPlus quantitative consumer study, December 2011; compared to results to equivalent question in 2009 Current & Future Market report by Thinktank International Research . Question: When advertised, were you certain on how much would be charged by the service? http://www.phonepayplus.org.uk/RSS-Feeds/~/media/PhonepayPlus%20research%20%20Curent%20and%20Future%20Market%20for%20PRS%202011.pdf page 20.

Perception of PRS pricing clarity 2010-2011



Second, Ofcom rely heavily on the following survey result which is misleading as it erroneously suggests a lack of price awareness and trust (which is later argued to support the false claim of suppressed demand under Effect 2):[91]

> *"For users of phone-paid services, accurate pricing information is the single most important factor that will help to improve trust, with just under three quarters (73.9%) of phone-paid service users citing this as a factor that would help improve trust"*

Astonishingly, Ofcom fails to mention that the 73.9% who stated their trust would be improved through more accurate information was in fact based on a sub-sample of only 3.0% of current 09 service users who cited "lack of trust of the companies offering these services" as the reason they were not interested in using additional types of 09 services. The relevant summary at page 145 from the same report puts Ofcom's misleading use of this survey result into proper context:

> *"Amongst users of PRS, the most commonly cited reason for not expanding their usage to additional PRS services was "lack of interest":*
>
> *50.6% of respondents selected this option, compared with 71.4% in 2009 and 60.1% in 2008.*
>
> *The next most significant reason for not using other phone-paid services was cost, with 24.4% of respondents perceiving phone-paid services to be too expensive, compared with 9.3% in 2009 and 40.5% in 2008.*
>
> *Only 3.0% of current phone-paid service users cited "lack of trust of the companies offering these services" as the reason they weren't interested in using additional types of phone-paid services (see Figure 7.4). This compares favourably with the 2009 survey, in which 4.0% of non-users of PRS cited their reason for non-use as a lack of trust in the company's advertising PRS; and with a figure from the 2008 Market Review which showed that on average, 20.0% of non-users of any given PRS service cited lack of trust in the service as a reason for*

91 Ofcom 2013, § 4.56.

> *not using it. This suggests that there has been a significant reduction in the prevalence of issues caused by less scrupulous."*[92]

EE notes that in the same Figure 7.4 of the 2011 PPP report, of those who gave reasons for not using PRS services 99.3% responded that they were not interested in the 09 service; with 44% stating PRS was "too expensive".[93]

It is relevant to compare these results with Ofcom's latest assessment that those consumers who use 09 numbers are likely to estimate 09 prices fairly accurately, and if they do estimate prices incorrectly this is likely to be an under- rather than over- estimate. If customers who use 09 services find them costly, presumably this is an accurate assessment and simply reflects a lack of willingness to pay a high price for the 09 service. If they underestimate 09 prices, then Ofcom's proposals are likely to exacerbate the proportion of consumers who view such services as costly, since any alleviation of price underestimation will, all else being equal, result in consumers perceiving more accurate but higher prices leading to more consumers regarding the service as too costly, thereby generating lower demand.

Taking into account all the evidence above, EE considers that there is no evidence for a lack of price awareness:

- Clarity in 09 pricing has improved substantially between 2009 and 2011, and had a similar survey based on 2012 data been undertaken it would be likely to show a continued upward trend as the market matures under PP+ regulation.
- Those that use 09 services are likely to estimate prices fairly accurately (if they underestimate prices, unbundling will improve their estimation at higher prices. Since cost is a major factor for not using the 09 number range, this improved estimation at higher prices will further discourage 09 use.
- Those that do not use 09 service clearly do not want to use the service because they are not interested in the service or because of cost.
- Of the 3% that would have more trust in using the range if provided with more accurate price information, this has dramatically fallen from 20% in 2008 to 4% in 2009 to 3% in 2010. In any event, there is no evidence that these respondents would necessarily call 09 services more often even with accurate price information. For instance Ofcom state:

  > *"This is in contrast to 09, where we consider it likely that many users simply do not need or want to call these [09] numbers".*[94]

Finally, EE's 09 and 118 consumer survey[95] results indicate that when respondents were asked about how they access information lines, such as

[92] The 2011 PP+ report, page 145.

[93] It appears that the 99% and 44% differ from the 50.6% and 24.4% in the bulleted quote above, because the former relates to whether current users of PRS would use additional PRS services and Figure 7.4 refers to those that don't use PRS but are active phone paid users. Note the percentages are not additive since multiple responses were provided.

[94] *Ibid.* § A11.80

[95] EE 09 and 118 consumer suvey, conducted May 2013. Response to the following question "*Here is a list of other ways of accessing these services. Which, if any, have you used in the past 6 months? Please select all that apply*".

news, sports, traffic updates or horoscopes the four most popular methods included:

- Internet services using fixed broadband or Wifi ([✂])
- Internet via a mobile phone ([✂])
- Mobile apps ([✂])
- Don't use these service ([✂])

These results further suggest that many 09 consumers are increasingly accessing services through internet based services and mobile apps.

EE concludes that Ofcom has not provided any evidence of a lack of price awareness in relation to 09 numbers whether people use or do not use 09 service. People who do not use 09 services and do not know the price cannot be simplistically assumed to face harm from suppressed demand. Moreover there is considerable positive evidence that consumers are benefiting from clarity in prices on the 09 number range.

09 (Scenario A and C)

The above analysis assumes that there is no price misperception in relation to 09 numbers and that consumers who use these services fairly accurately estimate 09 prices. EE has also considered how evidence on lack of price awareness may be impacted by assumptions on price misperception.

There is no evidence for the scenario of *price over-estimation*. EE considers this to be an unrealistic scenario

Under the scenario of *price under-estimation*, there could be a lack of price awareness since price under-estimation would lead to over consumption of 09 services. As highlighted in the earlier section, any alleviation of price underestimation will actually raise estimated prices and deter consumers from making 09 calls.

118 (Scenario B)

Ofcom's evidence for a lack of price awareness specific to the 118 range rests on Table A7.5 and Table A7.6 of the 2010 consultation which highlights the many different price <u>levels</u> and <u>structures</u> in the market. Ofcom state the following:

> *"Like other non-geographic number ranges, consumer price awareness is poor. This is due to the lack of transparency when it comes to prices and is in part due to the wide range of tariffs and tariff structures for different services (see Table A7.5 below) in an environment where price information cannot be unambiguously conveyed as the same service can also vary markedly between operators (see Table A7.6 below). This can also be observed by looking at BT's price list"*[96]

Ofcom also states the following:

[96] Ofcom, § 7.424, December 2010 consultation.

> *"The current level of prices is distorted by the combined effect of the lack of transparency over the charges and the vertical externality problem discussed in Annex 2. DQ providers do not set the retail price of calls to their service, with the exception of calls retailed by BT. As such, there is reduced opportunity for price differentiation and competition based on the price of the service"*[97]

A variety of pricing structures for 118 services are offered in response to competition and in particular, different consumer preferences that exist for these DQ services. OCPs currently offer different pricing structures but this must surely be one of the most innate and fundamental differentiators that competitors can use to better target customer niches in a competitive market. Although it is true that DQ operators do not set the retail price level, they can choose what tariff structure they wish to use to offer their service. To the extent that there is a desire by DQ operators to control their charges, including offering a national SC, this is a response to the vertical externality and not evidence of a consumer lack of price awareness (see below).

Even if it were legitimate (which it is not) to argue that different pricing structures generate a lack of price awareness, tariff unbundling cannot conceivably impact these charging structures, since tariff unbundling is only concerned with ensuring SPs can advertise their prices nationally, however those pricing structures are expressed.

- For example, if the call price point has both a set up fee with ppm rates thereafter, the SP would advertise "*our set up fee is X and our ppm rate thereafter is Y, plus your CP's charges*". If the charge was a simple ppm rate, the SP would simply advertise "*our ppm rate is X plus your CP's charges*".

Unbundling will therefore have no effect on these different pricing structures for OCPs and SPs. Nor is it intended to.

On the issue of price levels, EE accepts there may be limited evidence of vertical externality on 118 which is in any case mitigated (see below). But there is no consumer survey evidence to suggest consumers have a lack of price awareness whatsoever on the 118 range.

EE's 09 and 118 consumer survey[98] results further suggest consumers are aware of DQ services and competitive alternatives to 118. When respondents were asked about how they access specialist helplines, such as customer helplines, directory enquiries (118) or technical support lines, the four most popular methods included:

- Internet services using fixed broadband or Wifi ([✂])
- Internet via a mobile phone ([✂])
- Online help ([✂])
- Mobile apps ([✂])

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97 Ibid, § A7.425

98 EE 09 and 118 consumer suvey, conducted May 2013. Response to the following question "*Here is a list of other ways of accessing these services. Which, if any, have you used in the past 6 months? Please select all that apply*".

These results further indicate the competitive pressure exerted on the 118 range from internet services, many of which will offer free services (e.g. Google) or paid for apps (such as the “118 app”). The following are a selection of comments made by respondents to the survey:

“Looking up phone numbers is what Google is for. And as my phone has the internet it’s a no brainer.”

“I use my smart phone to Google the required number”

“I just use Google”

“There is always a good app available that does a similar job”

For both users and non-users of the 118 range, the majority of respondents access alternative DQ services via the internet ([✂] on mobile and [✂] online help for users of 118, [✂] on mobile internet and [✂] on fixed internet for non users). [✂] of 118 users respond saying they use mobile apps as well as call 118 at least once a month. This suggest that those who never use 118 simply get their numbers for free off the internet, whereas those that are willing to pay for 118 calls and are used to paying for the service are almost [✂] as likely to have paid for a mobile app ([✂] compared to [✂] of those that never use 118).

These results indicate that rather than there being a large disengaged group of non-users who don’t use 118 because they don’t know what’s on offer or lack trust, non users appear to be astute consumers who know they can find numbers for free using the web. In contrast those that do use 118 regularly are substituting to free services but are also willing to pay for alternative services such as mobile apps which suggest competition is working well for both users and non users of 118 services.

For these reasons, we consider that Ofcom’s interpretation of the evidence of a lack of price awareness on 118 is flawed.

118 (Scenario A and C)

EE notes that the level and direction of current price awareness is currently unknown on 118. In the absence of any contrary evidence EE’s analysis above assumes that there is no price misperception on 118 and that consumers who use these services fairly accurately estimate 118 prices. However, it remains unknown whether 118 consumers can estimate prices accurately.

b) Horizontal externality

09 and 118 (Scenario B)

Ofcom now accept that there is no positive evidence for horizontal externalities on the 09 number range:

> *“We place limited weight on the horizontal externality in the context of 09 and 118 numbers because we accept that consumers are more likely to see 09 and 118 as distinct number ranges”*[99]

[99] Ofcom, Simplifying non-geographic numbers – Part A, § 4.55.

EE agrees with this assessment and wishes to emphasise that there is no evidence whatsoever to support the claim that there exists a horizontal externality between the 084/087 number ranges and 09 or 118, between the 09 and 118 ranges or within the individual 09 and 118 ranges.

09 and 118 (Scenario A and C)

The above analysis assumes that there is no horizontal externality in relation to 09 numbers in a scenario in which consumers who use these services fairly accurately estimate 09 prices. EE has also considered how any horizontal externality may be impacted by assumptions on price misperception.

Under the scenario of *price under-estimation*, EE's concludes that under this scenario the horizontal externality is not applicable between the 09 and other number ranges and it is unknown whether the horizontal externality exists within the 09 number range.

EE considers the scenario of *price over-estimation* as unrealistic and therefore does not consider this scenario further.

c) Vertical externality

09 (Scenario B)

EE accepts that there may be some degree of market failure in the form of a vertical externality in relation to 09 numbers, but the impact is limited by:

- High retention by SPs, which gives them some measure of control over the ultimate retail price; and
- Increasing usage of mobile voice short code and premium SMS alternatives, where SPs can directly control the retail price.

The 2010 Flow of Funds survey states:

> *"As might be expected, SPs are able to generate a large amount of revenue from the 09 number range, totalling around GBP181 million or **67%** of total market revenues. In contrast, OCPs and TCPs retain 27% and just 6% respectively."*[100]

This evidence illustrates that the level of SP revenue retention on the 09 range is significantly higher than the average NGN range. Accordingly, this suggests that in practice SPs may not be revenue constrained by not being able to control explicitly their 09 retail price point(s).

In addition, the evidence suggests that alternative methods of accessing services historically provided on the 09 number ranges are being used, and in these cases the SP has control over the retail price such as mobile short codes and premium SMS. For instance the 2011 PP+ report[101] shows the following:

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[100] Ofcom 2010 Flow of Funds report Page 49. http://stakeholders.ofcom.org.uk/binaries/consultations/simplifying-non-geo-numbers/annexes/flow-funds.pdf

[101] SAND research for PhonepayPlus April 2012 "*SAND Current & Future Market for PRS 2011*", Page 22. http://www.phonepayplus.org.uk/RSS-Feeds/~/media/PhonepayPlus%20research%20%20Curent%20and%20Future%20Market%20for%20PRS%202011.pdf

- In 2011 Premium SMS/MMS (including mobile voice short codes) accounted for **£323 million** of the overall PRS market compared to £297.4 million in 2010.
- This compares with revenue from Voice 09 numbers of **£177.4 million** in 2011 and £195.3 million in 2010.
- Between 2010 and 2011, revenues increased by 8.6% for premium SMS/MMS and mobile short codes while revenues fell 10.7% for voice 09.
- TV red button and Payforit are also taking market share from Voice 09.

This trend should not be surprising to Ofcom. For example, TV competition and prize voting formats are already moving away from calls to 09 toward mobile voice short codes (which can be advertised as a single per call charge), premium SMS text and even mobile voting apps. For these reasons, EE argues that the case for the vertical externality in relation to 09 numbers is overstated by Ofcom because these factors are fast removing the lack of control SPs have traditionally faced on retail prices for 09 services.

09 (Scenario A and C)

The above analysis of the limited vertical externality in relation to 09 numbers is based on the scenario in which consumers who use these services fairly accurately estimate 09 prices. EE has also considered how the vertical externality may be impacted by assumptions of price misperception.

EE considers the scenario of *price over-estimation* as unrealistic and therefore does not consider the vertical externality under this scenario

Under the scenario of *price under-estimation*, EE's accepts that there is some evidence of a vertical externality but that the effect is mitigated owing to the extent of SP revenue share on the 09 number range and the ability of SPs to adopt alternative supply side substitutes (such as premium SMS, mobile voice short codes and mobile apps over which they can directly control the retail price).

118 (Scenario B)

EE accepts that there may be some degree of market failure in the form of a vertical externality in relation to 118 numbers, but any adverse impact is limited by the following factors:

- Very high combined retention by TCPs and SPs, providing them with some control over the ultimate retail price;
- Ability to use premium SMS codes – e.g. text directory questions to 118118, dq4mobile service on 83211; and
- Ability to use mobile apps – e.g. the "118 app" from the Number.

The 2010 Flow of Funds survey states:

> *"SPs are again able to retain a large proportion of revenues at around **46%**. However, with OCPs only retaining 20% of revenues this is not*

> *as large as might be expected with TCPs retaining an above average 34% of total revenues."*[102]

Accordingly, this suggests that SPs may in practice not be overly constrained by not being able to explicitly control their 118 retail price point(s). In addition, the evidence suggests that alternative methods of accessing DQ services on 118 number ranges are being used, where the SP has control over the retail price including SMS codes and mobile apps, including the "118 app" from the Number UK.

118 (Scenario A and C)

The above analysis of the limited vertical externality on 118 is based on the scenario in which consumers who use these services fairly accurately estimate 118 prices. EE has also considered how the vertical externality may be impacted by assumptions of price misperception.

Under the scenarios of *price under-and over-estimation*, EE's conclusions continue to apply and EE's analysis of the vertical externality remains unchanged (i.e. applies to some degree but is limited by mitigating factors).

Lack of evidence of consumer harm

This section highlights the lack of evidence for Ofcom's theory of harm to consumers on 09 and 118.

a) A reduction in demand

09 (Scenario B)

In the most likely scenario where callers of 09 services can fairly accurately estimate the price, EE considers that the claim that there is suppressed demand from pricing expectations is not supported by any evidence.

To the extent this assessment made by Ofcom is based on a lack of consumer trust and confidence in 09 numbers, EE considers this is not supported by any robust evidence. On the contrary as set out in the earlier section the primary reason people do not call 09 numbers is that they have no interest in so doing, especially at current pricing levels. Only 3% cite a lack of trust as a reason. Ofcom appears also to rely on an assertion that those consumers who do not use 09 services are somehow put off calling these numbers despite the overwhelming evidence to the contrary.

EE considers that any modelling of benefits in the form of alleviating suppressed demand needs to keep in mind that calls to the 09 number range is a "dwindling market". The 2011 PP+ report demonstrates that revenues obtained from alternatives to 09 services (such as premium SMS, mobile voice short codes and mobile apps) were larger than revenues from 09 services in 2011. In addition, revenues from these alternatives grew at 8.7% between

102 Ofcom 2010 Flow of Funds report, page 50. http://stakeholders.ofcom.org.uk/binaries/consultations/simplifying-non-geo-numbers/annexes/flow-funds.pdf

2010 and 2011 while 09 service revenues declined by 10.7% over the same period for the 09 number range.[103]

09 (Scenario A and C)

The above analysis which indicates there is no suppressed demand for calls to 09 services is based on the scenario in which consumers who use these services fairly accurately estimate 09 prices. EE has also considered how prices leading to reduced demand may be impacted by assumptions of price misperception.

EE considers the scenario of *price over-estimation* as unrealistic and therefore does not consider the claim of suppressed demand under this scenario.

Under the scenario of *price under-estimation*, EE finds that there is no suppressed demand for the 09 number range (i.e. our finding remain unchanged from our analysis of a lack of demand under Scenario B above). However demand will be reduced by elimination of inefficient consumption

118 (Scenario B)

EE considers that where customers estimate prices accurately, there should be no suppressed demand from pricing expectations. There is also no evidence of a lack of trust or confidence in 118 services.

EE notes that when Ofcom justifies why it has not introduced maximum SC caps for 118, Ofcom claim there are few complaints of bill shock arising from 118 services and that there is no lack of consumer price awareness. EE considers that if this is correct this would surely suggest no evidence of lack of consumer confidence suppressing demand for calls to 118 numbers.

118 (Scenario A and C)

Under Scenario A, demand would be further reduced by elimination of inefficient overconsumption

Under Scenario C, any modelling of demand needs to take account of the fact this is a dwindling market as set out in the 2011 PP+ report.

b) Relative prices do not reflect consumer preferences

09 (Scenario B)

Any improvements in this area are likely to be limited due to the clear survey evidence (outlined above) that most customers are not interested in calling 09 numbers.

09 (Scenario A and C)

EE's analysis under 09 (Scenario B) above applies equally to 09 (Scenario A). Scenario C is unrealistic and is not considered further.

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103 2011 PP+ Report.

118 (all scenarios)

EE considers that it is unlikely that existing relative prices do not reflect consumer preferences and unbundling will not lead to any material change in relative prices, especially given the vast range of 118 services from which consumers are able to choose in a competitive market, and relatively low OCP retentions (OCP revenue retention in relation to 118 services is only 20%).

c) Loss of access to socially important services

09 and 118 (all scenarios)

This criterion is not applicable to calls to 09 or 118 number ranges as there are no socially important services provided on these ranges.

d) Loss of service diversity and innovation resulting from SPs' lack of incentives to invest in the market

09 (Scenario B)

EE notes that the evidence presented within the Flow of Funds report indicates that SPs are not overly revenue constrained even where they do not directly control the retail price point. These SPs tend to achieve revenue retention of around 67% of the call price. This suggests that, far from reducing incentives to invest, SPs are able to achieve a significant retention from 09 price points to reinvest back into their services.

EE also notes that there are a range of alternative means for accessing these services where SPs can control the retail price (e.g. mobile voice short codes and premium SMS).

To the extent it is argued that loss in services and innovation are based on a lack of consumer confidence in 09 numbers – there is simply no evidence of this. As previously stated, the primary reason people do not call 09 numbers is that they are not interested in 09 services and the cost (which given they estimate prices accurately simply means they are not willing to pay the 09 price). Only 3% of those who do not call 09 numbers calls cite a lack of trust as a reason and there is no evidence these consumer would make more 09 calls even with more accurate information.

In addition for 09 (Scenario A), any benefits will carry the risk of being outweighed by exit from the market and inability to invest in new services as a result of reduced demand (as well as by any reduction in SP profits caused by greater pricing transparency of their charges).

118 (Scenario B)

Similarly, the evidence presented within the Flow of Funds report indicates that DQ operators are not overly revenue constrained even where they do not directly control the retail price point. These DQ operators tend to achieve revenue retention of around 46% of the call price. This suggests that far from reducing incentives to invest, DQ operators are making significant margins based on existing 118 price points to reinvest back into their services. EE also notes there are a range of alternative means for accessing these services where DQ operators can control the price (e.g. directory text and mobile apps) as well as considerable competitive pressure on DQ services from free web based alternatives, especially with the prevalence of fixed and mobile internet access over laptops and smart phones. EE reiterates there is no evidence of any customer lack of confidence. Ofcom also claim that complaints of bill shock on the 118 range are low which further suggests consumers do not lack confidence in 118.

In addition for 118 (Scenario A), any benefits will carry the risk of being outweighed by exit from the market and inability to invest in new services as a result of reduced demand (as well as by any reduction in DQ profits caused by greater pricing transparency of their charges).

Lack of evidence on benefits of unbundling 09 and 118

EE considers that Ofcom's assessment of benefits is flawed. In particular, Ofcom's analysis of the benefits of reduced harm considers two effects which are at best partial, and attempt to assert that customers who do not use these services would if the number range was unbundled. There is no robust evidence to support any such assertion. Ofcom's two effects are as follows:

> ***Effect 1*** *- consumers' price underestimation will be reduced which will lead to less over-consumption of 09 calls. This will reduce the volume of 09 calls; and*
>
> ***Effect 2*** *– unbundling 09 in addition to unbundling 08 will serve to simplify the pricing message for all NGCs and contribute to a gradual increase in trust in the 09 number range and, as a result of this increased confidence, we expect there to be an increase in the volume of 09 calls. In contrast, implementing the unbundled tariff on a specific set of number ranges, i.e. 084/087, whilst leaving out others, i.e. 09, may contribute to tariff complexity and confusion.*

In this and subsequent sections – and unlike the analysis of market failures and consumer harm - we now consider estimated benefits under Scenario A first, then Scenario B, which is the order used in Ofcom's CBA. This is simply to aid comparison with the approach taken by Ofcom in its latest proposals.

Effect 1

09 Effect 1 (Scenario A)

Ofcom's benefit assessment applies a number of assumptions when assessing Effect 1 which EE considers are not robust as in many cases they do not reflect the available market and survey based evidence.

Ofcom's assumption that the decline in the volume of traffic will drop to only 7.5% from 2015 seems highly unrealistic in an acknowledged dwindling market. EE notes that the PP+ 2011 report shows 10.7% decline in 09 voice revenues between 2010 and 2011 and there is no reason to believe it will slow down – if anything an acceleration is likely as alternative technologies continue to advance such as Premium SMS, mobile voice short codes, mobile apps and internet access generally.

EE strongly objects to Ofcom's elasticity assumption of -0.5 for 09 calls which has no evidential basis. The highest assumed elasticity for these services in the recent NCCN 1007 09 ladder charge dispute was -0.4 (with range of -0.2 to -0.4). Ofcom's assumptions in this consultation must be consistent with the Final Determination of that dispute.

The high levels of potential price awareness improvement listed in Table A11.18 seem to be quite unrealistic, and do not tie in with the modelling done for 08x in Table A11.9 which suggests ranges of between 1%-11%. In Table A11.9, the highest price improvement level that Ofcom considers is 10.6%, with all 8 of the other thresholds materially lower than this. Yet Ofcom's modelling for 09 only starts at a 10% improvement (and considering Table A16.8 from the April 2012 consultation, there is no clear reason for this based on the magnitude of current price underestimation).

Further Ofcom should have modelled the delayed implementation scenario (33% of benefits realised in year 1, 66% in year 2, 100% in year 3) as well as the base case implementation scenario, as both would seem equally likely at this stage.

Ofcom should use linear demand for the 08x (and 09) base case model, consistent with its approach in related areas. EE notes that linear demand will suggest a weaker demand response to changes in expected or actual prices. In its recent NCCN decisions for NCCN 1007 Ofcom emphasised a linear approach to estimating demand response.

09 Effect 1 (Scenario B and C)

Under Scenario B, there are no benefits under Effect 1 because there is no price misperception.

Under Scenario C, Ofcom does not seek to quantify this benefit. As the scenario is unrealistic, Effect 1 is not applicable

Effect 2

09 Effect 2 (Scenario A)

Ofcom's "Effect 2" is entirely speculative and not supported by any evidence. It is also contradictory or inconsistent with Ofcom's own analysis and findings in other areas. EE suggests that Effect 2 be removed from the 09 CBA for the reasons set out below.

Ofcom has already published consumer survey evidence that indicates consumers can distinguish NGNs to the second digit and are aware of the different services and prices on the distinct 08 and 09 ranges. There is no evidence that unbundling of calls to 09 numbers (e.g. calls to adult chat services and horoscopes) will simplify pricing messages in relation to calls to 080 or 084/087 numbers (e.g. calls to banks and utilities).

> *"We agree that consumers are likely to recognise that 09 calls are more expensive than 084/087 calls, and this is supported by evidence from our consumer survey. In addition, given the distinct identity of the 118 range, it seems plausible that consumers are capable of distinguishing 118 calls from 084/087 calls,…"*

Ofcom's correlation analysis of April 2012 shows that potential confusion on one range impacting on another is at best limited to that between the 080 and 084/087 ranges, but there are no analyses suggesting such a correlation between 08x, 080 and 09 ranges. This is part of the reason why Ofcom no longer rely on horizontal externalities on the 09 or 118 ranges to justify unbundling. Accordingly, there is no evidence that unbundling 09 will simplify pricing on 084/087 or 080 or that by not unbundling 09 this will make overall NGC tariffs, including 084/087 and 080 more complex or confusing.

Two thirds of 09 callers have price information at the point of call, in part owing to PP+ regulations. Given this regulation is an effective remedy to maintain trust and confidence on the 09 number range, the 09 range cannot be credibly characterised by a lack of trust and confidence warranting duplicate and highly interventionist regulation.

In addition, Ofcom already state that complaints on NGNs over bill shock – a possible indicator of the degree of trust and confidence in the 09 range - are low:

> *"Although we accept there are some incidences of consumer harm from fraud or bill shock, we do not see this as a widespread problem as the level of complaints is low and has decreased markedly over the last 5-6 years"*
>
> *…*
>
> *"…the risk is further mitigated by current low volume of calls to 09 numbers"*

Also important in this context are the PP+ 2010 report's findings in the context of the importance of pricing accuracy in improving trust: only 3% of those surveyed mentioned trust as an area of concern, down from 4% the year before and 20% the year before that.

Although very few consumers call 09 numbers, this is not evidence of suppressed demand, but rather the fact that services such as horoscope, adult and adult entertainment services will only ever be sought by a limited number of consumers and because of the wide availability of substitute services elsewhere, including over the internet. Ofcom now accept this point elsewhere in their discussion of the 09 CBA:

> *"This is in contrast to 09, where we consider it likely that many users simply do not need or want to call these [09] numbers. We note than calls to 084/0870 tend to be less discretionary than calls to 09 by virtue of the services located on these number ranges".*

There is also considerable evidence that there are many substitutes for 09 services. For example the 2011 PP+ reports states:

> *"The vast majority of interviewees point to the continued growth of smartphones as the most important development during the year. The fact that half the UK population – and an even greater share of the younger age groups – are walking around with small computers in their pockets has turned the sector upside down. Furthermore, having a smartphone rather than a feature phone is now becoming the norm, rather than the exception, further normalising the use of such devices.*

> *As has been noted in previous editions of this study, smartphones are a double-edged sword for PRS. Content consumption on the handset becomes more ubiquitous, but so does the ready availability of free content. In addition, paid content is typically accessed through app-stores and generally charged for through non-PRS payment mechanisms."*[104]
>
> *…*
>
> *"Some services were previously hard to offer using any other payment method – for example chat services – but with alternative distribution channels coming to the fore, this is clearly no longer the case."*[105]

The same report also refers to an 8.6% rise in Premiums SMS and mobile app revenues, while there has been a reduction in revenues for voice 09 calls of 10.7% between 2010 and 2011.

For these reasons EE argues that Effect 2 should be removed entirely from the 09 CBA for tariff unbundling given the weight of evidence against such findings on the 09 ranges.

09 Effect 2 (Scenario B and C)

Under Scenario B, Ofcom does not seek to quantify this benefit. It would appear to be strictly limited in impact if it is assumed that customers are already well aware of the prices they pay and in the absence of any other reason to assume a lack of confidence or any other way in which the proposals plan to improve confidence.

Under Scenario C, Ofcom does not seek to quantify this benefit. As the scenario is unrealistic, EE makes no further comment on this scenario.

118 Effect 1 (Scenario A)

Ofcom undertake no quantification of this effect in relation to 118 services. Any quantification of the impact of price estimation on demand would need to factor in serious market shrinkage due to increasing substitution to competing free web and app based services. The effect of this competition has seen 14% losses in DQ service revenues between 2010 to 2011 (as set out in the 2011 PP+ report).

118 Effect 1 (Scenarios B and C)

This effect for 118 services is not applicable under Scenario B The analysis in the 118 Effect 1(Scenario A) above applies equally to 118 Effect 1 (Scenario B)

118 Effect 2 (Scenario A)

Ofcom presents no hard evidence of any lack of confidence resulting in over-utilisation. There is no support for Ofcom's proposals resulting from this effect

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[104] 2011 PP+ report page 17.
[105] 2011 PP+ report page 25.

which EE anyway considers is not relevant overall to Ofcom's CBA for the reasons set out above in relation to 09 calls.

118 Effect 2 (Scenario B)

The benefit would appear to be strictly limited in impact if it is assumed that customers are already well aware of the prices they pay and in the absence of any other reason to assume a lack of confidence or any other way in which the proposals plan to improve confidence.

118 Effect 2 (Scenario C)

Ofcom presents no hard evidence of any lack of confidence resulting in underutilisation. This effect should therefore be given no weight under Scenario C.

Estimated Incremental costs of unbundling 09

09 (Scenario A)

This section sets out why Ofcom's analysis and quantification of the incremental costs of unbundling on the 09 number range is flawed and cannot be relied upon.

Ofcom's quantification of the incremental costs of unbundling 09 has been undertaken in respect of the less likely scenario where there is price under-estimation (referred to by Ofcom as Effect 1). Ofcom's reasoning is that under this scenario, the reduction in price under-estimation leads to consumer benefits in the form of reduced inefficient over-consumption. However, on the cost side, since the volume of 09 calls will fall, OCP (and SP) profits will also fall, resulting in a potential off-setting cost. However the analysis undertaken by Ofcom is at best partial because Ofcom understates its quantified costs while incorrectly excluding other costs on the basis that Ofcom does not consider them incremental to unbundling 09 (EE argues that they would most certainly be incurred only under these circumstances). In addition, Ofcom incorrectly assumes that for the most likely scenario, where there is no price misperception, there is no associated volume or profit effect from unbundling and hence there are no costs to be modelled. EE considers that this assumption is also flawed.

The following table provides an illustration of key incremental costs for 09 that will arise under tariff unbundling under the assumption of price under-estimation (Scenario A). The table is based on Ofcom's Table A11.16 to aid comparability between EE's analysis and Ofcom's flawed analysis.

	09			
	Consumers	**OCPs**	**TCPs**	**SPs**
Benefits	**B1 (09) reduced over-consumption**			
Costs		**C3 (09) incremental billing costs**	**C5 (09): cost of communicating with 09 SPs**	**C7(09): migration**
		C4 (09): incremental consumer communication costs	**C6 (09): fall in profits due to reduced volumes**	**C4a (09): incremental SP communication costs**
	C1 (09): higher prices passed on to consumers via the TPE	***Fall in profits due to reduced volumes***		***Fall in profits due to reduced volumes***
	C2 (09) reduced service availability and innovation			

The table is colour coded in the following way:

- The costs shaded in dark blue have been quantified by Ofcom but some of these costs are understated (C1 and C2);
- The costs shaded in green were considered by Ofcom but have incorrectly been excluded They are incremental to the unbundling of 09 calls and must be included (C3, C4, C6 and C7);
- The costs shaded in yellow have not been considered by Ofcom and therefore have not been included. They are also incremental to the unbundling of 09 calls and must be included (C4a).

EE considers each of these cost categories in turn below.

C1(09) – TPE as a result of OCP loss in profits

EE notes that Ofcom has only modelled the TPE impact in response to reduced consumption of 09 calls arising from greater price awareness. Ofcom also need to model the TPE to reflect the fact that:

- the mandated strictures of a single AC across the 08, 09 and 118 ranges will limit OCP ability to recover current margins;
- Ofcom should also consider this as a clear countervailing impact to any reduction in the AC brought about by increased competition between OCPs.

Both of these impacts will increase the amount of costs in this category compared to those estimated by Ofcom.

C2(09) – reduced service availability and innovation as a result of reduced SP profits.

EE strongly objects to Ofcom's failure to model this effect. Given the marginal nature of many 09 businesses, reduced profits and reduced volumes could easily force many marginal 09 service providers to migrate away or even exit.

C3(09) – incremental billing costs

EE strongly objects to Ofcom's assertion that the incremental billing costs are unlikely to be material. On the contrary, there are likely to be significant costs directly related to Ofcom's proposals on the single AC for 08, 09 and 118 and the new SC caps on 09 and 118.

First, as EE has argued previously, there is now significant commercial exposure in the unbundling proposals to mandate a single AC for both 08 and 09 ranges since OCPs must now manage a higher 09 bad debt risk when setting a single AC across both 08 and 09 ranges. This restriction on OCPs' commercial flexibility to set cost reflective ACs separately for 09 raises exposure to bad debt risk, and is a cost that is incremental to unbundling prices to 09 numbers (since EE would not have to manage the exposure to bad debt risk in this way if 09 was not unbundled).

Second, there is likely to be considerable billing related fraud risk from implementing the maximum SC caps under Option 2. These caps are significantly above the rates currently charged (£3 per minute or £5 per call charge). EE has previously advised that it expects a considerable increase in the amount of fraudulent activity under the proposed maximum SC caps which will in turn require a significant scaling up of our fraud detection teams. EE provided an indicative estimate (19 September 2012 in response to the Ofcom consultation) that a doubling of the incidence of fraud might require an additional 5 full time employees to be allocated to this task across the EE brands. Given that Ofcom has modelled that over 200 CPs will be required to make changes to their billing cost systems to implement tariff unbundling, to derive billing costs for the 084/087 CBA, these annual costs could be considerable for the industry. Again these risks are incremental to unbundling the 09 number range.

Third, EE expect SC prices to change more often for 09 services than for 08 services due the nature and diversity of services on 09 and the value added entry predicted by Ofcom under the maximum SC caps. For this reason the annual costs of unbundling are likely to be higher for 09 than for 08. For instance, prices are likely to change more under the new SC caps on 09 owing to:

- diversity of discretionary 09 services reflecting a wide variety of preferences;
- disruptive price discovery generated by new PRS entrants as they "learn by doing" and iterate to price points that maximise profit. This is likely to generate higher ongoing billing costs;
- costs of correcting any billing errors or handling call centre queries from customer confusion where new entrant 09 prices are changing frequently; and
- where prices for existing 09 services are opportunistically raised in response to the introduction of the new caps which create a focal point.

C4(09) – OCP incremental communication costs

OCP 09 pricing will need to be significantly revised and this is complex as there are a lot of 09 price points. There will also be costs in maintaining existing pricing information for business customers plus updated information for 08.

C4a(09) – SP incremental communication costs

All 09 SPs will need to change the way they currently advertise their prices. There must be a cost associated with this, and all of it will be incremental to unbundling 09 since there are unlikely to be many, if any, 09 SPs also providing 084/087 services.

C5(09) – TCP cost of communicating with 09 SPs

EE has no evidence to suggest an alternative value to that estimated by Ofcom.

C6(09) – TCP fall in profits due to reduced volumes

EE strongly objects to the exclusion of this cost category. The current TCP retention on 09 calls is 6% compared to OCP retention of 27%. This would suggest in Table A11.18 that for each 10% incremental level of reduction in price under-estimation, the TPE effect for the TCP will be considerably higher than stated (i.e. it will be the size of the TPE effect for the OCP multiplied by the ratio 6/27).

- For example, at the 10% level of reduction in price under-estimation, the TPE effect for the OCP of -0.65m would be equivalent to a -0.14 million TPE effect for the TCP (rather than -0.02 million as currently stated in Table A11.18). This TPE effect adjustment is material relative to the total effect of £2.33 million on net welfare.

C7(09) – migration costs

Migration costs will include the range of costs already identified by Ofcom in the 08x CBA (such as reprinting promotional material). Exit will result in the total costs related to the cessation of the 09 service. In both cases (i.e. migration and exit) there will also be misdialling costs incurred by consumers dialling the 09 number range no longer in use and the time spent finding the alternative means of accessing the service.

Ofcom should estimate migration and misdialling costs in line with the approach taken on 08. Mobile voice short codes and premium SMS are obvious migration alternatives and there will be costs to consumers from misdialling and to SPs from migrating to these services.

09 (Scenario B)

EE has also considered how the costs would arise under the more likely assumption of no price misperception. EE's analysis under Scenario B will be the same as under Scenario A except in relation to the following cost categories.

C1(09) – TPE as a result of OCP loss in profits

EE notes that Ofcom has only modelled the TPE impact in response to a reduction in 09 traffic volumes from greater price awareness. Ofcom also need to model the TPE under Scenario B where there is no price misperception to reflect the fact that:

- the mandated strictures of single AC across 08, 09 and 118 will limit OCP ability to recover current margins
- the impact of any reduction in the AC brought about by increased competition between OCPs

C2(09) – reduced service availability and innovation as a result of reduced SP profits.

Increased transparency of SP margins may lead to increased competition and thus reduce SC prices, sending some SPs out of business

Different approaches between pricing of mobile voice short codes and premium SMS and 09 under unbundling may make 09 numbers less popular and cause customer confusion.

C7(09) – migration costs

Ofcom needs to consider a possible fall in SP's profits due to more competition from transparency of the SC causes migration or exit from the market by SPs

09 (Scenario C)

EE has not considered the cost of unbundling 09 further under the scenario of price - overestimation which is unrealistic for 09.

Summary of analysis on 09 incremental costs

EE considers that under the scenario of price- underestimation, Ofcom's cost analysis is flawed and significantly understates the incremental costs of unbundling 09. Even under the more likely scenario where there is accurate price estimation, EE has indentified many of the same costs will still be relevant as well as a few different costs.

Estimated Incremental costs of unbundling 118

118 (Scenario A)

Ofcom has not attempted to quantify incremental costs for unbundling the 118 range. EE considers that this is a glaring failure by Ofcom. Despite accounting for just over 1% of volume generated, Ofcom's own Flow of Funds research show that 118 calls generated over £300 million in 2009 (over 15% of total NGN market revenues of £1,905 million).

The lack of a CBA for 118 is unacceptable and EE has therefore has set out factors Ofcom would need to have regard to in undertaking the necessary work.

The following table provides an illustration of key incremental costs for 118 that will arise under tariff unbundling under the assumption of price under-estimation. (For consistency with the discussion above the table is based on Ofcom's Table A11.16.)

	118			
	Consumers	**OCPs**	**TCPs**	**SPs**
Benefits	**B1 (118) reduced over-consumption**			
Costs		**C3 (118) incremental billing costs**	**C5 (118): cost of communicating with 118 DQoperators**	**C7(118): DQ migration or exit**
		C4 (118): incremental consumer communication costs	**C6 (118): fall in profits due to reduced volumes**	**C4a (118): incremental DQ communication costs**
	C1 (118): higher prices passed on to consumers via the TPE	***Fall in profits due to reduced volumes***		***Fall in profits due to reduced volumes***
	C2 (118) reduced service availability and innovation			

EE notes that as Ofcom has not undertaken a CBA for 118 all the costs categories identified for the equivalent 09 CBA are represented here in yellow (i.e. since they were not considered by Ofcom in 118 but should have been). Ofcom asserted there were qualitative benefits B1(118) above, but these have been overstated (see below).

EE considers all three scenarios of price estimation. Ofcom considers each cost category in turn. To aid comparability with the results for 09, EE considers the scenarios of price underestimation first (Scenario A).

C1(118) - TPE as a result of OCP loss in profits

Ofcom must model the TPE impact on OCPs in response to reduced consumption of 09 calls arising from greater price awareness. In addition, Ofcom also needs to take account of the fact that the mandated strictures of a single AC across 08, 09 and 118 ranges will limit OCP ability to recover current margins as discussed above in relation to 09 ranges.

Ofcom should also consider the impact of any reduction in the AC brought about by increased competition between OCPs.

C2(118) -Reduced service availability and innovation as a result of reduced DQ profits.

This would be expected to have an important negative impact on DQs business. EE therefore strongly objects to Ofcom's failure to model this effect. Given the marginal nature of many DQ businesses, reduced profits and reduced volumes could easily force many marginal DQ operators to migrate away or even exit.

C3(118) – incremental billing costs

EE strongly objects to Ofcom's assertion that the incremental billing costs are unlikely to be material. On the contrary, there are likely to be significant costs directly related to Ofcom's proposals on the single AC for 08, 09 and 118 ranges as well as the new SC caps on 09 and 118.

See EE's comment in relation to the 09 CBA under the assumption of price under-estimation which apply equally to the incremental billing costs of unbundling of 118.

C7(118) – migration costs

Ofcom should at least estimate the misdialling costs associated with exit from the market of some 118 SPs

Other cost categories

EE's comment in relation to the 09 CBA under the assumption of price under-estimation above apply equally to the incremental costs of unbundling of 118 in relation to:

- C4(09) – OCP incremental communication costs
- C4a(118) – DQ incremental communication costs
- C5(118) – TCP cost of communicating with 09 SPs
- C6(118) – TCP fall in profits due to reduced volumes

118 (Scenario B)

EE's comment in relation to the 118 CBA under the assumption of price under-estimation above apply equally to the incremental costs of unbundling of 118 in relation to Scenario B except for the following categories:

C1(118) - TPE as a result of OCP loss in profits

- As for Scenario A for the 118 range but no need to model traffic volume losses since there is no price misperception

C2(118) -Reduced service availability and innovation as a result of reduced DQ profits.

- Increased transparency of SP margins may lead to increased competition and thus reduced (SC) prices, sending some SPs out of business. These costs must be estimated.

C7(118) – migration costs

- Ofcom should model misdialling costs in the event a fall in DQ operator profits due to more competition from transparency of the SC causes DQ operator exit from the market

118 (Scenario C)

EE's comment in relation to the 118 CBA under the assumption of price under-estimation above apply equally to the incremental costs of unbundling of 118 in relation to Scenario C except for the following categories:

C1(118) - TPE as a result of OCP loss in profits

- As for Scenario A for the 118 range but in addition the TPE effect will be mitigated by increased demand (resulting from reducing price overestimation)

C2(118) -Reduced service availability and innovation as a result of reduced DQ profits.

- This cost category is not applicable in the case of price over-estimation.

C7(118) – migration costs

- Ofcom should model misdialling costs in the event a fall in DQ operator profits due to more competition from transparency of the (SC) price causes DQ operator exit from the market

Summary of EE's analysis of Ofcom's CBA for unbundling 09 and 118

EE considers that the CBA for unbundling the 09 and 118 number range is not robust and does not provide an adequate basis for its policy proposals.

Of the three market failures identified by Ofcom, only one of these is relevant to 09 (the vertical externality). Even here, the effect is largely mitigated by high revenue retention on the 09 number range by SPs and the growth in alternative means of accessing services that give SPs full control over the retail price (e.g. mobile short codes, Premium SMS and mobile apps).

Ofcom claim that two types of market failure are present on the 118 number range, including a lack price awareness and a vertical externality. However, Ofcom's evidence on lack of price awareness is weak and is based on a table in the 2010 consultation which simply lists OCPs offering different 118 charging structures and price levels. In addition the vertical externality effect is largely mitigated by high revenue retention on the number range by DQ operators as well as the growth in alternative means of accessing services that give DQ operators more control over the retail price (e.g. text directory, the "118 app" services and search engines such as Google).

Ofcom has also failed to identify a compelling theory of harm occurring in relation to the 09 or 118 ranges, with little if any evidence of price misperception, lack of trust or confidence or suppressed demand. Many other criteria applied by Ofcom lack supporting evidence or are simply not applicable to the 09 number range.

Ofcom's method for estimating the benefits of unbundling 09 prices has serious weaknesses. The most like scenario is that there is no price misperception, but even where there is price misperception, consumer are under-estimating prices such that unbundling would in fact raise costs, further deterring consumers from using from 09. In addition, the available survey evidence clearly contradicts Ofcom's Effect 2 (an alleged lack of trust and confidence leading to suppressed demand) which must be struck out of the CBA analysis for 09.

In addition Ofcom has either understated or erroneously excluded many costs that are clearly incremental to unbundling 09 call prices. In particular, by mandating a single AC for 08 and 09, Ofcom's unbundling proposals present an inherent commercial exposure to managing bad debt risk on 09 (since the proposals as they stand remove any commercial flexibility to set cost reflective ACs for 09 to cover this potential cost). This is a significant incremental cost to the 09 unbundling proposal. If this restriction was removed, this could go some way to lowering the incremental cost of unbundling 09.

Taking all these deficiencies in the Ofcom CBA into account, the likely conclusion is that a proper analysis would reveal the benefits of Ofcom's proposal for 09 being outweighed by the costs.

Ofcom has not even undertaken a separate detailed assessment of the costs or benefits for unbundling 118. For this reason EE has, in this response, considered how the CBA framework set out by Ofcom for the 09 range should be applied in relation to 118 number range to demonstrate that the benefits of the unbundling proposal for 118 is also likely to be outweighed by the costs.

EE considers that there is now irrefutable evidence of increasing use of substitutes for accessing equivalent services which are steadily overtaking traditional voice 09 and 118 services revenues. Premium SMS, mobile voice short codes, mobile apps and internet services increasingly reflect consumers preferred means of accessing information and entertainment services. In some cases, these alternatives are free or offer simpler pricing messages than could ever be achieved under unbundling (e.g. per call charge structures on mobile short codes). EE considers these market based solutions are in fact better at responding to market imperfections especially when heavy handed regulatory intervention does not appear justified on an objective cost benefit assessment.