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28 September 2009

Dear Catherine

**OFCOM CONSULTATION ON WHOLESALE CHARGES FOR NTS AND PREMIUM RATE SERVICES**

I am writing with a response to the Ofcom consultation published on 28 July 2009. This response is specifically on the issue of premium rate telephony and bad debt and is prepared on behalf of Telecom Express Ltd and DM plc who have requested that I represent them in this matter.

Telecom Express and DM plc are leading providers of phone-pay services using premium rate numbers that are the subject of this consultation. As a former Chief Executive of PhonepayPlus I agreed to provide support in assessing the proposals and in responding to the Ofcom consultation.

Telecom Express is the leading provider of bureau services to publishers, broadcasters and other providers of entertainment and information services using phone payment. Their client base includes Channel Five, the BBC, News International, Guardian News and Media, Daily Mail & General Trust, Northern and Shell Group, Telegraph Media Group and numerous other publishers and TV Production companies. DM plc is a marketing company with many years experience in running conventional and online competitions and gaming. The company employs over 200 staff and has a turnover of over £20m. Further information on the companies is being provided under separate cover.

We welcome the extended opportunity to comment on an issue of major importance to all those involved with phone-pay services.

## Executive Summary

1. We do not believe the assessment in the Ofcom consultation document provides an evidence base for a dramatic upward revision in the bad debt provision at this time.
2. All the evidence available shows complaints about services on 09 premium numbers are very low and have been falling for at least the last four years. Consumer research shows that those who use 09 and mobile premium-rate services do so infrequently and that the amounts spent per month are generally low. If BT has evidence of misconduct we would want them to share this with Ofcom and for it to be addressed robustly through preventative actions, code reforms or/and targeted and robust enforcement.
3. If there are no major new issues over conduct and no equivalent bad debt issues with other billing networks then the focus should be on how BT has come to its bad debt figures. The consultation document implies only an indirect association between those customers with debt and a greater or lesser propensity for these customers to use premium rate services. Ofcom has rightly said that this is a matter they intend to pursue. This should, in turn, allow an exploration of incentives Ofcom might consider to reduce bad debt. We think it would be wrong and detrimental for consumers and businesses to use questionable historic data and unclear methodologies to act now when it is not clear this action takes account of past and planned new measures to protect users – and businesses.
4. Ofcom has consulted on the scope and form of premium rate regulation. We believe the issue of a bad debt provision and the methodology for setting and reviewing the provision should be dealt with as part of this broader strategic review of regulation and consumer protection. We understand that BT wish to see matters addressed soon and we hope this exercise will proceed with urgency. In the meantime we wholly support the Ofcom proposal to explore the methodologies that have been used and that might be used in future to calculate any element of bad debt that is clearly attributable to use of premium rate services.

Those involved in this response have made major investments in the sector. With a wide range of corporate clients and duties and the responsibilities that exist for publicly quoted businesses we are committed to supporting regulation and will not defend those responsible for serious wrongdoing.

### The market and the importance of effective regulation

Ofcom published data on the UK phone-pay market in its 2009 consultation on the scope and form of regulation. While there has been some downturn in total spend, the market is still around £900m-£1billion per annum. This reflects the wide and varied range of services offered, from conventional directory enquiries to charity-giving, competitions and game-paying and mobile video services. Mobile services have grown significantly in recent years but the 09 landline market continues to account for about 30% of total activity as defined in Analysis Mason research published by PhonepayPlus and included in the PhonepayPlus 2008/9 Annual Report.

The use of landline numbers is of critical importance in some market sectors, most obviously participation television services, contact and dating services, information and competition services and “Red button” participation on the Sky platform. These services are, accordingly, a core element of the customer offering and commercial package for all leading broadcasters and publishers. These services can be costly to develop and promote and there are compliance costs related to requirements rightly set by Ofcom and PhonepayPlus to ensure consumer protection. There is a limit to the extent these costs can be passed on to consumers without affecting their willingness to use phone-payment for entertainment, information or convenience.

The characteristics of phone-paid services vary but are well captured in the Ofcom Scope Review of PRS regulation published on 15 May 2009. There is clearly a need for consumer protection to deal with services that are often distance-sold impulse buys for immediate consumption and gratification and with relatively low-cost and little contact between the provider of the services and the buyer.

The roles of revenue-sharing networks, intermediaries and billing networks are of importance. While BT is often active in the premium market offering network services on a revenue-sharing basis the company’s role in providing consumer access, billing and customer services and information is absolutely key to the health of this market and this should be recognised.

In the consultation on BT and the bad debt provision there are various references to the impact of “scams” and misconduct and the suggestion this is a major contributor to the alleged levels of bad debt. Some service categories are mentioned but details are not provided. We think it important that all relevant data is included in the assessment of BTs proposal. We think the following sources, figures and questions are of relevance:

1. Over the four years since 2005/6 the level of complaints over services using 09 landline premium numbers has fallen 85% from 10,400 in 2005/6 to 1,478 in 2008/9.
2. In 2008/9 landline services accounted for 29% of the public spend on phone-pay services but only 6% of complaints to PhonepayPlus.
3. PhonepayPlus complaint data includes complaints that may prove to be out of remit, not attributable to any breach of the Code or capable of resolution through informal procedures. Over the year 25% of 267 mobile and landline services complained about went to formal adjudication. This has to be taken into account when looking at the gross figures for complaints at bullet point 1.
4. There is valuable information in the individual PhonepayPlus adjudications and in the aggregate data. This is set out in full at Annex A. In 2009 (to end August) there had been eighteen Code Compliance Panel sittings. All but one heard mobile-related cases. Only five panels (less than one in three) heard land-line cases and only five separate cases were involved. In total there were 12 recorded complainants related to these five services – less than 3 complainants per case. The 43 mobile cases in 2009 (to end August) had 3,107 complainants: 72 per case. In 2008 there were 29 adjudication sittings. Less than half heard land-line cases and the 21 cases had 41 complainants: roughly 2 per case. The

59 mobile cases had 3,718 complainants: an average of 63 per case. The 2007 figures were broadly similar: the 43 land-line cases had 250 complainants (average – 5.8) and 49 mobile cases had 626 complainants (average 12.8). We are not suggesting the complainants represented everyone harmed by the services – but any process of “aggregating up” to take account of those with un-recorded concerns has to start from these very low base numbers and any assessment by Ofcom should take account of the continuous downward trend in land-line issues in total and as a percentage of compliance action.

5. The “web-based “number checker” run by PhonepayPlus is a further barometer of complaints across different platforms. In the 2007/8 PhonepayPlus Annual Report the regulator listed the five land-line numbers that were most frequently checked. These accounted for over 70,000 checks. None of the services listed were the subject of investigations and sanctions. By contrast we understand PhonepayPlus has told the industry that at times nineteen of the twenty most-checked mobile premium short-codes related to services under investigation or where a sanction had been imposed. This situation may have improved in terms of the overall numbers and the frequency of alleged wrongdoing with the action taken on mobile services in 2008. PhonepayPlus reported a marked fall in complaint levels in its 2008/9 Annual Report.
6. The Fathom market research commissioned by PhonepayPlus in 2007 explored the use and frequency of use of premium rate services. About 45% of those surveyed said they had used services recently. Competitions, TV show participation and information services were the services most likely to be used (see Fathoms Figure 2h at Annex B). None of the other services asked about had a more than 20% take-up. When Analysis Mason did follow up research in 2008 they found these service categories – all of which are mainstays of the landline premium market - were amongst the least likely to give consumers cause for complaint about incorrect billing (see their Figure 5.10 at Annex B). Between 7 and 12% of users had concerns as compared with 60% of users of adult video services to mobile handsets.
7. The 2007 Fathom research found that the majority of those who had used premium rate services had only done so “once or twice”, that 3% spoke of use of more than once a month and 3% said they used services more than once a week (See Figure 2.f at Annex B)
8. This was reflected in the average monthly spends reported (see figure 2.k, also at Annex B). In every age group those spending £20-30 or more than £30 accounted for less than 3% of the sample. In every group the most likely spend figures were £0-1 and £1-2. The next tier (£2-5) was at its highest in the age 45-54 group where it reached about 33%. Fathom found consumers were ready to try more services if/when they were offered things that excited and interested them. The industry is clearly keen to achieve this but the low levels of spend currently reported, the frequency of use and the overall percentage of people using services must all be of relevance to the issue of debt.

In looking to understand the significance or otherwise of the bad debt issue we think Ofcom could find it useful to look at how it has been addressed in other fora.

This should include the published minutes and Action Plans of the PhonepayPlus Industry Liaison Panel. BT has been a member of this Panel throughout, and chaired the Panel for some time. The ILP clearly and rightly looks at issues of compliance, at trends at market developments and at the effectiveness of the regulation and the regulator. In a situation where bad debt levels in double digits are being reported it appears that the issue was never put on the ILP agenda by BT or other carriers. It does not seem to be central to any of ILP work programmes listed. We can see no record of the debt issue in any of BT's responses to PhonepayPlus consultations on its Plans, budgets of compliance reforms. The ILP material, PhonepayPlus consultations and stakeholder responses are available on-line so are not annexed to this document.

The issue was not raised in the BT response to the review of Live Voice Services. These services were the cause of major problems about fifteen years ago when BT played a critical role in supporting the creation of a regime with bonds and a compensation fund. These were not set up primarily to deal with non compliant services but to deal with the risk of unauthorised or excessive use of services and the risk that a service provider would be unable or unwilling to deal with claims for refunds. It is, therefore, of particular relevance.

In 2008 PhonepayPlus consulted on the case for winding up some or all of these service-specific arrangements on the basis that the compensation fund, in particular, had never needed to consider and pay on a case. The most relevant extract from the BT response is set out below:

***Q1 – What evidence are you able to share to support our data and intelligence about the growth in the number of mobile phone calls to live entertainment services?***

***BT's current experience of complaint volumes is in line with the information shown within section 3 of the consultation. BT does not experience high volumes of unauthorised usage complaints. That said there is probably quite an unknown impact on business communications where employees may use their workplace communications and the charges are "lost" in the overall business bill.***

***Again referring to PPP information the number and value of claims compared to the size of the overall market is negligible and does not warrant a scheme which is overly costly to Service Providers or overly costly to manage in itself.***

***BT does not favour option 1. The scheme is outdated and needs to reflect the current state of industry and consumer risk, whilst restricting opportunity for that risk to be increased.***

We do not suggest the BT response implies any indifference to issues of excessive or unauthorised use. The views expressed by BT were consistent with other responses to the PhonepayPlus consultation. But given that these were the services that had been most likely historically to generate billing and debt issues we think the degree of comfort in the BT response is relevant – as is the absence of reference to high levels of customer debt.

Other potential sources of data on a worrying trend in debt include cases considered by Otelo and the general position at ombudsman services in relation to content services. The position taken by billing networks was “live” in 2004 when internet dialer misconduct and unauthorised and/or apparent excessive use had to be investigated. These were very serious consumer issues at the time and the volume of complaints and the levels of some individual bills was understandably a matter of concern for BT and other carriers. We understand a number of cases were considered by the ombudsman and that this was necessary because carriers were generally insistent that bills with premium rate dialer costs were paid on the basis that dial-ups had happened and related payments made. Otelo rulings generally were limited to issues relating to the conduct of the billing network in terms of the adequacy of their customer services; not the behaviour of the “service” provider.

Ofcom may wish to review the most recent Otelo reports and the extent to which premium call related debt has or has not been highlighted as an issue. We do not believe this to have been the case in any recent year. We think any such assessment of issues at the ombudsman should extend to billing and bad debt more generally as we have concerns these are being “bundled” with alleged issues over use of phone-pay services.

The other “market” conduct issues in the consultation document related to participation television. We assume this to be reference to the issues of deception and bad practice discovered and confessed to in 2007. We understand that the broadcasters most directly involved volunteered to make refunds to everyone effected by the misbehaviour. The cost of voting calls to the services in question was in the 35p-£1.00 range. Notwithstanding the limited losses at an individual level we understand extensive arrangements were put in place to meet every legitimate claim.

While the cumulative financial impact of the breaches of Ofcom and PhonepayPlus rules was considerable we know of no reports from carriers of issues of customer accounts lost or serious bad debts incurred as a result of calls at the individual consumer level. If issues relating to participation television are being raised in support of a case for a revision in the bad debt provision we would look to Ofcom to collect and assess the data specific to the claim and look at the broadcaster responses...

Finally, there is reference in the consultation to the arrangements that exist in relation to Artificial Inflation of Traffic. Historically it is fair to suggest that most of the activity in this field has related to the risk of inter-connect arbitrage and possible “business-on-business” fraud. We would expect any consumer-related premium market AIT action to be documented and that this information should be available to Ofcom.

### The regulatory evolution

There is clearly a link between the regulatory actions taken and the developments in the market. At the heart of the improvements in compliance seen – and the fall in complaint levels for land-line premium services - are the Ofcom review of 2004 and the subsequent action taken by Ofcom and ICSTIS/PhonepayPlus. This included, most significantly:

- Service specific licensing, bonding and other rules that brought an end to misconduct in the dialler/web-payment market

- New rules and responsibilities on networks to carry out due diligence – and direct financial and other consequences for networks if they fail in this duty
- Rules to regularise the arrangements for out-payments to content/service providers – the 30-day rule
- A regulatory approach that was more able to deal with content provider as well as agents, aggregators and other intermediaries
- Action to define and set meaningful conditions on those who might be considered networks in relation to premium numbers
- The continued use of redress as a valuable sanction – and action to codify when and how this might be invoked and achieved
- An increase in the regulators power to fine – to £250,000.
- Voluntary action by billing and revenue-sharing networks to share information and act together when risks appear

The regulators ability to deal with refunds is of obvious relevance. So too was the proposal for better inter-industry dialogue to spot and prevent problems. Arguably the general effectiveness of the actions taken has reduced the impetus for this dialogue. It would be helpful for content providers to hear what use was made of these arrangements in relation to “scams” that were resulting in 10+% premium-specific bad debts.

In addition Ofcom and PhonepayPlus had taken industry-wide steps and sector specific action to protect the market and all in it. These include:

- Action specific to the new niche all-night TV competition channels. This covered pricing, methodology and the “odds” of a call going live to studio
- Ofcom licence condition on broadcasters and PhonepayPlus prior permission arrangements on content service providers to ensure proper processes in mainstream participation television
- The creation of the Code Compliance Panel and publication of a sanctions policy and the PhonepayPlus approach and expectations in relation to refunds

#### The methodologies used and the link between bad debt and use of phone-pay services on 09 premium rate numbers

In the consultation document Ofcom identified uncertainties over the methodology used to estimate the BT bad debt attributable to premium rate calls. Without access to the data and an explanation of the methodology it is difficult to comment in very specific terms. In the apparent absence, however, of serious wrongdoing in the market over

recent years and with in-remit complaints related to adjudications at an all time low there is a pressing need to address the data and methodologies before any changes are made in bad debt arrangements.

Ofcom has invited comment from other carriers. This is helpful, although the absence of any common methodology will be a problem too in considering any replies received and their “consistency”.

The consultation document suggests a connection between bad debt in overall billing terms and the propensity of bill-payers to use premium rate or other NTS-based services. In the absence of data we cannot comment on whether this is fair.

2007 research by Fathom commissioned by PhonepayPlus examined the use of phone-pay services by service category, by age and by social group. The size of the sample base (4,000) may or may not also allow some analysis by geographic region. The full details are available to Ofcom but the following extract may be of particular relevance:

***According to the consumer research commissioned for this study, 45% of users of phone-paid services are using premium voice to access services. Younger age groups are less likely to use premium voice – 37% or less of those under 34 use it, while 44% or more of those over 35 do so (see fig. 2.c). There is also variation between social classes. Forty-eight percent of the AB segment use voice, but only 41% in the DE segment. Fathom Consulting***

The market review was repeated by PhonepayPlus in 2008 with Analysis Mason and the following extracts appear to re-confirm the earlier assessment:

***There are also differences according to socio-economic status, with the social group AB (managerial and professional) being most likely to have used a phone-paid service in the past six months, while those in social groups D and E (unskilled occupations and unemployed) are least likely to have used these services.***

***There are few regional differences in the use of phone-paid services in terms of overall usage, although a marginally higher percentage of respondents from London have used phone-paid services in the last six month. Analysis Mason***

A look at the services of most interest to the age groups most likely to use mobile or fixed line telephony seems to confirm that older users who are marginally more likely to be in “higher” socio-economic groups are more likely to use television, competition, contact/dating and other services that are thought less likely to mislead on pricing or other grounds – see the related research referenced above and at Annex B.

With 45% of people surveyed having used premium numbers in the survey period it is obvious that the services have been used by people in every socio-economic group. This is welcome from an industry perspective. Insofar as the “spread” of use varies across socio-economic groups the rate of variance does not appear significant in terms of land-line numbers. If “spread” is of policy interest in terms of consumer protection the

community of most concern appears to be the millions under 16 with mobile handsets and premium “credit”. This is reflected in PPP action over recent years.

Given this information we think care is needed in considering the suggestion that those most likely to default on a BT debt are significantly more likely to be users of phone-pay services – and that this use is a driving factor in the default. All businesses have customers who default. All businesses have ways of managing this risk. In telecoms this can include traffic monitoring and intervention, limited credit/access offerings and frequent/ monthly billing (which are the norm apart from BT).

The fact that impact of that BT is apparently alone in applying 90 day credit terms must be part of any consideration. We know there are mechanisms for checking bills online and for introducing other safeguards. What is for Ofcom to assess is the levels of customer awareness and take-up and whether this understanding extends to the community of debtors BT is saying it has to address because of their use of 09 services.

These are broad billing, customer service and debt management issues that go beyond PRS numbers. But it is clearly possible that BT does have some customers who have lost control of use of premium services and that this has led to serious bill shock and defaults. The controls and rules in place and the evidence of usage patterns and spend levels suggests such situations are exceptional. If so we believe they should be treated as such.

Our concern is that there is an inappropriate, incorrect and damaging link being made between some who are defaulting on bills and their possibly limited (i.e. average level) use of code-compliant phone-pay services. The fact a fully code-compliant phone-pay service has been used cannot be the basis for attributing a bad debt for all telephony services to this “premium rate activity”. A mechanism that allows this creates no incentives for the carrier to address its general approach to debt, to billing information and various forms of credit management. Increasing the existing bad debt provision by more than 300% and passing this on to content providers may seem a cost free solution. It is not.

#### The commercial impact of a bad debt provision of 9.7%

We have recognised BT’s legitimate right to cover the costs associated with providing access to premium paid services but explained why we have doubts over the evidence base to substantiate a 300% increase in the bad debt provision.

We do not believe this increase is justified. If implemented now and on the scale proposed we believe the change would have profound negative impacts:

Much of the telecommunications-based activity around phone-pay services is highly competitive and low margin. Some network services are highly commoditised and the “revenue” taken by the “revenue-share networks” is generally less than 10% of the cost of the call. The arrangement proposed would put a higher share of the total call cost with the originating network than the network responsible for providing the technical support, monitoring, due diligence, reporting and other responsibilities set on it under the PhonepayPlus Code of Practice. At a time when we are seeing the benefits of effective

regulation and good practice we risk reducing the capabilities of networks whose role is critical.

The same is definitely true of bureau and agency businesses. These businesses provide the specialist services that are essential if publishers, broadcasters, charities, rights-owners and others are properly to provision services to ensure they meet customer expectations. Much of this work is provided on agency fee basis. Very significant change in the bad debt provision and, therefore, the out-payments that can be made by terminating networks is bound to impact on bureau and agency businesses wherever their business customers feel able to cut payments to protect their own position.

It is certain, however, that the vast majority of the increase proposed would have to be passed on to the content/service/information provider. In considering the impact of this Ofcom will want to understand the gross margins currently generated by a range of services and the likely response of the service providers involved. At its most simple a 6+% decrease in net revenue will make profitable business marginal and will make marginal business unprofitable. This could be the case with long-established services in print, radio and television.

Ofcom needs to consider very carefully the actual regulatory impact of this course of action. As described it does not simply move about 6% of the costs across the value-chain to BT as an originating network. This sort of move in payments might, for purposes of discussion, prompt decisions that might end 10, 20 or 50% of activity.

Setting aside the many questions as to the evidence –base and appropriateness of the action, we believe Ofcom should take account of the fact the implementation of decisions will take place during a period of recession and rising unemployment.

We are also worried that the action proposed would result in “negative migration”. Those whose businesses are dependent on using their skills and technical capacity for phone-pay services face losing their blue-chip and responsible customers and could end up looking at proposals from far less responsible parties. The new total cost of bad debt and communication charges may only be sustainable by those with services of a far higher “profitability” margin. The worrying reality is that these margins may only be available to some through negative actions – to obscure pricing and total cost, to cut corners with service standards and delivery and to mislead customers as to the nature of the deal. If so an increase in bad debt provision could be self-defeating.

These are all things Ofcom, PhonepayPlus, BT and the industry at large have been addressing with apparent success for 3-4 years. They are issues at the heart of the Ofcom review of scope and plans for the PhonepayPlus Code 12 and future regulation. We worry that an inaccurate and excessive bad debt provision would drive all the wrong behaviours, creating the very problem we say we are seeking to address.

We believe the action could further distort consumer choices based on the power applied by fixed and mobile networks. The serious issues relating to price transparency are set out fully in the Ofcom review of the scope of premium rate services. The issue of competition between fixed and mobile platforms is complex. So too is the question whether carriers on each have effective monopoly control on access and pricing is a complex one. The bad debt action could exacerbate this issue.

### The relevance of the Scope review

We have referred to the current review of scope of premium rate regulation. We argue that any issues over consumer debt attributed to these services must be addressed as part of the overall package. If the debt exists and can be attributed to misconduct or inadequate customer service at the service provider level the solution must lie in reforms of the regulation, in consumer literacy and in raising industry standards. It is not enough to allow debt to rack-up and constantly hike the originating networks “insurance premium”.

For the reasons set out we question the level of debt attributable to misconduct, or even to excessive unpaid use of the services on offer. We totally agree, however, that this issue has to be addressed if we are to have a healthy market in which BT and others can be clear and confident as to where they stand. Ofcom has identified key issues over the value chains and over the need for customer service and appropriate arrangements for refunds when things go wrong with premium-paid services.

### Conclusion

We understand that BT wish to review and raise any debt issues that are not addressed by existing arrangements. We think it is essential that this is done as part of the broader and current review of premium services regulation. Any such exercise should draw fully on the evidence base available and the methodologies involved should be available to all and need to command general trust. A review on this basis should bring out options for action – and an appreciation of the consequences of these actions - that Ofcom and others can consider with high levels of assurance.

*George M Kidd*

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On behalf of Telecom Express Ltd and Dm plc.