

**Telefónica UK Ltd's (Telefónica's) response to Ofcom's consultation on
Service Charge Caps for 09 and 118 Services¹**

¹ Ofcom; 25 July 2012

Introduction

1. Telefónica welcomes the opportunity to respond to Ofcom's consultation on maximum service charges for PRS and Directory Enquiry services in the Unbundled Tariff Regime ('the Consultation').
2. This response follows, and should be read alongside, Telefónica's earlier responses to Ofcom's consultations, 'Simplifying Non-geographic Numbers'².

Executive Summary

3. In the course of Ofcom's review of non-geographic numbers it has been important to consider carefully the circumstances where regulation can stimulate or hinder growth and innovation, as well as those when it is most appropriate to allow competition to develop solutions to existing market failures, thereby promoting the interests of consumers. Indeed, Ofcom's primary duties oblige it to favour the latter.
4. To that end, it is encouraging to see Ofcom highlight the success of mobile shortcodes, as a benchmark against which the price cap levels and pricing structure proposed in this consultation have been measured. The inherent clarity and successful industry self-regulation demonstrated by the mobile shortcode model are, we think, a perfect example of how the aspirations of the Non-Geographic Number Review can be achieved in practice, without the need for regulatory intervention.
5. Notwithstanding our overarching reservations about regulatory

² Ofcom; 'Simplifying Non-Geographic Numbers' published in 16 Dec 2010 ('The 2010 consultation') <http://stakeholders.ofcom.org.uk/binaries/consultations/simplifying-non-geo-numbers/summary/non-geo.pdf> 'and 'Simplifying Non-Geographic Numbers – Detailed Proposals on the Unbundled Tariff and Freephone' published 4 April 2012 ('The 2012 consultation') <http://stakeholders.ofcom.org.uk/consultations/simplifying-non-geographic-no/> .

intervention by means of the Unbundled Tariff Regime itself, if pricing disaggregation is imposed then an increase on the price cap for service charges would appear to be a sensible precautionary measure against opportunism and rogue service providers. But, it is essential that Ofcom take great care to diagnose the right level of cap.

6. Misdiagnosis at a level too high could increase the opportunities for rogue service providers to exploit consumers for maximum profit, causing a reputational cost to the premium-rate industry and the non-geographic market as a whole. On the other hand, misdiagnosis at a level too low could throttle the ability of service providers to innovate and compete effectively with each other and alternative micro-payment options.
7. We think that the correct diagnosis can only be achieved by quantifying Ofcom's assessment criteria and applying it to a simple logical formula that begins with the current BT retail price cap inflated by the Retail Price Index ('RPI'), less efficiency savings and adjusted for capital investment, consumer protection and factors such as the extent to which demand and productivity may increase (and lower costs) in a new Unbundled Tariff Regime. By calculating price caps in this way, the relative weight of each of Ofcom's assessment criterion becomes more transparent and the overall decision able to withstand challenge.

Assessment Criteria

8. Ofcom identify the precise criteria against which they intend to measure the appropriateness and level of a price cap on 09 and 118 numbers. What is less clear is the weight that Ofcom assign to each criterion, without which it is impossible to offer a comprehensive response to Ofcom's questions about the appropriateness and level of the caps and whether they have been measured correctly.
9. Furthermore, it is important to understand the relative importance of each criterion (and assign a value to each one) in order that Ofcom can demonstrate the thoroughness and logic they have used to settle on their preferred price cap level. The more detail and transparency Ofcom deliver

with this part of their consultation, the less risk there is that Ofcom may need to reassess the cap level in the short term, of legal challenge to the decision and of reputational damage to the industry if the price increases are met with resistance from consumer groups.

Efficiency of Pricing

10. In our view, the weight assigned to 'efficiency of pricing' needs to be adjusted to account for the complexity of consumer buying decisions, which are not necessarily based on price or direct preferences at all, as Ofcom implies. In our response to the 2010 consultation³, we explained how consumers' on-going preference for calls to geographic numbers was reflected in cheaper prices. But these cheaper prices can only be delivered by means of cross subsidies from less demanded services (namely non-geographic calls). In our response we shared our research with Ofcom that showed consumers often feel obliged to call non-geographic numbers, rather than displaying a genuine preference for calling them. Strict pricing efficiency would not account for the subtleties of human behaviour and their consumption decisions. Accordingly, in these circumstances, we think it is important to consider 'efficiency of pricing' in this consultation, but that it need not carry significant weight in Ofcom's calculations to set the right cap level.

Service quality, variety and innovation

11. We agree that the price cap needs to be set at a level that incentivises service providers to be both statically and dynamically efficient and consequently we would attach significant weight to this criterion.

Access to socially important services

12. We agree with Ofcom's reasoning for dis-applying this criterion for 09 services. We also suggest that it only requires little weight in the

³ Ofcom, March 2011; <http://stakeholders.ofcom.org.uk/binaries/consultations/simplifying-non-geo-numbers/responses/O2.pdf>

assessment of 118 services given the wide availability of the internet and the very limited circumstances and members for whom the protection offered by Ofcom's Universal Service obligations would be required.

Exposure to fraud and bill shock

13. Consumer protection should carry significant weight in the assessment of the level of the price cap and, we suggest, that the definition of protection required is extended beyond the criminal definition of fraud.
14. A brief review of PhonepayPlus adjudications demonstrates that the consumer harm encountered on 09 numbers, in many cases, do not fit into a strict classification of 'fraud' but rather, a persistent level of misleading advertising designed, not necessarily to hide the price from consumers, but to mislead them into calling *despite* the price, and without necessarily delivering the service that the caller had been led to expect⁴. It is these persistent 'scam-type' operations that cause the greatest damage to consumer faith in the industry. And, precautionary measures such as pre-call announcements, opt-ins or time notifications are unlikely to be effective, at resolving this type of harm, in our opinion.
15. As a result, we think it is even more important that the weight given to 'consumer protection' is significant and reflected in the level of the cap itself, rather than imposing any additional regulatory devices to minimise harm, that are unlikely to be effective.

Exposure to bad debt

16. We agree with Ofcom's assessment of the risks of bad debt that could arise with a price increase for 09 and 118 numbers, but we are not convinced that the concerns about increased risk of bad debt can be managed just by setting the cap level from the options (1 to 3) that Ofcom propose. It, therefore, seems, inappropriate to assign a weight to this criterion for the

⁴ PhonepayPlus Adjudications; Example Case - Case Ref 07101 Daniel Marshall t/a Housing Help UK
<http://www.phonepayplus-services.org.uk/output/search-adjudications.aspx>

purposes of calculating the right cap level, when the more important question would seem to be “given the increased risk of bad debt with a price increase, is it more appropriate to have a separate Access Charge for calls to 09 and 118 numbers?”.

17. If Ofcom fail to properly assess the increased risk of bad debt and its consequent effect on the Access Charge, it risks imposing a disproportionate detriment on customers of 08 numbers (which are more likely to give access to socially important services, including banks and helplines) to the benefit of a proportionately fewer number of 09 customers (who are more likely to be using entertainment and adult services). This is clearly not what Ofcom intend to happen.
18. We think the extent of the bad debt risk under all three options must be quantified and that quantified figure used to calculate whether it is still appropriate, under the Unbundled Tariff Regime, to impose a single Access Charge for access to all non-geographic numbers. Ofcom’s earlier assessment that the increase in cost of calling 08 numbers as a consequence of imposing a single Access Charge would not be significant is likely to be materially changed if the impact of Options 1,2 and 3 could be properly calculated, rather than assumed. We accept that this is a matter outside of the scope of this consultation but firmly in the scope of the 2010 and 2012 consultations. We, therefore, urge Ofcom to consider the matter of bad debt exposure in the wider context of the non-geographic review and not just on the narrow head of price cap levels.

Mobile Shortcodes

19. Ofcom highlight the mobile shortcode as a key reference point in its assessment on the level of the price caps and a good example of successful self-regulation and industry co-operation benefiting the market and consumers. Both text and voice shortcodes have been proven to provide customers with the type of pricing transparency that Ofcom aspires to achieve in their review of non-geographic numbers. It has also enabled the mobile premium-rate industry to flourish with service quality, variety and innovation - another of Ofcom’s stated aims. The mobile shortcode (voice

and text variations) are a market-born solution to the failures Ofcom have identified, to the extent they are relevant.

20. The voice shortcode, in particular, offers stakeholders a range of single price points that are aligned to current BT retail prices, making it simple for consumers to understand and for service providers to market their services with a single, simple, clear price.
21. By introducing the Unbundled Tariff Regime Ofcom will be removing the ability to align voice shortcode prices with those single BT retail prices, at once dismissing a consumer benefit that has arisen naturally from competition in the market. We think this is directly in conflict with Ofcom's principle duty "to further the interests of consumers in relevant markets, where appropriate by promoting competition"⁵.

A Maximum Service Charge

22. Notwithstanding our concerns about the Unbundled Tariff Regime, a maximum service charge provides one way of furthering the interests of consumers whilst limiting the attractiveness of 09 numbers to rogue service providers.

A different maximum service charge for calls charged on a 'per call' and a 'per minute' basis

23. Ofcom argues against setting an equal service charge for both 'per minute' and 'per call' services, preferring instead, a cap of £3 per minute and £5 per call, on the basis that services requiring a one-off payment that is higher than the £3 per minute would not be satisfied, but increasing the 'per minute' to £5 per minute could increase the risk of bill shock and fraud.
24. It seems, however, that these concerns are best resolved when assessing the appropriate level of the cap, rather than the equality of the charge between 'per minute' and 'per call' measurements. To date, that worry has certainly not been realised for services requiring a higher charge than the current £1.53 BT ceiling, as service providers appear satisfied with the price

⁵ Section 3(1)(b) of the Communications Act 2003.

points and options offered by mobile shortcodes. Again, the market has delivered a solution to a perceived problem.

25. Moreover, Ofcom's concerns cannot be resolved by considering the appropriateness of two different price caps, but rather whether the cap levels are appropriate regardless of their unit of measurement. If the respective cap levels can demonstrate that they have been calculated properly, fairly and scientifically, then the fact that they might be different is less likely to require debate or invite challenge.

The level of the price cap

26. The consultation presents three options for the level of the price cap:

Option 1- Using the RPI measure of inflation to uplift BT's current maximum retail price for 09 calls;

Option 2- £3 per minute or £5 per call; and

Option 3- Between £3-£5 per minute and between £5-£10 per call.

27. The BT maximum retail price, uplifted by RPI (option 1) is, we think, the most logical starting point when calculating the right level of price cap. But, it should not be the end point. Ofcom fail to pursue this line of assessment further, instead leaping to consider price points in Options 2 and 3.
28. With regard to Option 2, Ofcom suggest that a £5 per call price point on the basis that it enables service providers to offer equivalent services on the 09 range to those currently provided via mobile shortcodes. But we do not consider that this, a thorough means of diagnosing the right cap level, but merely an indicator of the level that service providers and consumers might be happy to use. Nothing more.
29. It is unlikely to achieve absolute parity given the different pricing structures proposed under the Unbundled Tariff Regime. From a consumer's perspective, the total cost of a mobile text service is £5, but the total cost of the equivalent 09 service is £5 + VAT + Access Charge, making the former

service more attractive in terms of simplicity and pricing clarity.

30. Ofcom rely heavily on an AIME survey to support their preference for a £3 per minute cap, reasoning that the survey results indicate that it would satisfy most service providers revenue requirements. But it is unclear whether the revenue calculations service providers made to determine their preference was based on the level of demand one would expect today or the level of demand that Ofcom expect in an Unbundled Tariff Regime. If the latter were to increase as significantly as Ofcom expect, then revenue calculations and capital investment requirements may be satisfied by greater demand at a lower price point, rather than static demand at a higher price point.
31. The concerns that this raises can be resolved by using a more scientific approach to diagnosing the right level of service charge cap, starting with the BT retail maximum uplifted by RPI ('R').
32. Once 'R' has been calculated it can be adjusted up or down, to reflect the quantified values and weight assigned to Ofcom's assessment criteria. The case and evidence for efficient pricing ('P'), service quality and innovation ('I') would naturally take account of capital investment and the increase in demand that the Unbundled Tariff regime is intended to influence, and thereby uplift the starting price.
33. The case for consumer protection ('C'), prevention of fraud and bill shock ('F') (graded to account for any additional consumer protection measures that are imposed), and bad debt ('B') would, conversely, decrease the starting price. Steadily, Ofcom could develop an effective formula to calculate the most appropriate cap level in the circumstances.
34. The result would be an optimal price that is supported by robust figures and more accurately reflects the relative weight of all the assessment criteria.

Consumer Protection Measures

35. If the level of the cap is properly diagnosed then, we agree, that no further

consumer protection measures are needed. We think PhonepayPlus are best placed to assess, on an ongoing basis, whether unexpected levels of consumer harm will occur and whether they can impose any additional measures if that harm occurs, for services or service providers that cause the harm. Furthermore, we are not convinced that the measures that Ofcom suggest will add any greater benefit that the pricing transparency Ofcom suggest can be achieved by unbundling prices, particularly where the purpose of the service is to mislead customers into calling the service regardless of price.

Disputes about Network Access

36. In Telefónica's view, Service Charges will be charges for Network Access within the meaning of section 185 of the Communications Act 2003. It follows that disputes about SCs will, therefore, be capable of being considered under the statutory dispute resolution mechanism set out in sections 185 – 191 of the Act.
37. Jurisprudence has revealed that when considering disputes about charges for Network Access, Ofcom must consider whether such charges are "fair and reasonable". In Telefonica's view, it is not clear that SCs levied in accordance with the proposed maximum price caps would necessarily be fair and reasonable within the meaning of sections 185 – 191, in all circumstances. Whilst compliance or otherwise with the price caps might be an important factor that Ofcom should have regard to in resolving disputes, that consideration should not be regarded as determinative.

Conclusion

38. A price increase is, perhaps, long overdue and consequently likely to require a significant increase to achieve an level high enough to kick-start the 09 and 118 markets. However, with a significant increase and, in light of an increase occurring at the same time as the disaggregation of pricing structures consumers have become familiar with, a cap seems an essential consumer protection measure, at least in the short term.

39. But the level of the price cap must be diagnosed correctly and, we think, that is best diagnosed by quantifying each of Ofcom's assessment criteria and devising a formula which reflects the weight of each criterion, to calculate the optimal price caps.
40. It may well be that £3 per minute and £5 per call are the optimal prices after all, but using the current consultation it is hard to see how Ofcom have arrived at these levels and how they have been adjusted to reflect all of the assessment criteria set out in the consultation. As a result Ofcom's preferences appear to be built on uncertain foundations and subject to challenge by industry (for not being high enough) and resistance from consumers (for being too high). A more thorough, scientific approach would, we think, avoid the risk of such a challenge.
41. Furthermore, Ofcom's assessment in this consultation has a direct bearing on its proposals to impose a single Access Charge on all non-geographic numbers. We suggest that an increased price on 09 and 118 services will, inevitably, result in an increase in bad debt. Where there is a single Access Charge, that risk will be spread across numbers resulting in calls to 08 numbers being much higher than Ofcom assumed when they first considered the matter in their 2012 consultation. We therefore look forward to Ofcom's reassessment of the Access Charge in light of the conclusions of this consultation.