



Telefónica O2 UK Limited's response to:

SIMPLIFYING NON-GEOGRAPHIC NUMBERS

An Ofcom Consultation

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A *Telefonica* company



INTRODUCTION

Telefónica O2 UK Limited (“O2”) welcomes the opportunity to comment on Ofcom’s proposals to improve the market for non-geographic numbers in the UK.

O2 is the UK’s second largest mobile Communications Provider (‘CP’) with over 22 million subscribers. In May 2010 O2 also launched a fixed-line home phone service. BE Unlimited is also part of O2’s business portfolio and launched its fixed-line home phone service in August 2010.

EXECUTIVE SUMMARY

1. Ofcom opens the consultation with the suggestion that the market for non-geographic numbers (‘NGNs’) is not functioning well and identifies three market failures as evidence of this:
 - Lack of price awareness; and
 - The vertical externality which causes service providers to have minimal influence over retail prices and
 - The horizontal externalities which result in a failure to preserve the reputation of non-geographic number ranges.

2. Ofcom then identifies five outcomes it believes arise as a result of these market failures and suggests two preferred solutions (the ‘Unbundled Tariff’ solution and the ‘Maximum Price’ solution) to mitigate them. Ofcom argues that these outcomes result in a loss of welfare to consumers and citizens. It describes them as:
 - The direct effects of poor consumer price awareness
 - The distorted level of non-geographic prices relative to other telephony services
 - An increased consumer exposure to fraud
 - Diminished service availability and innovation and
 - Distributional concerns, in which vulnerable consumers and citizens are disproportionately affected by high retail prices for NGNs.

3. Ofcom’s analysis is deficient. In this response we set out our concerns about the absence of sufficient evidence in support of Ofcom’s arguments, and a failure to consider the evidence and all relevant factors. As a consequence, it appears that the extent of the outcomes Ofcom attributes to these market failures have been overstated and, in turn, the solutions favoured



by Ofcom to combat these outcomes would, in our opinion, fail to meet the appropriate statutory tests.

4. In our view both the Unbundled Tariff and the Maximum Price proposals favoured by Ofcom reveal such failings that they are even unable to withstand the scrutiny of Ofcom's own relevant assessment criteria¹.

Failing to improve consumer price awareness

5. The Unbundled Tariff option would not make it easier for customers to understand prices of NGN services, in our opinion.
6. Ofcom has been too quick to assume that the success of the 'Access Charge ('AC') plus Service Charge ('SC')' model used in the premium SMS market can be replicated in the NGN market, without any attempt to understand the differences between the two. Services offered on NGNs are operated on a greater number of ranges and price points, they carry a more diverse range of service types, carry different customer perceptions about what they can be used for and they react very differently to competitive forces. What may be transparent pricing in one market cannot be assumed to deliver transparent pricing in another.
7. When applied to the NGN market, the Unbundled Tariff option continues to place a burden on the consumer to research and calculate the actual price per minute charge for the call they need to make. The Maximum Price option perhaps offers more of an opportunity for better pricing clarity at the point of promotion but would, on the face of it, unduly discriminate against mobile CPs if the maximum tariffs were not differentiated to consider the different costs and demand preferences associated with mobile and fixed electronic communications services.

What really causes bill shock?

8. Ofcom has failed to properly examine why issues like 'bill shock' and cost over-estimation occur. Ofcom's research showed that participants were unlikely to be confident about the *unit*

¹ The Consultation; Annex 1, A1.8 I – V. The 5 criteria for assessment are headlined 'Transparency / Consumer Price Awareness'; 'Price'; 'Service quality, variety and innovation'; 'Access to socially-important services'; and 'Regulatory burden'.



price of these calls and the researchers have simply assumed that this is the cause of over-estimation².

9. However, the complaints presented by Ofcom all demonstrate a concern, not for the *unit price*, but for the *cumulative cost* of the call to the service³. Qualitative feedback,⁴ gathered from participants in our own research, is consistent with research commissioned by PhonepayPlus during its adoption of the regulation of 0871 range, that “*the main consumer concern is excessive call-waiting times*⁵”. Regrettably, Ofcom has failed to consider whether either of their proposed remedies will improve call waiting times or enable customers to make a more informed assessment of the cumulative cost of a call to one of these services.

Lower prices for NGNs will result higher prices for everything else

10. It is Ofcom’s approach on this issue that causes O2 most concern. Ofcom’s position appears to be that the price of calls to NGNs is ‘too high’ and, as a result, its ambition is to drive down the retail price of calls to non-geographic numbers even if that means driving up prices for other more frequently used mobile services.
11. Ofcom’s own research, tucked away in this consultation in a footnote, shows that customers have a clear objection to paying more for other mobile services (which they are guaranteed to use) just to benefit from the potential for lower costs for calls to non-geographic numbers (which they are less likely to use at all or on a regular basis). Customers, it would seem, prefer the status quo. Ofcom’s proposals appear to fly in the face of this clear expression of preference, contrary to its primary statutory duty.

² The Consultation: A2.6 “*Callers’ limited awareness of NGC prices, both at the time they make a call and when making their phone company subscription decision, leads to consumer anxiety, bill shock, poor and uninformed decision making (under- or over-consumption)...*”

³ The Consultation: Consumer Experience Boxes A2.1 and A2.2 respectively state: “*Consumer called to complain about [a fixed OCP] charging an excessive amount of money for calls to ‘08’ number. He states he received a bill for over £200 due to making such calls.*” and “*Consumer was charged 39.00 GBP to call two premium rate numbers from his landline. He states that he feels these charges to call these numbers is far too high.*”

⁴ Sample feedback from the ‘O2 Join In’ online community. 8 April 2010: “*I haven’t had to call any of these numbers in a long while, which I am very grateful for. What annoys me more, is if you have to call these numbers and then you get passed around lots of departments before you get to where you need to be. British Gas are dreadful for this.*”

⁵ Analysys Mason “Implications of regulatory changes in the 0871 market – final report”, 17 April 2007. the <http://www.phonepayplus.org.uk/upload/087RESEARCH.pdf>



12. Furthermore, it would appear that Ofcom is underestimating the extent to which a rebalancing of prices may be required. Our initial estimates indicate that either one of Ofcom's proposals could result in a considerable loss of income for the mobile arm of our business. We suspect that if we were to rebalance our mobile tariffs to increase prices on services to which customers are more price sensitive (and for services which are, ultimately, more valued) there would be disproportionately high reduction in demand from those customers with a resulting loss in welfare. Ofcom has not considered this loss of welfare at all.

Demand unlikely to increase

13. Increased service quality, variety and innovation are positive outcomes that, by Ofcom's reasoning, will arise as a consequence of an increase in demand prompted by clearer price information. However, we are not convinced that demand will increase to the extent that Ofcom expects, particularly as its assumption appears to be based on negligible and uncertain evidence⁶.
14. Our initial research indicates that customers feel *obliged* to call NGNs⁷. Accordingly, whilst clearer pricing may help customers become more informed about the cost of calling the number, it would not necessarily incentivise them to call more often or stay on the call for longer⁸ or even increase the volume of fixed to mobile call substitution.

Better quality services aren't guaranteed

15. Even if Ofcom can establish, with confidence, that demand would increase, it is unable to say with any certainty that the increased revenues would be directed back into the services available for consumers in their entirety. There is nothing to prevent service providers from diverting those funds to other business priorities or in tax or dividend payments. If Ofcom is unable to establish the extent to which either of the remedy options is likely to achieve a purely *consumer* welfare benefit, then it is inappropriate for Ofcom to highlight this is a desirable and definite outcome that can be achieved.

⁶ The Consultation A2.91

⁷ O2 research – online survey of the 'O2 Join In' online community. Unpublished.

⁸ On knowing the price of a call, 53% of participants said they wouldn't do anything differently, and 38% said they would try and make fewer calls from their mobile.



Customers have no choice but to call NGNs – price competition is limited

16. The extent to which price competition will have any discernable effect within non-geographic ranges is unclear. Given the intermittent use, the extent to which many of the services on 08 ranges are ‘locked in’, and Ofcom’s research results⁹ which demonstrate that an overwhelming majority of customers are not inclined to ‘shop around’ for these services, we think that the benefits that can be achieved by price competition between SPs has been dramatically overstated.
17. We urge Ofcom to carry out a more thorough assessment of the extent to which price competition is achievable on the different number ranges and then to consider whether the options proposed by Ofcom offer a reasonable and proportionate response to achieve that limited level of competition. It is clear to us that it would be disproportionate to require the costly implementation of a single AC regime (the Unbundled Tariff option) for *all* revenue-share number ranges, when price competition and the benefits of a single AC are only likely to be achievable, at best, on only *some* of the numbers included in that range (some, but not all, 0871 numbers and 09 numbers).

Keep socially-important services separate from other NGNs

18. Once again, Ofcom appears to be using a broad brush approach to regulation and the outcomes it seeks to achieve without first assessing how regulation could be utilised in a more targeted and proportionate manner.
19. Ofcom refers, in passing, to their assessment that “...*socially important services tend to be located on a few number ranges, particularly 080 and 0845. Setting a maximum AC for all non-geographic calls is thus not particularly well targeted*¹⁰” It is therefore surprising that Ofcom does not suggest any options for encouraging service providers to operate on these ranges or for establishing alternative means of accessing these services.

⁹ Table A5.6, The Consultation.

Table A5.6: Whether respondents “shop around” between SPs based on call prices

Yes, all the time	Yes, sometimes	No, never	Don't know the prices	Don't know
5%	10%	62%	15%	7%

Source: 2010 Consumer research, question 38

¹⁰ The Consultation, A5.82



20. We do accept that it is important to ensure that socially-important services are easily accessible to consumers. It is the very reason why O2 imposes no retail charge on consumers, nor origination charge on service providers, of 080 numbers that fall within the scope of the Telephone Helplines Association. Ofcom has not appreciated that its proposal to impose a zero-rated maximum retail charge on all 080 numbers will impose an *additional* cost on these providers. That is, Ofcom's intervention would make the current arrangement, which has operated satisfactorily for years, worse, not better.

Is it worth it?

21. Both the Unbundled Tariff and Maximum Price options favoured by Ofcom would impose a significant cost on the industry (based on the assessment of the likely cost impact to O2).
22. The Unbundled Tariff option is, in our view, significantly more expensive to implement than Ofcom's estimate. Our initial assessment is that these costs are not mitigated to any significant degree by taking a staggered approach to implementation. In both cases, the most significant costs are incurred as a consequence of the level of pricing granularity that Ofcom hopes to achieve.
23. Ofcom has yet to define what its expectations are in terms of achieving "considerable" and "reasonable" levels of granularity for 09 and 08 numbers respectively but we are confident that if the level of granularity extends beyond that which we already offer, (and this would be inevitable to achieve Ofcom's objectives), that costs of implementation would be significantly compounded.
24. Furthermore, Ofcom's hints that the levels of costs that it would allow mobile CPs to recover is unlikely to include a contribution to common and fixed costs. This would result in a damaging impact on revenues – the cost and unintended consequences of which Ofcom has failed to consider.

The proposed remedies won't work

25. It is clear that Ofcom has had second thoughts on its proposals, ahead of publication. There can be no other explanation of why Ofcom, at the eleventh hour, has embarked on customer



research about its main proposal, the Unbundled Tariff. O2's research confirms that these doubts are well founded; consumers do not understand it.

26. Without the relevant evidence and fair consideration of all the key factors that are likely to impact on consumers, it is impossible for either Ofcom or industry to say with any certainty, at this stage, that the favoured options will offer the best chance of an increase in consumer welfare.
27. Consequently, we have reserved our right to state a preference for Ofcom's options until such time as Ofcom can adduce sufficient evidence. In the mean time, we do not consider that either of the favoured options is able to achieve all the outcomes that Ofcom is seeking.

OFCOM'S DUTIES

28. We have approached our response to this consultation with Ofcom's statutory duties and regulatory principles in mind. The duties we consider most relevant to this consultation appear to be:

" 3(1) It shall be the principal duty of Ofcom, in carrying out their functions;

(a) to further the interests of citizens in relation to communications matters; and

(b) to further the interests of consumers in relevant markets, where appropriate by promoting competition¹¹

29. We consider that the relevant regulatory principles that apply to this review are:

- Ofcom will intervene where there is a specific statutory duty to work towards a public policy goal which markets alone cannot achieve.*
- Ofcom will operate with a bias against intervention, but with a willingness to intervene firmly, promptly and effectively where required.*
- Ofcom will strive to ensure its interventions will be evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome.*
- Ofcom will always seek the least intrusive regulatory mechanisms to achieve its policy objectives.*

¹¹ Section 3 (1) Communications Act 2003



- *Ofcom will research markets constantly and will aim to remain at the forefront of technological understanding.*
- *Ofcom will consult widely with all relevant stakeholders and assess the impact of regulatory action before imposing regulation upon a market¹².*

30. Should Ofcom find it appropriate to impose regulation they would also need to demonstrate:

- i. The principles of transparency, accountability, proportionality and consistency and of ensuring that actions are targeted only at cases in which action is needed¹³.
- ii. The desirability of promoting competition as well as encouraging investment and innovation in relevant markets¹⁴
- iii. The interests of those consumers [whose interests Ofcom is seeking to further] in respect of choice, price, quality of service and value for money¹⁵.

31. In addition, any revised condition must be objectively justifiable, non-discriminatory, proportionate and transparent.¹⁶

32. These statutory duties clearly set out the *consumer welfare* standard by which Ofcom is bound to measure the benefits of its proposals (as opposed to a wider *social welfare* standard).

MARKET FAILURES

33. This review arises from Ofcom's concern that there are three market failures prevalent in the Non-Geographic Number ('NGN') market. We examine each of these concerns in more detail below.

¹² Ofcom's regulatory principles: <http://www.ofcom.org.uk/about/what-is-ofcom/statutory-duties-and-regulatory-principles/>

¹³ Section 3(3) Communications Act 2003

¹⁴ Section 3(4) Communications Act 2003

¹⁵ Section 3(5) Communications Act 2003

¹⁶ Section 47 Communications Act 2003



34. In summary, we accept that consumer information about price is imperfect and that, at present, there are insufficient incentives for consumers to take the trouble to investigate the market properly and insufficient incentives for service and communications providers to present the information as clearly or simply as it could be. In O2's view, that, of itself, is insufficient to conclude that there is any consumer detriment; evidence of suboptimal purchasing decisions that result would be necessary.
35. We are not convinced that the vertical and horizontal externalities exist either at all or to any significant degree. Even if it can be argued that these externalities do exist, Ofcom acknowledges that they are only significant when exacerbated by the lack of pricing clarity.

PRICE AWARENESS

36. O2 has conducted its own research,¹⁷ the results of which marry with Ofcom's understanding, that customers are not confident with knowing the cost of calling these lines and either over-estimate the cost of these calls or have no idea about call costs. Very few are accurate.
37. We feel it is appropriate, therefore, to consider proposals that will deliver the best and most proportionate level of pricing clarity to improve consumer awareness.
38. However, our research results differed from Ofcom's assumption that increased pricing clarity would lead to an inevitable increase in demand for NGNs.
39. 66% of our respondents felt that they already called NGNs more than they would like. Generally, they felt obliged to call these numbers and consequently would not be inclined to call the numbers more just because they were better informed of the price. Customer Insight Boxes 1 and 2, below set out examples of feedback we have in this vain.

Customer Insight Box 1

"... it annoys me when a company uses a non-geographical phone number. For example, when I had my credit card stolen, I was forced to call an 0845 number to report it stolen – the call cost me £5 in the end"

¹⁷ Research is unpublished, but we are happy to discuss how we can make the research data available to Ofcom should they like to see it.



Customer Insight Box 2

“Utilities and service require you to call them as they don’t offer a choice”

How much will demand increase?

40. The results from O2’s research indicated that only 4% of participants would be inclined to make more calls once they had certainty about the price of calling. A further 5% said they would make the same amount of calls but would use their mobile more, and 53% said they wouldn’t do anything differently.
41. This empirical evidence is at odds with Ofcom’s assumption that greater clarity *will* increase demand for NGNs.
42. Many of the positive outcomes Ofcom seeks to achieve appear to be dependent on the assumption that demand will increase. Ofcom argues that more demand will increase competition, lower prices and increase revenue flows to Service Providers (‘SPs’) which, in turn, will boost investment and innovation. Given the extent of this reliance, it is essential that Ofcom’s assumption about demand can withstand profound and rigorous scrutiny.
43. Our research illustrates that Ofcom cannot simply assume that greater clarity will, inevitably, result in increased demand. The wider benefits that Ofcom has assumed will stem from better price transparency are therefore unlikely to materialise, or at least not to the extent that Ofcom suggests. We urge Ofcom to reconsider their proposals in light of the likelihood that demand would not increase, otherwise it would seem difficult for Ofcom to satisfy itself that its proposals meet the statutory tests.

How do you measure better consumer consumption choices?

44. One of the benefits that Ofcom assumes will arise from clearer pricing is that consumers will make better consumption choices, taking the price of non-geographic calls (‘NGCs’) into account at the point of purchasing a subscription, making a call and choosing which platform to make the call from. But this assumption fails to take into account issues



highlighted in Oftel's paper 'Assessing potential consumer savings'¹⁸. The paper illustrates the uncertainty factor that applies when assessing how consumers will behave in certain circumstance or with certain imperfect and perfect sets of information. It demonstrates that even where service providers provide access to a perfect set of information customers may not feel incentivised to research it. Furthermore, even if a perfect set of information is provided to them customers may still make irrational purchasing decisions.

45. We refer to this paper, not to deter Ofcom from seeking to find an optimal and proportionate means of increasing price transparency, but rather to urge Ofcom to apply caution in using assumptions about how consumers will behave once they have been given better information. We feel it is unsafe to base the success of Ofcom's price transparency proposals on a measure of demand.
46. We suggest that Ofcom focus its efforts on ensuring that consumers receive the level of transparency that is *proportionate* to the level of interest and care that consumers show for those services, at the point at which they will most value the information.

What influences a customer's choice of Communications Provider?

47. It does not surprise us that Ofcom's own research reflects lack of interest or care in NGN prices, in terms of influencing consumers' choice of communications provider, concluding, "*consumers have a poor understanding of prices and do not take NGC charges into account when selecting an OCP*"¹⁹.
48. This evidence is consistent with our understanding that customers simply do not value NGC services to the same degree that they do other mobile services (like geographic calls, texts, data, monthly subscription fees, handset design and functionality). And it is these customer preferences that are reflected in our market pricing structures. The market has not failed if the price of some calls are greater than others. Quite the reverse: calls which have inelastic demand should be expected to cost more than calls with elastic demand. Output is higher and welfare enhanced.

¹⁸ Oftel, Office of Telecommunications; 'A consultation on a methodology for measuring consumer savings in telecoms services' 8 April 2003.

¹⁹ The Consultation. Paragraph A2.142



49. We maintain the view we presented in our response to the Call for Inputs²⁰, that if our customers had shown any significant preference for NGNs to be included in mobile phone bundles, we would have been obliged by market forces, to provide it by now.
50. In any event, Ofcom has previously used iterations of the argument that “*the lack of easily accessible price information is likely tofurther weaken competitive constraints on OCPs in pricing NGCs at the point of subscription*”²¹ in order to impose increased price transparency obligations on OCPs under General Conditions 14 and 23²², neither of which have had any tangible success in increasing price awareness. We suggest that these measures have been unsuccessful precisely because customers simply do not care enough about these costs at this stage of their purchase. Therefore, any further regulatory remedies aimed at enhancing pricing transparency of NGNs at the point of subscription would be unjustifiable.
51. We urge Ofcom to learn the lessons arising from previous attempts at regulating at this point in the value chain and ensure that any regulatory requirements that arise from this consultation will ensure consumers receive the level of clarity that they will find useful, *at the point in time at which they will find it useful*. We think there is sufficient information available at point of sale for the minority of mobile customers who do want it, to access it, and any further price transparency requirements may be disproportionate to consumers needs.
52. Additionally we would argue that, at the point of subscription, the level of price competition for the broader mobile / telephony services on offer, is fierce. It is perhaps inappropriate for Ofcom to attempt to create a distinct ‘market place’ for NGNs at this point in the customer experience when all the evidence suggests that the relevant market place for NGNs is at the point of calling.

²⁰ Ofcom Review of Non-Geographic Calls Services – Call For Inputs, 30 April 2010.
<http://stakeholders.ofcom.org.uk/consultations/ngnservices/>

²¹ The Consultation, Paragraph A2.150

²² O2 provides this information to prospective customers in its online terms and conditions and to new customers in its welcome literature.



The options will not influence a customer's choice to call from a landline or a mobile

53. Ofcom argues that increased transparency of price at the point of call will allow customers to make a competitive choice between the platform from which they wish to initiate the call. We will be interested to read Ofcom's forthcoming consumer research on the unbundled tariff option to see if this solution will offer sufficient clarity to enable customers to make an informed choice. Our research indicates that consumers do not want to see this implemented²³. Our preliminary view is that this solution is too complex. It depends on the customer's ability to remember the ACs for the different platforms available to him which, in our view, replicates Ofcom's concern about price transparency and the difficulty customers have when trying to recall and compare different charges from each of their providers.
54. Furthermore, Ofcom relies on Consumer Focus' research report²⁴ as evidence²⁵ that pricing information from OCPs is not readily available to consumers at the point of call. We urge caution in using these results as firm evidence. We note Consumer Focus themselves highlight the very small sample sizes used in their research and how, as a consequence, the results should not be used as anything more than indicative.

How much choice does a customer have between SPs?

55. Ofcom correctly identify that the level of competition between SPs varies by range and service type. Broadly speaking, our experience is that most services offered on 084 and 0870 ranges are not competitive and 'lock in' customers. Customers feel compelled to call them and do not feel like they have a choice in doing so. Their choice of platform on which to make the call is determined by the level of urgency with which the call is required²⁶.
56. To illustrate, we have analysed the ten most frequently called²⁷ '0845' numbers. They all exclusively connect to call centres operating on behalf of: [X]. Customers of all of these services are 'locked in'. Consequently, not one of these services would deliver any significant consumer benefits or service improvements as a result of increased competition. In any event, for the majority of these businesses any desirable improvements could easily

²³ Only 14% of participants said that they would prefer the Unbundled Tariff approach.

²⁴ *Strictly unclear: Research into information on the cost of TV voting*, Consumer Focus, September 2010, <http://www.consumerfocus.org.uk/assets/1/files/2009/09/Strictly-unclear-WEB1.pdf>

²⁵ The Consultation Paragraph 1.7; 4.8 and 4.22

²⁶ O2 consumer panel research

²⁷ Top ten '0845' numbers most frequently called by O2 customers, Sept 2010.



be funded from core business activities. The only apparent beneficiaries of Ofcom's proposals are these providers who will receive a windfall increase in their revenues.

57. This contrasts with 09 and 118 services for which there is, generally, a wider set of similar services to choose from, although even in these ranges it appears that customers tend not appear to select services based on price by shopping around, but rather on marketing and quality²⁸.
58. Given this stark difference between how the ranges work in practice, and how differently consumers respond to them, we consider it inappropriate for Ofcom to argue that the direct impacts arising from the vertical externality (described as OCP behaviours that “*undermine any attempt [by the SP] to differentiate either the headline price or additional service*”) can be applied to all ranges. In our view the direct impacts of the vertical externality are only relevant to those ranges and services which do not ‘lock in’ customers and for which there are consumer benefits from price competition.

Other causes of unclear pricing

59. Ofcom's solutions for increasing price transparency offer opportunities for service providers who are subject to competition to more easily promote their prices. But they do not explore to what extent this will benefit consumers of ‘locked in’ services or how it will seek to increase transparency generally.
60. In the current regulatory environment 0871, 09 and 118 numbers (which are more likely to be subject to price competition) are all required to publish pricing information in their promotion material. Despite this, it appears that the cost of calling these ranges is still not clear to consumers. But, Ofcom do not consider to what extent this lack of awareness is a general market failure resulting from the variation in OCP pricing or whether the lack of awareness is exacerbated by a lack of proper enforcement of PhonepayPlus pricing regulations.

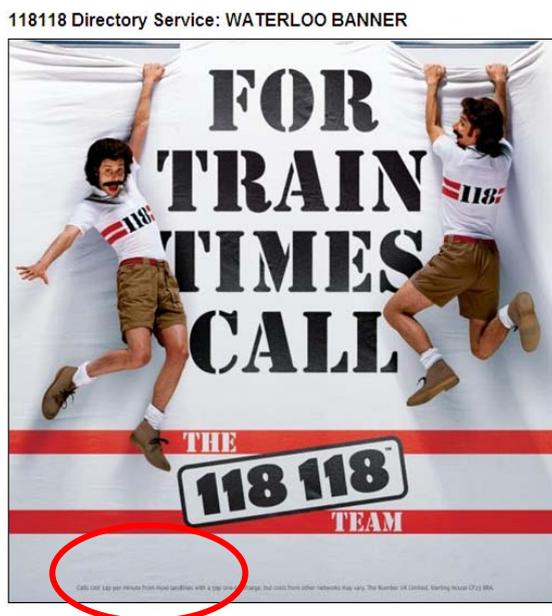
²⁸ The Consultation, paragraphs A7.409 and A7.427

61. For those ranges which most frequently carry 'locked in' services we note there are currently no regulatory requirements to provide pricing information. Again, Ofcom do not consider the extent to which the absence of any obligation to provide pricing information may have contributed to the lack of understanding of NGN ranges and price points.
62. At Figures 1 and 2 we present two examples of pricing information advertised by service providers in attempted compliance with the PhonepayPlus Code of Practice. In both cases, the pricing information is too small to read, unclear and not easily legible. However in only one of these examples (Figure 1) was the service provider found to be in breach²⁹. The lack of consistent enforcement of pricing regulations will, no doubt, be a significant contributing factor on the lack of trust consumers put in premium rate services.

Figure 1



Figure 2: Billboard



²⁹ PhonepayPlus adjudication case reference: 845393

63. In our view, the most important question for Ofcom to assess, in terms of pricing, is whether the solutions it suggests will incentivise SPs (both those who may be subject to price competition and those who may not) to improve their role in delivering pricing information to consumers? Figures 1 and 2, above, are examples of adverts for which the presentation of pricing information is regulated. Figures 3 and 4, below, offer examples of non-premium-rate service providers who choose to offer no pricing indicators at all.

Figure 3

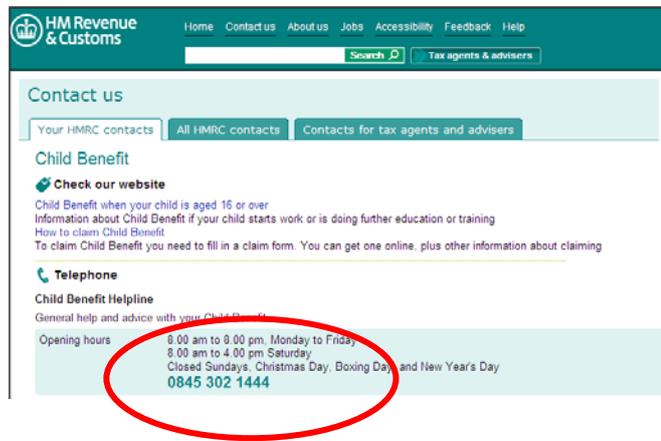
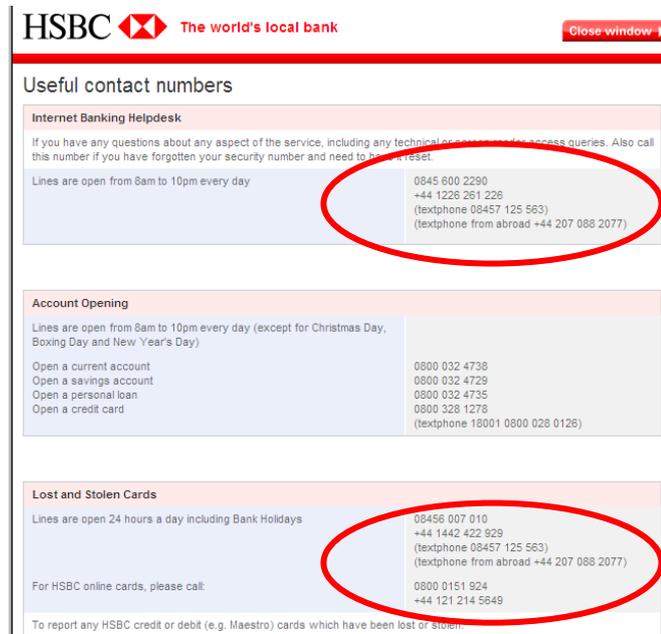


Figure 4





64. From these figures it is clear that there is no will amongst service providers to offer their customers any remote indication of cost on a voluntary basis. In these circumstances there is little wonder that customers have little or no understanding of number ranges or, at the very least, the BT-regulated price.
65. We also note that Ofcom indicate that whilst it may suggest PhonepayPlus adopt regulatory oversight for 0843 and 0844 numbers³⁰, it does not consider the same level of price clarity is necessary for socially –important services (see banking and tax examples above) which operate on 0845 numbers.
66. Ofcom has also made no attempt to encourage service providers to improve call-waiting times, to advertise likely call durations or to take any steps that would enable customers to make a more informed assessment of the *cumulative* cost of a call – an issue which appear to be the root cause of bill shock³¹ and consumer harm about price transparency³². Instead, Ofcom has limited its focus to the *unit* price of a call which, we think, is insufficient to address the consumer harm identified by Ofcom. Customer Insight Boxes 3 and 4 below represent feedback from O2 customers to illustrate this point.

Customer Insight Box 3

*“... even on landlines the 0845 racks up charges, what with the “thank you for calling. This call will be recorded...” Followed by numerous “all our staff are busy please hold” punctuated by c**p music. These are used by so called customer services. I try to use email which is free.”*

Customer Insight Box 4

“My local council being an 0845 really takes the biscuit. They are shockingly slow at answering calls then put you through to the incorrect people, and putting us on hold for over half an hour most times. I have to shut up and put up? I don't think so ”

³⁰ The Consultation: 7.68

³¹ The Consultation: Consumer Experience Box A2.1, A2.2 and A2.6

³² PhonepayPlus commissioned research by Analysys Mason “Implications of regulatory changes in the 0871 market – final report”, 17 April 2007. <http://www.phonepayplus.org.uk/upload/087RESEARCH.pdf>



67. There is nothing in either Ofcom's proposed remedies to suggest how these other causes of pricing obfuscation will be improved.
68. Instead, Ofcom appears to be seeking to lay the blame of confusion at the door of mobile CPs' retail prices without being able to produce any reliable source of evidence that mobile pricing is the sole, or even the primary, cause of price confusion. Furthermore, we consider that SPs have a great deal more influence over pricing, and how it is presented to customers, than Ofcom appears to acknowledge in this review.

THE VERTICAL EXTERNALITY

69. Ofcom suggests that Service Providers have limited or no influence over the level of retail pricing for their service. They base their evidence for this on:
- The Analysys Mason study for PPP in 2008;
 - Submissions from the Number UK Limited and responses from a survey of NGC service providers³³; and
 - Evidence that there is a variety of retail prices for calls to the same non-geographic numbers; and

The Analysys Mason Report

70. The Analysys Mason report suggests that high prices from Mobile CPs are responsible for the "lack of price transparency [which] was having a negative impact on consumer perceptions of phone-paid services". However, we note that this report highlighted a number of other issues that it suggests has contributed to the declining demand for premium-rate services and of lack of pricing clarity, which Ofcom has not considered in its review, for example:

"Several contributors expressed concern about the largely negative tone of announcements by Ofcom and, especially, by PhonepayPlus. They felt that this gave consumers the impression that the industry in general was highly suspect, and did little to promote confidence.

"The TV scandals created a PRS maelstrom, it was the straw that broke the camel's back. They [the regulators] should be enthusing about PRS, not just regulating against it and highlighting bad practice and rip-offs by the minority. They need a rethink." [Service provider and NTS vendor].

³³ Only 5% of SPs indicated that they have an influence over retail price. The Consultation: A2.130



“A significant consumer issue is confusion on pricing. This has been increased, rather than reduced, by recent changes in number ranges and codes of practice. Consumers generally do not understand either the benefits or the costs of using PRS. Consumers will be suspicious whatever the industry does.” [118118]”

71. By failing to consider the broad range of potential causes for the lack of pricing transparency, Ofcom are giving undue weight to SPs opinion. Ofcom has not given due consideration to the fact that the report is little more than an opinion survey of SPs, not empirical fact. We think it is unlikely that these SPs would admit their own culpability in contributing to the lack of trust and pricing clarity in premium-rate services.
72. SPs who genuinely consider that mobile retail charges are a significant cause of pricing confusion which limits their ability to generate custom, can offer their customers a single, clear price point on both fixed and mobile platforms, by adopting voice shortcodes to deliver services to mobile customers. However, the inquiries and take up of voice shortcodes has not been significant which calls into question the veracity of SPs opinion and the scale of any vertical externality. We note that Ofcom, too, fail to consider the alternative option of voice shortcodes for delivering clear pricing information.

The SP Survey

73. As with the Analysys Mason report Ofcom appear to have accepted SPs opinions that they are unable to negotiate with originating providers without testing their assertions.
74. In practice, we have rarely been approached with proposals from a service provider. In a recent example of such an approach (from the Department of Work and Pensions) a successful negotiation took place. There are other similar examples (e.g. 0800 reverse). This demonstrate that any vertical externality that might exist can easily internalised.

Variety of retail prices

75. In O2's view the existence of different retail prices is merely an example of price differentiation. This is widely acknowledged as increasing welfare and is also seen in the context of other calls, e.g. calls to mobile numbers.



Evidence about the scale of any vertical externality

76. As we have explained above, any vertical externality that exists can easily be internalised either through commercial negotiation or the adoption of voice shortcodes. This suggests that if the externality does exist, it isn't material (since few service providers take advantage of these opportunities).
77. This is further evidence suggesting that the quantum is small. Service providers using 0845 numbers receive a relatively small revenue share (termination costs average about 3ppm). For several years, they have had the opportunity to migrate to the 03 range, which benefits from far greater correlation with geographic call prices. However, few SPs have taken advantage of this opportunity. Accordingly, it is reasonable to conclude that those SPs actually attach very little importance to greater price clarity for callers; it is certainly worth less to them than the revenue share they presently enjoy.
78. Additionally large SPs and Terminating Communication Providers ('TCPs') acting on behalf of SPs have a direct and significant means of influencing the retail price, through the termination rates that they set. Using the Number UK Limited as an example, they have set their termination rate at £1.50 per minute. Such a steep incline in termination rate is bound to have a direct impact on higher retail prices to the detriment of consumers – particularly when there is no evidence of any increase in costs. Ofcom refer to our concerns in its consultation, but fail to address them in any way.

THE HORIZONTAL EXTERNALITIES

79. Ofcom presents the view that Originating Communications Providers ('OCPs') and SPs are not incentivised to take account of the NGC "brand" impact when setting retail prices, relying on evidence of relative and absolute price levels to support this view.
80. O2 accepts that consumers' understanding of the various 08 number ranges is poor. In our view, part of the problem lies with the overly ambitious assumptions about consumers' ability to understand the subtle differences between the different ranges. In other words, the scheme was doomed to fail because it was overly complex. The problem has been compounded when definitions simply do not make any sense (what is meant by "local call" in the context of mobile, for example?).



81. Regular attempts by Ofcom at piecemeal reform has, in retrospect, only served to confuse matters further. The removal of the regulatory underpinning for revenue share for 0870 numbers, whilst leaving revenue share intact for all other 084 and 087 number ranges, for example, hardly clarified matters.
82. Further, Ofcom does not attempt to quantify the scale of the horizontal externality. This is important, because attempts to address it will undoubtedly result in costs (for example, through implementation costs, or the mobile tariff package effect ('MTPE')). In order to determine whether those proposals pass the relevant statutory tests (for example, whether they are proportionate), it is necessary to weigh up the costs against the benefits. Clearly, if we do not know the quantum of the externality, it is difficult to assess the benefit of "internalising" it.
83. Certainly, we agree that simplicity and consolidation of the National Telephone Numbering Plan is necessary. Ofcom appears to be shying away from the current prescriptive sub-division approach to a broader one, where 08 numbers will represent small micro payments. O2 welcomes this.
84. Ofcom needs to evaluate whether or not any further change is necessary. O2 believes that there are reasons to believe not.
85. There are now many forms of micro-payments (eg, premium text, Payforit, applications stores, Paypal, etc) and it seems reasonable to suppose that others will come to market in the coming years. A reformed 08 range will, therefore, exist as part of a wider market of micro-payment mechanisms.
86. O2 believes that the competitive constraint exerted by these other mechanisms is likely to constrain the behaviour of providers. The competitive dynamic can be expected to operate to prevent them from exploiting any monopoly power or taking advantage of customer confusion. This is because customers will simply migrate to other micro-payment methods if they do not trust the 08 range.



WELFARE LOSS

87. Ofcom assumes that poor consumption decisions, bill shock and over/under consumption result directly from a lack of awareness of the unit / per minute cost of calls to particular number ranges. We do not agree.

Direct impact on consumers (bill shock / poor consumption decisions)

88. It is clear from the Ofcom consumer experience boxes that it is not the lack of awareness of the 'per minute' price that resulted in the bill shock, but rather the inability to assess the total duration and, ultimately, the total cost of the call.

89. Our research indicates a significant proportion of animosity towards the providers who choose to adopt NGCs as means of contacting them because they felt that long holding times and protracted calls and transfers between departments were methods employed to prolong the call and to make money³⁴. Without testing the impact of this element of bill shock, it is impossible to say with any certainty the extent to which the lack of awareness of the unit cost price will have any bearing on resolving this suggested market failure or the outcomes of bill shock and poor consumption choices.

Distorted price structures

90. In this review it appears that Ofcom has repeated the arguments presented in its Final Determination in the 0845/0870 dispute with British Telecommunications Plc ('BT')³⁵, which is that call prices for NGCs are higher than they should be but, that the benefits accrued from the tariff package effect do not neutralise any harm arising from these higher prices because this pricing structure does not reflect the preferences of SPs or callers.

91. In terms of caller preferences, we stress that mobile retail prices reflect our higher origination costs, formulated in the highly competitive mobile access and call origination market. We consider that the prices reflect the fact that the unit costs in providing mobile services tend to be higher than for fixed. Furthermore, they accurately reflect caller

³⁴ See paragraph 65 and customer insight boxes 3 and 4.

³⁵ Final Determination to resolve a dispute between BT and Vodafone et al, about BT's termination charges for 0845 and 0870 calls. http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/761146/Final_Determination.pdf



preferences for cheaper prices on frequently used mobile services (calls to geographic numbers, mobiles and texts) over cheaper prices on infrequent, obligated use of NGCs. This preference is further supported by Ofcom's research which clearly indicates that customers would overwhelmingly prefer the current pricing structure to a re-balance in which call prices to NGCs are lower³⁶.

92. Furthermore, the mobile retail market has already provided tariffs with cheaper calls to NGNs, including options for such calls to be included within call bundles. Ofcom has a duty to further the interests of consumers, where appropriate by promoting competition. It has failed to explain why the competitive outcome is deficient.
93. Additionally, the evidence suggests that demand for NGNs is relatively price inelastic. The recovery of proportionately more fixed and common costs from these services increases output and therefore, welfare. Interfering with competitive prices is the way Ofcom suggests is, therefore, likely to reduce prices.

Exposure to Fraud

94. Ofcom use the example of fraudulent behaviour on 070 ranges to illustrate the risks of fraud that can exist on NGCs. The 070 range provides a good example of the fact that some NGCs may expose customers to a greater risk of fraud than others and that the exposure to fraud stems from far more than a lack of price awareness. It is disappointing that Ofcom has not addressed these wider issues in its analysis.
95. Ofcom fails to take into account the extent to which such a fraud was perpetuated not by the price (or lack of awareness of it), but by Ofcom's failure to heed industry warnings that the allocation a number range that so closely resembles the mobile number range, would lead to confusion and vulnerability. Furthermore, it is not clear how the solutions proposed by Ofcom go any further in educating customers that these aren't mobile numbers. By

³⁶ The Consultation: A6.40 and footnote 598 which states: "The 2010 Consumer research asked "Which would you prefer? To keep the costs for ... 08 and 09 calls the same as they are now, or reduce the costs of these calls and increase the costs of local and national calls?" (question 42; base: all; n=1,189). 70% of respondents wanted to keep prices the same and only 9% wanted to rebalance prices in this way (13% responded "don't know"). As discussed in Annex 6, there are reasons for treating this result with some caution since the qualitative research suggests that respondents may have believed that overall telephony costs would increase (2010 Consumer research, page 23). Nonetheless these survey results do not provide support for significant rebalancing of retail prices"



pricing them at the same rate as mobile numbers it further exacerbates the misunderstanding that they are mobile numbers and expectations that calls will be included in bundle.

96. It is regrettable that Ofcom failed to accept the view that consumers do confuse the 070 range with mobile numbers during their 'Review of the 070 personal numbering range'³⁷ consultation. Had it done so, we suspect, that Ofcom could have taken more robust action then to close the 070 range and migrate 'follow-me' personal numbers to a separate and distinct range. Subsequent instances of 070 mis-use and consumer harm may have been avoided³⁸.
97. Furthermore, regulating the retail price, and not the wholesale (interconnected) price would only service to increase fraud. If wholesale charges are higher than retail prices then unscrupulous providers will simply call their own number to guarantee an instant 'profit'. Surely Ofcom must recognise this. The only solution to this problem would be for originating CPs to stop access to these numbers. Ofcom has simply failed to think this through.
98. Ofcom presents this detrimental outcome of market failure as one that applies to all NGN ranges, which is contrary to our experience. We do not see similar levels of risk on the 0800, 0845 or 0871 ranges. Instead we consider that customer exposure to fraud is greater where:
- i. A number range offers opportunities for high levels of revenue sharing (09, 118 ranges); and / or
 - ii. A number range can be confused with other number ranges that are commonly found in bundle (070)
99. In order to present the most balanced cost / benefit assessment against which Ofcom's proposed solutions can be measured, it is essential that Ofcom offer a more precise assessment of potential consumer detriment, especially where that detriment is limited only

³⁷ <http://stakeholders.ofcom.org.uk/consultations/070options/> - 15 October 2008

³⁸ We note that PhonepayPlus adjudicated on a '070' case as recently as 17 February 2011. Case 840404 <http://www.phonepayplus.org.uk/output/Search-adjudications-1.aspx>



to specific number ranges. Only then will Ofcom be in a position to develop a proportionate and targeted means of regulating NGNs.

Diminished Service Availability

100. Ofcom argue that SP and OCP incentives are not aligned in terms of setting retail prices. This, coupled with a lack of price transparency, results in suppressed demand for NGN services and suppressed incentives for SPs to invest and innovate. Ofcom classify this lack of investment as a consumer welfare loss.
101. Ofcom, therefore, suggests that any measures that would increase SP revenue (and subsequently SP incentives to innovate and invest) provide an equal and opposite welfare gain. We question this conclusion.
102. Ofcom base their conclusion on several unsafe assumptions. They assume:
 - i. that the measures proposed to lower retail prices will definitely increase demand.
 - ii. that increased demand will result in more revenue flowing directly and proportionately to the SP (with no increase in TCP or transit costs / prices).
 - iii. that the full amount of the SPs revenue will be re-invested into service quality and innovation (as opposed to increased dividends to shareholders or changes in tax revenues to the Government), and
 - iv. that these effects could neutralise any detrimental impact of the MTPE.
103. We are concerned that these assumptions are unsafe as there is little or no convincing evidence on which to base those assumptions, nor are there any proposed regulatory measures to ensure that the outcomes will be realised, nor that there will be a *consumer* welfare gain, as opposed to a *social* welfare gain:
 - i. As we have explained above, our research suggests that lower retail prices is unlikely to result in higher output;
 - ii. It is by no means certain that increased interconnect revenue will flow to SPs. Indeed Ofcom is aware that when BT increased interconnect charges to 0845/0870 numbers, it planned to pass no additional revenue to SPs;



- iii. Ofcom presents no evidence to suggest that additional SP revenue will be ploughed back into service development since Ofcom's statutory duty is to promote consumer welfare (as opposed to broader, social welfare). This omission is critical; and
- iv. Our experience and evidence suggests that the demand for calls to NGNs is price inelastic. The artificial reduction in the price of calls to NGNs, with the consequential increase in prices of other calls, is likely to *reduce* output and, therefore, consumer welfare, in stark contrast to Ofcom's statutory duties. Ofcom doesn't appear to have considered this at all.

Distributional concerns

- 104. Ofcom argues that there is a disproportionate amount of lower-income households who rely solely on mobile phones and, that they are disproportionately affected adversely by the higher retail charges, from accessing services that are socially important, either by paying higher prices or by paying higher costs to avoid those higher charges.
- 105. Ofcom goes even further. Ofcom argues that the apparent benefits of the MTPE – whereby higher call prices for calls to NGNs allow OCPs to offer lower call prices for other mobile telephony services that are in higher demand – still carries an overall detriment because those customers who make more calls to NGNs than they use other mobile telephony services are at a disadvantage (because they do not experience the net benefit of lower charges for other services). Ofcom consequently conclude that “...we (Ofcom) believe that there is a negative impact of the market failures in NGCs even in the presence of a complete tariff package effect”³⁹.
- 106. Ofcom draws its conclusion without taking any steps to investigate the extent to which vulnerable consumers show a preference for using NGNs more than other mobile telephony services or taking account of its own findings that the majority of ‘socially important’ services are operated on freephone or geographically-rated ranges. This means that the concerns Ofcom demonstrate for the welfare loss arising from distributional effects

³⁹ The Consultation: A2.189



generally extend to freephone and geographically-rated ranges only and cannot be used to justify a policy change for *all* number ranges.

107. One particularly negative impact of imposing a prohibition on mobile operators from recovering costs through retail charges, which Ofcom do not appear to have considered at all, is that services offered on numbers provided by members of the Telephone Helplines Association, currently incur no origination costs at all. This arrangement was agreed in order to ensure that all mobile customers did indeed have access to socially important services.
108. With the proposed remedy for 0800 numbers Ofcom is, at once, increasing the financial burden of those freephone service providers who do not currently incur any origination costs and increasing the risk that service providers may choose to minimise their costs by barring calls that originate on a mobile⁴⁰.
109. Another example that demonstrates industry is mindful of vulnerable consumers, is the successful negotiations to offer free mobile calls to services operated by the Department for Work and Pensions ('DWP'), negotiations that concluded without any need for regulatory intervention.
110. Ofcom does not appear to have considered any alternative options for ensuring the best policy for citizens and consumers in gaining access to socially-important services, for example:
 - i. More explicit measures to encourage SPs who operate socially important services to use only freephone or geographically-rate numbers;
 - ii. Exploring options for government funding of socially-important services;
 - iii. Working with other regulators to ensure that services that are provided under a universal service obligation (fixed line telecoms, utilities etc) provide access to their support services via a free to caller phone line;

⁴⁰ The Consultation. Paragraph 6.136



- iv. Exploring options for operating socially-important services at a lower cost on voice shortcodes;
- v. Liaising with other regulators to require socially-important service providers to offer free access to support services. For example, in its recent consultation 'Ofcom's review of consumer complaint procedures'⁴¹, Ofcom amended General Condition 14 to require that CPs offer customers at least two no-charge options by which they can make and escalate a complaint, and yet Ofcom has not considered how it may use its influence to secure similar accessibility criteria from its peer regulators of utilities suppliers, for instance; and most importantly;
- vi. Whether the proposed remedy for 0800 numbers might deliver worse, not better, outcomes. By removing any opportunity for OCPs to recover origination costs through a retail charge (which currently allows mobile OCPs to provide free access to services operated by the Telephone Helplines Association, at no charge to the service providers), consumers and providers of these services will be in a worse position.

THE PROPOSED REMEDIES

111. We now turn to Ofcom's proposals, which aim to neutralise the outcomes of the suggested market failures.

Unbundled Tariff Option

112. We do not consider that the Unbundled Tariff option satisfies the assessment criteria against which Ofcom is analysing its options.

113. *Transparency and price awareness*: Notwithstanding the results of the research Ofcom has commissioned to test consumers understanding of this proposal, our own research indicates that an unbundled pricing structure does not appear to provide customers with any greater level of transparency.

⁴¹ Statement published 27 July 2010:

http://stakeholders.ofcom.org.uk/consultations/complaints_procedures/statement/



114. This proposal still assumes that customers are incentivised to apply even a limited level of research, in order to find out the ACs between one or more provider and to calculate the total 'per minute' charges that may apply to them. We do not think Ofcom has presented any evidence to suggest that this proposal will incentivise consumers in a manner which will “*provide more certainty for consumers and expand call volumes*”⁴².
115. Our research suggests that customers do not want to call these numbers but do so as a matter of obligation in order to make contact or access primary services that they need to (but may not want to), for example banking, tax advice, doctors appointments etc. Consequently, clear pricing may not drive greater demand in itself. Furthermore, we are unconvinced that such an approach will help customers manage 'bill shock' in circumstances where there is no indication of how long or short a call may be. When extended holding times are a significant ground for complaint of 08 numbers, it is surprising that Ofcom has not considered its impact on the level of 'bill shock' experienced by customers and how clarity may be improved in this respect.
116. Ofcom argue at A5.216 that with the unbundled tariff option the “*complexity of prices is likely to be significantly reduced*”. We do not agree.
117. Today a customer does not have to search the myriad of OCP sites to compare prices, he simply has to find the cost of calling a single number from their relevant OCP only (fixed and/or mobile). It is a single-step research cost.
118. Under the new regime the extent of the research they are required to do would not be significantly reduced. The customer would, instead, have to retain information from the promotional material about the SC cost. It will then have to research the 'ACs' of their providers to compare the prices. Given that the price may vary depending on the package type, the person making the call (in a fixed environment this may not always be the account holder) would also need to know what package the account holder had chosen in order to determine which AC was applicable to them. Provided the caller has established the correct AC, he must then calculate the total unit charge and approximate how long the call will last him. This involves a multiple-step research cost to the consumer.

⁴² A6.60 The consultation



119. Furthermore, we note that Ofcom do not propose to introduce regulation to support greater transparency or promotion of the SC costs for 0845, 070 or 0870 numbers under these proposals, resulting in consumers being no more informed about the total cost of the call than they are today. Although Ofcom suggest options for expanding PhonepayPlus' remit to regulate pricing prominence on the 0844/43 range, we suspect that this will merely result in a migration to 0845 numbers. This is evidenced by the industry's response to PhonepayPlus' regulation of 0871 numbers.
120. Ofcom assumes that the SC will not vary between OCPs but offers no evidence on which they base this assumption, or why this would be detrimental to consumers and the market.
121. Ofcom assume that *"this should ensure that consumers find it easier to subscribe to the tariff package and OCP which better meets their overall needs"*⁴³ but there is no evidence that customers will respond to these or even care about the costs of NGNs at the point of subscribing, rather there is sufficient evidence within Ofcom's own research to the contrary.
122. We suspect that the risk of over or under consumption is more directly related to the overall cost of calling these services, as a result of long holding times and bad customer experiences and these issues haven't even been acknowledged in the current review, let alone addressed.
123. We do accept that the Unbundled Tariff option presents an opportunity for the SC costs to be better communicated to consumers. But its benefits are limited by the following factors:
- i. Better pricing information will only be delivered where there is supporting regulatory regime to enforce it, yet under Ofcom's proposals PhonepayPlus's remit will only be extended so far; there are no additional benefits for customers of 0845, 070, 0870, 03 or 0800 calls.

⁴³ The Consultation: A5.216



- ii. Even where regulation exists, it would be necessary to ensure that the requirements are clear and enforced consistently. Figures 1 and 2 provide a good example of how a lack of consistent enforcement may exacerbate customer confusion about prices.
- iii. The benefits of this option are limited as there are no corresponding measures to incentivise customers to take the extra steps necessary to make the manual calculation and research of the AC + SC + the likely length of the call before making an informed decision about whether they can afford the call.
- iv. The benefits of this option are limited only to those services where customers feel that they have a choice in consuming the service in the first place. If customers feel unable to exercise their consumer power to 'walk away', then any potential benefits of having the relevant costs to hand are limited.
- v. A single AC for all non-geographic calls does not reflect consumer preferences. Our experience is that 0845 and 0870 ranges are more popular than 0871, 09 and 118 ranges. A pricing structure which causes those services that are consumed more to increase in price, whilst those services that are consumed less, and which carry a greater risk of non-payment and bad debt, to decrease in price appears to be inefficient.
- vi. Ofcom's proposal to amend the PRS condition to make 0843/4 services subject to premium-rate regulation could result in an additional cost burden to providers of 0843/4 services and 09 and 118 services. Using PhonepayPlus' adoption of 0871 regulation as a reference point, we note that mobile shortcode, 09 and 118 service providers were obliged to carry the cost of regulating 0871 services for some time before 0871 providers began to contribute. If the same costs are incurred again they should be considered in Ofcom's analysis.
- vii. The NGN market is very different to the premium SMS market. There is no analysis of the differences between the two and the extent to which the success of the 'AC+SC' model can be replicated in the NGN market without unforeseen consequences.



124. *Price effects:* The effect of the Unbundled Tariff on driving down prices would, we suspect, not be as effective as Ofcom suggest. Ofcom suggest that the AC element would “*be likely to increase competitive pressures both at the point of subscription and at the point of call*” without any supporting evidence that that would result in a reduction in prices.
125. At the point of subscription it is already established that customers care little for the cost at this stage and that it is unlikely to sway their judgement in terms of choosing an OCP provider, even if they would like easier access to the information – this finding does not support the view that competitive pressure would increase under this option.
126. At the point of call the AC will always put mobile CPs at a competitive disadvantage to fixed platforms, in terms of price, given that the costs of originating and retailing calls on a mobile network are higher than those from a fixed phone. This challenges Ofcom’s assumptions about how this solution (and greater pricing clarity) could increase competition and demand for services, or even the extent of fixed to mobile substitution.
127. For the purposes of basic modelling, Ofcom suggest that fixed OCPs might set an AC of 2.3ppm and mobile OCPs might set an AC of 14ppm, based on the assumption that average retention does not change. Later, at paragraph A5.74, Ofcom highlight concerns that these proposed charges represent a “*degree of risk that the AC exceeds an appropriate measure of the OCPs costs*”.
128. However, Ofcom fails to consider the extent to which ACs should recover a proportion of fixed and common costs, as well as the marginal cost of originating and retailing the call itself. If all relevant costs are accounted for, an AC of 14ppm may accurately reflect an appropriate measure of mobile OCP’s costs. Indeed, Ofcom has presented no evidence that current call prices to NGNs do not recover an optimal element of common and fixed costs.
129. In the absence of a thorough assessment of the costs that mobile CPs must account for, Ofcom risks failing to appreciate the magnitude of the detriment that may be caused by a rebalancing of prices under the MTPE.



130. Service quality, variety and innovation: Ofcom assumes that the Unbundled Tariff solution will increase price clarity and, consequently, that will increase demand. We have already set out our concerns about the basis of this assumption. We feel it is unsafe to assume that demand will increase on all or even some of the ranges.
131. An additional concern, however, is the extent to which the Unbundled Tariff option is able to deliver the level of price clarity and flexibility for service providers that Ofcom assumes it will. Ofcom suggest that “*OCPs billing systems are capable of charges at a level of granularity corresponding to at least the same level as BT’s current level of charging granularity*”⁴⁴ and that as a result they “*didn’t identify any insurmountable implementation barrier in adopting an unbundled tariff structure*”⁴⁵ In order to arrive at this assumption we do not consider that Ofcom can have taken account of the structure of our billing systems. Our initial assessment of costs suggest that any level of granularity which goes further than that offered for mobile premium shortcodes is likely to be insurmountable [X]. Alternatively a limited range of price points, may substantially affect the extent to which increased price competition could be achieved.
132. In the event that the implementation costs can be overcome, and found to be proportionate, Ofcom is unable to demonstrate how it can be confident that any revenue resulting from an increase in demand will travel directly through to the service provider and that they would re-invest the full amount of that revenue to realise a direct benefit to consumers. We note Ofcom’s own uncertainty of this effect, where it states “*We consider it uncertain whether and to what extent SPs will improve the availability or quality of their services to the benefits of 0845/0870 consumers*”⁴⁶. This is testament to the fact a positive benefit to consumers from increased revenue to service providers cannot be assumed.
133. Access to socially important services: We are not convinced that this is a relevant assessment criterion for the higher-rate revenue-share numbers. Almost all the number ranges that Ofcom proposes should be covered by a single AC carry few socially- important services, if any.

⁴⁴ The Consultation, paragraph A5.193

⁴⁵ The Consultation, paragraph A5.194

⁴⁶ Ofcom’s final determination in the 0845/0870 dispute, 10 August 2010. Paragraph 7.168

http://stakeholders.ofcom.org.uk/binaries/enforcement/competition-bulletins/closed-cases/all-closed-cases/761146/Final_Determination.pdf



134. Nonetheless under the current proposal it is feasible that a service provider of a socially important service may wish to operate on a revenue-share range and require callers to pay for access to its socially important service. In these circumstances it is almost inevitable that the customers of the service will be ‘locked in’ and the service itself free from any competitive constraints, and so it is unclear how the unbundled-tariff option provides any assurance for low-income customers that they will be able to access the said service at a reasonable cost that they can afford.
135. The threat of being exposed to adverse publicity on prices only works if there is a requirement to publish that price. Given that Ofcom has not proposed to require publication requirements on 0845, 070 and 0870 calls, service providers have an easy means of ‘opting out’ of the risk of adverse publicity.
136. Ofcom state that they are aware that this concern rests largely (we suggest exclusively) on the decision of the service providers as to which number range they operate on. Consequently it is of limited value to assess the Unbundled Tariff option as one which has any positive impact on vulnerable consumers where measures to encourage SPs to operate socially-important services on the 0800 or 03 range are starkly absent.
137. Even more significantly, we consider that this is a good example of the unnecessary complexities that can arise if Ofcom insist on applying a single AC to several ranges which are used and perceived very differently. We feel it would be more appropriate and more targeted, if Ofcom were to distinguish between the revenue-share ranges that it has bundled together to create a single AC and assess whether two ACs (one for lower-rated revenue-share numbers 084, 087) and one for the more competitive, risky and price sensitive ranges (09 and 118).
138. Regulatory burden:
- i. Ofcom suggest that the Unbundled Tariff will offer OCPs and SPs “*considerable flexibility to select the level of AC and SC, taking into account the extent of competition and consumers’ preferences*”⁴⁷. This implies that OCPs billing systems

⁴⁷ The Consultation:A5.220



will need to be able to offer SPs an unlimited number of price point variations or at least to the same level of granularity as that currently offered by BT. [X]. This is a significant barrier to implementation. We would be happy to discuss our cost assessment with you.

- ii. If Ofcom is satisfied that only a limited range of price points can be offered under this proposal, then it is essential it consider how this will impact the SPs ability to compete effectively. We consider that there could still be sufficient difference in price for each range such that SPs who wish to compete can do so by migrating to a more appropriately priced number range.
- iii. At present our systems would be able to consider a limited number of price points (as we do for premium SMS) but if Ofcom expect that the price points could vary by range and sub-range [X], then the costs again are significantly altered.
- iv. Furthermore, there is the cost of maintaining and updating the system. The costs allowing for SPs who may be constantly competing on price or who wish to change their price point frequently has not been considered, but we expect that this could not be easily permitted.
- v. Whilst we agree that the Unbundled Tariff is unlikely to be worse than the deregulated scenario, we argue vehemently that it is certainly not better than the status quo.

Maximum Price option

- 139. Although these proposals require more detailed consideration, on the face of it, the Maximum Price solution offers far greater benefits in terms of consumer clarity than the Unbundled Tariff option.
- 140. Our research indicates that a firm single price point was considered to be far more clear to our 65% of our research participants than the Unbundled Tariff option (14%). 22% of participants responded in favour of leaving things as they were or that they did not care.



141. Although the evidence does not support the idea that increased clarity would stimulate demand, it convincingly demonstrates that consumers prefer it as an option which provides them with more certainty (and arguably more confidence) when making the call, in comparison with the Unbundled Tariff option or the status quo.
142. However there are a number of complexities.
143. As explained above, the level of granularity required to realise the benefits of effective service provider price competition would impose significant implementation costs.
144. Ofcom suggest that a ladder of price maxima within each number range is preferable, but they do not balance this against the risk that any confidence a customer may have about the cost of calling a particular range risks being diluted.
145. The effects can be demonstrated in the 090 range. Regulated price points range from 10p a minute to £1.50 a minute from a BT landline, and so customers cannot be expected to even offer an accurate estimate of the price point represented by this range. Instead customers rely heavily on the regulatory requirement to publish pricing in order to be informed about price.
146. Where the range offers more opportunity for price competition to develop,(e.g. 09 numbers) a limited set of ladder pricing within a particular range may be appropriate. But we do not consider that that is necessarily true on ranges for which there is little or no opportunity for price competition (e.g. 084 numbers), either because the services are capable of locking customers in or because there are no or limited obligations to advertise the price in promotional material.
147. The greater the number of maxima that Ofcom suggest should be applied, the greater the cost of amending our billing systems. [>]. If more granularity is required, [>>], then there is a significant increase in the complexity and cost that we would entail for our business.
148. It would therefore be helpful if Ofcom could clarify what it means by “considerable granularity” and a “degree of granularity” when it refers to the number of price points it



expects, in order for us to better assess the likely cost impact. Without more detail on this point, it is impossible for us to provide a complete response to this consultation.

149. It appears to us that simple rules are easier to implement and to educate consumers. If there is a consistent message that all numbers with the same prefix are priced the same then that price consistency is more likely to be retained by consumers. This may be one reason why recognition of the 0800 number price point is far more successful than that of any other range.
150. We do not accept Ofcom's view that the Maximum Price option would be less indicative of cost than the Unbundled Tariff and that it would be less clear than a deregulated or status quo option. We suggest that even if there is a relatively large amount of headroom between the termination rate and the retail price, a Maximum Price tariff does give callers a far better 'ball park' figure from which to make a decision about whether to call or not, more so if Ofcom consider that it is appropriate to set different price maxima for mobile and fixed line calls.
151. The end result is that customers who feel obliged to call numbers have greater transparency that a call will cost no more than a certain amount per minute. Whilst there is a risk that customers do not like the price and choose to use avoidance tactics, it would ensure that the issue of bill shock would be almost entirely negated, but for the service provider's ability to set customers expectations on the length of the call. The same cannot be said of the Unbundled Tariff option.
152. Furthermore, given the evidence that consumers do not want cheaper NGC prices, at the expense of higher prices for other mobile services, it is appropriate for the Maximum Price to include sufficiently large headroom to ensure that there is no need to rebalance prices.

Fixed to mobile substitution

153. We suspect that the level of fixed to mobile substitution may not be as dramatic as Ofcom suspect given our understanding that customers do not actively choose to call these numbers but feel obliged to do so.



154. The dramatic levels of substitution demonstrated in the Department for Work and Pensions ('DWP') example is likely to be a special case. It seems likely that callers who may be in need of DWP's services are very price sensitive, which will not be the case for all callers to NGNs in general or even all 0800 services. Furthermore, we do not know whether DWP invested heavily in advertising the fact that their services would be free to all callers or whether their particular skills and advice services resonate with customers in the current difficult economic climate. If promotion was minimal then the rate of substitution could be informative, but perhaps only for the freephone ranges. If the level of promotion was significant then it is unlikely that all providers will be able to deliver the same level of promotion so the actual figures are likely to be less dramatic for general freephone numbers and even more so for non-freephone numbers.
155. If Ofcom were to set a single price point for mobile and fixed OCPs there is a risk that fixed OCPs will migrate towards the higher margin. Mobile OCPs are likely to need to be at the higher margin (as a result of higher costs of origination and retailing NGNs). Consequently without careful consideration, Ofcom could risk adopting a policy which favours a larger headroom for fixed CPs and a lower headroom for mobile CPs. We do not think this would achieve the aim that Ofcom desires and may unduly indicate an inappropriate preference for one form of technology over another, in breach of Ofcom's statutory duties.
156. We feel it may be more appropriate to distinguish between mobile and fixed tariffs. The level of headroom that should be applied should take into account the potential consumer impact in each market. A lower headroom in the mobile market is likely to lead to a more dramatic rebalancing of prices as a result of the MTPE which we do not think is in the consumer interest. Furthermore, Ofcom's own research shows that consumers had a particular dislike for such a trade off, which it would be difficult for Ofcom to ignore if it wishes to comply with its statutory duties. In the fixed line world there may be less need for a large headroom, as no discernable tariff package effect has been suggested or evidenced for that market, in the review.
157. The fundamental problem with NGNs is, undoubtedly, the fact that many customers do not know the price. Notwithstanding our disagreement with Ofcom's view of the vertical and horizontal externalities, both those externalities are only considered to have any significant impact because customers do not know the price of calls. In our view, the Maximum Price



option achieves a more beneficial outcome in this regard than the Unbundled Tariff option. It does not necessarily follow that the prices themselves need to be low, merely that they are transparent.

158. Ofcom suggest that there can only be two options – a Maximum Tariff with large headroom and one with low headroom. In our view it is well within Ofcom’s ability to determine a range of Maximum Tariffs with the *appropriate* amount of headroom relative to the market (fixed or mobile) and to allow the best overall outcome for consumers (taking account of the MTPE).
159. Price transparency: We agree that this could achieve more favourable transparency outcomes than the Unbundled Tariff option.
160. Price: We accept that there are potential consequences and risks to competition and consumer benefits if Ofcom set an inappropriate maximum retail price. Ofcom is right to consider that there could be negative impacts from setting a maximum retail price too close to the termination rate. It is also true that its choices may not maximise the longterm benefit to consumers and that a rebalancing of prices may have negative consequences. However we consider that these consequences can be managed and mitigated in the following ways:
- i. Working in close consultation with industry
 - ii. Differentiating between mobile and fixed customers where it is appropriate to do so
 - iii. Remaining vigilant to adverse consequences
 - iv. Setting more robust price transparency measures on service providers
161. Ofcom has suggested that it has only one option (to set the maximum price at a point which allows for little headroom). However the risks that Ofcom identifies could easily be mitigated if Ofcom were to consider that headroom must neither be too large nor too small, but at a satisfactory level at which OCPs can minimise the need for tariff rebalancing, can recover marginal, fixed and common costs and can maximise opportunities for OCPs to offer alternative packages for those who have a strong interest in NGN calls.
162. We would be happy to discuss this further with Ofcom.



163. Service availability: We agree that maximum retail prices offer SPs more opportunities for retail competition, but we urge Ofcom to assess the benefits of such competition against the costs of implementing a ‘*considerable amount*’ of granularity. Our understanding is that the greater the granularity the greater the costs. Given that the majority of services on 08 numbers are not subject to competition and, where they are, it is not price but quality on which they compete, that the level of granularity required is minimal.
164. Access to socially important services: Ofcom should consider other alternatives to achieving easier access to socially important services for vulnerable people, other than options that rely too heavily on service providers recognising that their service is socially important and choosing an appropriate tariff on which to operate.
165. 0800 numbers are used by a variety of organisations, including those that are run for profit. Directly intervening to suppress market prices in the way Ofcom proposes is completely disproportionate to the problems identified by Ofcom.
166. To complete a thorough assessment of the 0800 remedy, it is essential that Ofcom consider what the appropriate amount of call origination costs might be, at the very least to work out the magnitude of the MTPE and the extent to which those service providers who do not currently pay any origination costs, may incur additional liabilities and the likelihood of SPs barring the receipt of calls originating from a mobile.
167. Our view is that Ofcom’s initial and rudimentary suggestion of a range between 0.5ppm and 2ppm, demonstrates a clear failure to give the appropriate weight to the higher marginal and common and fixed costs arising from a mobile network. It is not uncommon for origination payments to differentiate between calls from a mobile and from a fixed line, to the extent we could say that Ofcom’s regulatory peers in Europe have already set a benchmark. We understand that [\times]. There is no explanation for Ofcom’s dramatic departure from this benchmark, in proposing a range of 0.5 – 2ppm.
168. As we mentioned earlier, it is imperative that Ofcom gives full consideration to the fact that its proposals may be worse for consumers and providers of the socially-important services operated by members of the Telephone Helplines Association, rather than better. This is



particularly important if the proposals result in a disproportionate and unjustifiable benefit to those service providers who operate 0800 numbers in order to simply drive profits.

169. We would expect Ofcom to make a more thorough assessment of the likelihood of this happening and the degree to which SPs could reasonably absorb an origination payment that more adequately reflects all relevant costs, which we believe to be considerably more than 2ppm.

MARKET POWER

170. Ofcom raise concerns about imbalances in the wholesale negotiating power of OCPs, TCPs and SPs. We do not agree with much of Ofcom's analysis, here.
171. Ofcom suggests that, in some circumstances, OCPs may refuse to originate non-geographic calls and that termination rates offered to smaller TCPs/SPs will be too low. In this way, the monopoly power of TCPs may be constrained, Ofcom argues. Our experience has been that neither of these scenarios is realistic.
172. In order to remain a credible telephony supplier in a competitive market, customers expect to be able to connect to *any* number they want to at any time. Unless the number concerned carried concerns of fraud or serious consumer harm, terminating access to a number is not a legitimate option. This affords TCPs great market power.
173. In terms of smaller providers, it is often the case that these providers use BT as a transit provider. OCPs originate calls to these services in accordance with BT's standard interconnect agreement. There is no sense that termination rates are 'agreed' between TCPs and OCPs. Rather, interconnect charges are set by TCPs and simply presented to OCPs, as BT presents its own charges. In this way, TCPs vicariously adopt BT's market power. TCPs' increase in interconnect charges for 0845 and 0870 numbers is evidence of this process in operation.
174. The situation with DQ providers and their seemingly arbitrary increase in interconnect revenue, also illustrates this point very well (see Figure 6, below).



175. Given the dramatic increase in revenue, and the lack of any demonstrable corresponding costs, it is surprising that Ofcom has accepted the argument that DQ providers are unable to influence pricing – and therefore innovate new services – so readily and without scrutiny⁴⁸.

Figure 6

[✕]

CONCLUSION

176. There are too many deficiencies in Ofcom's analysis. These must be addressed before the proposed remedies, or any alternatives, can be progressed.
177. There are too many unfounded assumptions, unsafe or absent evidence, on which Ofcom has justified its policy decisions. This causes us great concern that if any of the proposed options are progressed, they would do so in breach of Ofcom's statutory duties.
178. There is a significant amount of work that still needs to be done to sufficiently quantify the harm Ofcom suggests arises from each of the market failures, without which it is unable to assess the likely impact of its proposals. Our initial assessment is that the cost of implementing the Unbundled Tariff option would be grossly disproportionate to any potential benefit.
179. We urge Ofcom to move forward with a more targeted approach to this review, such that regulatory intervention is targeted only at cases in which action is needed and no more.
180. We look forward to meeting with Ofcom to discuss our response in further detail.

-END-

⁴⁸ The Consultation, paragraph A2.135