



Tanya Rofani
Competition Policy Advisor
Ofcom
Riverside House
2a Southwark Bridge Road
London
SE1 9HA

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Dear Tanya,

CW 963: Dispute from BT against various operators about 0870 termination rates

1 Introduction

This is FleXtel's response to Ofcom's consultation on the second draft determination of CW963 dated 23rd April, 2009 (the Determination)¹.

We note that Ofcom has simultaneously issued its "0870 Statement" (the Statement)², based on this draft Determination. Thus Ofcom has determined the outcome of the new 0870 regime prior to receiving all the responses to the Determination. It follows that Ofcom's cost-benefit analysis cannot have considered any input that might vary the dispute determination or any information on unintended consequences that the proposed charges might have. Dependent on responses to this determination, it follows that Ofcom's Cost-Benefit analysis (CBA) for the Statement may be flawed.

We note that the Statement relies on the Determination [Statement: 1.24] and the Determination relies on the Statement in order to justify biasing the proposed rates in favour of BT. [Determination: 1.14 & 1.15]

We find the cyclical arguments deeply troubling and unsound, since the Statement requires the Determination to deliver reasonable rates [Statement: 1.24] and the Determination relies on the validity of Statement policy to justify adjusting those rates in favour of BT. [Determination: 1.14 & 1.15]

In this response, FleXtel demonstrates that Ofcom is committing a gross error in its CBA, by ignoring strong evidence regarding mobile 0800 price inelasticity and instead basing its core policy on luck ("good chance"). [Statement: 1.23 & 3.91, 3.107, A2.114, A2.180, A3.25, A3.48, A5.15, A5.16]

Furthermore to support its flawed policy, Ofcom is attempting to impose below cost rates on FleXtel and other TCPs to the detriment of 0870 consumers. Ofcom's method of forcing through its policy in this manner appears to be driven by the need to avoid another embarrassing U-turn by Ofcom (as per 070) and/or simply to favour BT's pre-emptive adjustment of its tariffs [Statement: 1.24 & 3.22, 3.19, 3.107, A2.114, A2.180, A3.42]. If this were the case, this would imply malfeasance (possibly at a very senior level) within Ofcom.

¹ Draft Determination: <http://www.ofcom.org.uk/consult/condocs/resolve0870calls/>

² 0870 Statement: <http://www.ofcom.org.uk/consult/condocs/0870calls/0870statement/>

We note that BT made its retail changes at its own commercial risk. Should then Ofcom factor such rate changes into its considerations? If it does so, then surely Ofcom is in danger of becoming complicit in encouraging BT to abuse its significant market power.

Furthermore FleXtel is not a charity and so cannot be expected to operate 0870-service at a loss. If the draft rates are upheld, FleXtel will have no choice but to close down its 0870 service on 1st August. As a result of Ofcom's extremely short timescales for final implementation, FleXtel has had no choice, but to write to all its customers with respect to this risk, giving them only three months notice of Ofcom's enforced number change.

Despite being repeatedly warned by industry, since 2005, of this unintended consequence, we can find no evidence that Ofcom has considered service closure in its Statement or CBA. This is a further error by Ofcom. Perhaps Ofcom assumed this was just an idle threat by FleXtel and others. We can only hope that Ofcom will factor this significant impact into the final rates for the Determination and adjust the "balance" accordingly. [Determination: 1.12, 1.16, 1.19, 3.24]

We are also deeply concerned that such 0870-service closures will have significant health and safety implications, given the very short notice Ofcom has permitted stakeholders in its Statement. In this case we can only declare force majeure by Ofcom upon FleXtel. We must assume that Ofcom will make the appropriate HSE Risk Assessment, required by law, in such enforced changes to life critical systems, since it is now wholly outside of FleXtel's control.

2 The Determination

We note that Ofcom provisionally concludes that BT offered termination charges [rates] were unreasonable and that FleXtel was justified in rejecting BT's rates. [Determination: 1.13].

We note that Ofcom accepts BT view that Ofcom's changes to 0870 justify changes to termination charges that they pay to TCPs. [Determination: 1.12] *FleXtel agrees with this view. However, the Determination shows that the only feasible rates for OCPs complying with Ofcom's "policy for 0870" are below cost for TCPs. So at last, Ofcom has proved that Ofcom's own 0870 changes have never been commercially viable. Large multi-play CP may be able to brush the problem under the carpet by cross-subsidising 0870. However, it is especially difficult for the many TCPs, who specialise in 0870. For such TCPs without the multi-play cross-subsidy benefits, the only viable outcome must be 0870-service closure. 0870-service closure carries with it all the risks associated with PCA in terms of health and safety. Ofcom has not adequately assessed the impact of such closure in its Determination or its Statement.*

We note that BT does not believe that the termination charge is the only source of revenue for TCPs for 0870, and considers that charges made by TCPs to their NTS SP customers could reflect the degree of costs associated with 0870 termination. [Determination: 4.19]

This assumption is wrong, since it only applies to high and medium volume 0870 numbers. BT, and therefore Ofcom, continue to remain blind to the infeasibility of deploying a cost-effective single-play retail billing and collection system for very low volume 0870 numbers e.g. for SoHo, small business and SME users; for alarm systems etc. Therefore the rates proposed by this intervention expect such collection and thereby unintentionally targets an economically important set of 0870 Consumers that FleXtel serves and the Ofcom studiously ignores. This ignorance by Ofcom may be due to it listening to big TCPs, such as BT, who are not necessarily knowledgeable

in the very low volume 0870 market. The 0870 micropayments system is a highly efficient and elegant solution to the low volume revenue collection risk problem.

We note that Ofcom provisionally conclude that that some TCP charges are too high to be reasonable, **given Ofcom's proposals to re-establish the links between retail charges for 0870 calls and those for geographic calls**. [Determination: 1.14] *What then does Ofcom mean by the text in shown in red? Surely, it means that such charges would be reasonable, in the absence of Ofcom's proposals.*

Therefore, if Ofcom's Statement proposals were varied, e.g. as result of a revised cost-benefit analysis considering 0870-service closure, it might be possible for this dispute to be determined more in favour of TCPs. Indeed, this paragraph confirms that Ofcom has biased the balance of the outcome, in favour of OCPs, in order to make Ofcom's shaky 0870 proposals work.

3 The Statement

Since Ofcom admits that the rates determined by this dispute depend on Ofcom's policy as set out in the Statement it is right and proper for the integrity of the Statement to be examined here.

We note that Ofcom admits "the termination rates proposed in our draft determination of the 0870 Dispute have been set at a level to enable BT and others to continue with this pricing strategy [BT 0870 bundling]. [Statement: 1.24 & 3.22, 3.19, 3.107, A2.114, A2.180, A3.42].

We note that Ofcom admits that its delivery of improved Price Transparency for 0870 is based on its view that "there is a **good chance** that the reduction in termination payments resulting from our proposals will lead to a significant proportion of 0870 calls to be charged at geographic rates". [Statement: 1.23 & 3.91, 3.107, A2.114, A2.180, A3.25, A3.48, A5.15, A5.16]

Ofcom also admits "that the objective of improving pricing clarity for 0870 call would be compromised if OCPs en masse were to reject including these calls in their price plans." [Statement: 3.91]

FleXtel agrees with Ofcom's assessment of the risk to its policy objective. However we ask Ofcom, on what evidence is the cited "**good chance**" based? We believe it is not consistent with the available evidence. This evidence was supplied to Ofcom in FleXtel's letter to Neil Buckley on the 16th November, 2008.

In this letter we asked Ofcom to consider the price inelasticity of mobile originated 0800 calls, as a key test and indicator for the probability of success for Ofcom's core policy objective of mobile OCPs bundling 0870 calls.

To reiterate the analysis then consider that:-

- 1) 0800 calls have a significantly lower termination rate than the 0870 calls draft rates proposed by Ofcom.
- 2) Note that BT and most fixed OCPs have charged 0800 calls below geographic rates (free) for over 20 years.
- 3) Note that Vodafone and CellNet (now O2) charged 0800 at significantly higher than geographic rates, for over 20 years.
- 4) Note that Orange and One2One (now T-mobile), originally offered 0800 at the same level as BT, but very soon after launch, acknowledging a commercial error, they revised 0800

tariffs to align with all other mobile OCPs. Today Mobile OCPs typically charge 0800 significantly above geographic rates. (FleXtel has previously supplied Ofcom with prima facie evidence to support this).

This proves that unless Ofcom has significant evidence to the contrary, Ofcom's "good chance" of all major OCPs bundling 0870 becomes "no chance".

Ofcom has not considered this critical evidence in either its Statement or this Determination. In the Determination Ofcom misunderstood the basis for our input. Here FleXtel was questioning Ofcom's basis for 0870 policy, as well as model benchmarking. [Determination: 6.155, 6.156]

This evidence proves that the benefit to consumers is much reduced and therefore Ofcom's CBA is grossly in error, since it has ignored over twenty years of evidence that mobile 08 pricing remains highly inelastic. The result is that Ofcom's core policy objective is likely not to be delivered and the intervention may not be objectively justifiable.

The impact of this "revelation" will be that rather than improve price transparency Ofcom will in fact further confuse consumers, by permitting the term "national rate" to continue to be used and be published in papers, magazines and TV, thereby misleading many mobile users. In fact Ofcom's 0870 intervention will make matters worse.

Furthermore, all 087, except for 0870, will be designated "Premium Rate" on 1st August. So Ofcom's 0870-transparency policy is in tatters and it also makes a shambles out of Ofcom's numbering policy:

- 01 – Geographic
- 02 – Geographic
- 03 – Geographic rate (NTS)
- 0870 – Geographic rate ("good chance" national rate - except from mobiles)
- 04 – unused
- 05 – legacy services
- 06 – unused
- 07 – Mobility services (typically higher rates) e.g. Personal, Fax and Mobile.
- 080x – Freephone (except from mobiles)
- 0844 – 5p (typically, except from mobiles)
- 087 (except 0870) – 10p Premium Rate (typically, 10p except from mobiles) -
- 09 – Premium rate

Therefore this failure to deliver price transparency fatally weakens the CBA, since it reduces the benefit of the intervention and thereby impacts the reasonableness of Ofcom's proposed rates in favour of the TCP and the Consumer of 0870 termination. [Determination: 6.68, 6.99]

4 The Impact on FleXtel's Business and its Customers

FleXtel notes the offered charges and wishes to reconfirm that they are clearly well below its cost of the service.

This means that the established micropayment model for 0870 is no longer sustainable. Therefore all TCPs must add an additional billing and collection process, for each and every 0870 call, to recover their costs.

This additional process imposes significant additional costs on smaller TCPs, who typically do not have the benefit of a multi-service billing platforms and retail collection processes e.g. the multi-play offering of BT, Sky and Talk-Talk³. Furthermore for those specialists, who operate solely in the micropayment space, using only the highly efficient wholesale bulk-minute monthly billing process (between carriers), such retail billing and collection processes do not exist.

This is likely to be true for all TCPs confined to the normal micropayments model i.e. single play low volume TCPs with or without a retail-billing platform. BT assertion to the contrary in the Determination is wrong, since it only applies to high and medium volume 0870 numbers. [Determination: 4.19]

Ofcom, in a letter to Gareth Davies, had already been informed that it is not commercially viable to bill for low volume 0870 call termination. This was rejected out of hand, in his reply.

However, FleXtel would have to establish a retail billing system, plus retail collection processes for very small amounts. FleXtel 0870 consumers are mostly small businesses and SoHos that present a flexible number, for a very wide range of applications, some highly complex e.g. alarm and emergency cover use. The common factor in these myriad applications is that call volumes are extremely low. It is obvious to us that retail collection for such low call volumes is neither efficient nor is the commercial risk justified. The micropayments system via 0870 termination rates is ideally suited for this purpose. Therefore the only viable source of cost recovery is via bulk collection using the 0870 termination rate.

FleXtel does not see any merit in taking the commercial risk to deploy a billing system solely for the 0870 market. If the 0870 intervention proceeds with these rates, our view is that Ofcom will have killed the 0870 service and that further investment in this niche market cannot be justified. FleXtel would therefore have no choice but to close its 0870 service and migrate its customer base to other viable micropayment solutions such as 0871, 0872, 0873 or 0844.

5 In Conclusion

We see no evidence that Ofcom has adequately considered the costs and business model for TCPs serving low volume users such as small business, but has been heavily influenced by BT. Therefore, under the Freedom of Information Act (FOIA), we request Ofcom supply FleXtel with the data that clearly demonstrates that Ofcom has modelled the cost of billing and collection for single play specialist TCPs, for **low call volume scenarios**.

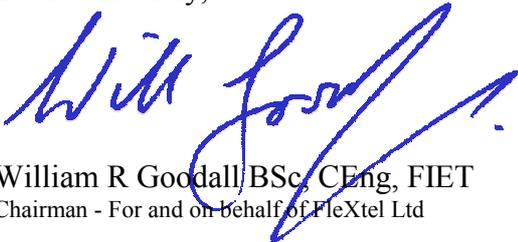
We feel Ofcom has left it to chance that 0870 will be bundled within OCP packages. This is a critical issue, underpinning its core policy objective of delivering price transparency. We have cited evidence that indicates a good chance of abject failure in this area. Under the FOIA, we formally request that Ofcom supply the evidence for which its view of a “good chance of bundling” is founded. [Statement 1.23]

Despite FleXtel and others warning of the risk, we are concerned that Ofcom has not considered the impact of 0870-service closure on consumers of both 0870 origination and termination. Under

³ Four-Play: <http://news.bbc.co.uk/2/hi/technology/4896104.stm>

the FOIA, we formally request that Ofcom supply the evidence for how it has considered this in its CBA. Under the FOIA, we also formally request that Ofcom supply evidence for how it has made a formal Risk Assessment, of the Health and Safety implications, in the event of it forcing service closure.

Yours Sincerely,



William R Goodall BSc, CEng, FIET
Chairman - For and on behalf of FleXtel Ltd

Footnote

Removing BT's commercial desire for 0870 destruction out of the frame for a moment, it should be pretty obvious to all, that given Ofcom's decision to make 087 premium rate, it would make a deal of sense, to move 0870 under the same regime. A "deal of sense", also means the measure is:

- **Targeted:**
*It would protect Consumers. Since PPP could fine anyone who mislead by promoting 0870 as National. BERR's Unfair Trading Regulations also come into play where some users might be considered outside PPP jurisdiction.
It would address the very significant mobile overcharging issue.*
- **Proportionate:**
*It solves the 0870 problem as documented by Ofcom, without creating a dangerous disconnect in an established business model.
It would permit TCPs to continue with service, as termination rates would be set high enough to continue to support service, without the threat of enforced closure.*
- **Objectively Justifiable:**
*It protects the interests of both originating and terminating consumers of 0870 service in a balanced manner.
It simplifies the numbering plan, since 087 would all operate under the same regime.*