



NCC super-complaint

Response to super-complaint on the cost of calls
made by prisoners

This is the non-confidential version.
Confidential information and data have
been redacted. Redactions are
indicated by [X]

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Section 1

Executive summary

- 1.1 On 24 June 2008, the National Consumer Council (the NCC) submitted a super-complaint to Ofcom about the price of telephone calls made by prisoners in England, Wales and Scotland. The complaint was submitted to us on behalf of the NCC, the Scottish Consumer Council and the Welsh Consumer Council, with the support and assistance of the Prison Reform Trust.
- 1.2 In its super-complaint, the NCC states that it believes that the interests of consumers are significantly harmed by aspects of the market for telephone services from prisons and requests that we refer the market to the Competition Commission (the CC) for a full market investigation. The key concerns raised by the NCC, which we have considered in the course of our investigation, are:
- “the high cost of calls from prisons and the extent to which these appear unrelated to the cost of provision;
 - the continuing high level of charges during a time when most other basic telephone services, and other ICT-related products and services, have fallen significantly in price;
 - the fact that the terms and conditions of the existing service explicitly seek to prevent competition; and
 - the extent to which these issues are caused and exacerbated by the unsatisfactory and secretive nature of the contract and, the apparent arbitrariness of decisions since it came into effect, to the disadvantage of consumers.”¹
- 1.3 During our investigation we have obtained further evidence from the NCC as well as collecting evidence from the relevant government bodies, the providers of these services, and a range of other organisations that have an involvement or interest in these services.
- 1.4 Ofcom is required, within 90 days after the day on which we receive a super-complaint, to publish a response stating whether or not we have decided to take any action in respect of the super-complaint and what action, if any, we propose to take. The response must state the reasons for our proposal. This document represents our response to the NCC's super-complaint about the cost of making telephone calls from prisons.
- 1.5 Aspects of the evidence on how these services operate and the contractual arrangements is confidential, and where we have redacted information from our report this has been indicated in the text marked with a [§<] with a summary where appropriate for clarity.
- 1.6 It is important to note that our investigation has focused on whether there may be a case for further investigation or action by us or another appropriate body.

¹ NCC super-complaint, available at:
http://www.ncc.org.uk/nccpdf/poldocs/NCC207_prisoner_phoncalls_supercomplaint.pdf

Recommendation

- 1.7 Our assessment of the available evidence during the course of our 90 day investigation suggests that there are a number of issues in the current arrangements for the provision of telephone calls to prisoners in England, Wales and Scotland that may merit further action.
- 1.8 We have focused on the arrangements between BT and HMPS in England and Wales and the SPS and Siemens in Scotland for the provision of telephone services in prisons.
- 1.9 In reviewing the prices charged for calls made from prisons, we have considered a number of possible comparators. The evidence we have reviewed indicates that the price of telephone calls made by prisoners appears to be high in particular relative to some measure of costs or compared with the price of prisoner telephone calls in some Serco Home Affairs (Serco) managed private prisons. Our analysis shows that in HM Prison Service (HMPS) and the Scottish Prison Service (SPS) managed prisons, the average price of a call to a UK telephone number is 60 pence. If the same pattern of calls were made using the rates applied in most Serco-managed prisons the average price would be between 48 and 51 pence.
- 1.10 We note that in HMPS prisons in England and Wales, British Telecommunications plc (BT), the provider of the service, appears to have earned a relatively high return on its investment in the Pinphone system; HMPS also receives a 7% commission on the calls made by prisoners. However, we note that this commission is used towards other services to all prisoners either by crediting it to a general prisoner welfare fund, or by offsetting costs of distribution through the prison shop where that is contracted out.
- 1.11 In Scotland, Siemens Enterprise Communications Ltd (Siemens) appears to have made lower returns than BT, but the SPS receives a higher level of commission (up to 25%) on the calls made by prisoners; this is in addition to a rebate and decommissioning fee of £250k over the minimum term of the contract. We understand that the commission received by the SPS has been used to offset costs the SPS incurs in operating the system.
- 1.12 The current contracts are nearing the end of their respective contract periods.² HMPS and the SPS (together, the Prison Services) have comprehensive procurement programmes which we understand continue to be adapted to reflect best practice in procurement and any changes in procurement legislation since the original contracts were negotiated. In particular, we understand that since the original contracts were agreed, the National Audit Office (NAO) has carried out two reports into the procurement of goods and services by HMPS. The NAO's most recent report, published on 23 July 2008, concluded that:
- “[HMPS] has made major progress in achieving better value for money in procurement since we last reported in 2003. Through substantial recruitment and training of qualified staff, investment in supporting information technology and adopting centrally controlled

² The HMPS contract expires on 1 June 2011 and the SPS contract expires on 31 March 2010.

contracting [HMPS] has realised steadily increasing and significant savings".³

- 1.13 We welcome these advances and would expect that best practice will continue to be built upon in the next tendering round for telephone services from prisons. The Ministry of Justice (the MOJ) has informed us that it has already begun a project to determine how best to run the next tendering process for these services, to ensure value for money and a more competitive outcome for prisoners. We have set out in paragraph 5.14 below some suggestions the Prison Services may wish to consider in the next tender process.
- 1.14 We understand that in England and Wales, HMPS has also already agreed to implement a recommendation from the Prisons and Probation Ombudsman (the Ombudsman) to conduct impact assessments of the effect of bidders' proposals on prisoners' welfare. The SPS does not fall within the jurisdiction of the Ombudsman and therefore was not included within the Ombudsman's review. However, the SPS may also wish to consider whether to conduct an impact assessment of the effects of call charges on prisoner welfare as part of the next tendering process.
- 1.15 Notwithstanding the action already being carried out by the MOJ and the SPS to ensure that the next contracts are procured in an effective manner, we invite the MOJ and the SPS to consider whether it would be appropriate to open negotiations with BT and Siemens to reduce the price of calls under the current contracts.
- 1.16 Renegotiation may have implications for the prices charged by the service providers and/or the commission structure received by the SPS/MOJ which we have not considered in detail in this investigation. We recognise that there are wider public policy and security issues involved which may need to be taken into account in any renegotiation or re-structuring of the current contracts.
- 1.17 We consider that an early renegotiation of the current contracts and the continued adherence to best practice for the procurement of any new contracts should address the concerns raised by the NCC in its super-complaint. We consider that renegotiation, if successful, would provide a timely and effective remedy to these concerns.
- 1.18 If renegotiation of the contracts is not successful in achieving improvements to the current market for calls for prisoners, then we may reconsider this matter. However, at this stage we consider that it would be premature to refer this market to the CC under the Enterprise Act 2002 (the Enterprise Act) prior to allowing the MOJ and the SPS an opportunity to take further action.⁴

³ NAO Report - *The Procurement of Goods and Services by HM Prison Service* dated 23 July 2008, available at: http://www.nao.org.uk/publications/nao_reports/07-08/0708943.pdf

⁴ We note that if we were to refer this market to the CC at this point we would first need to consult on the proposed reference. The CC's investigation and report would then take a period of up to two years from the date of reference by Ofcom.

Section 2

Introduction

The complaint

- 2.1 On 24 June 2008 the NCC submitted a super-complaint to Ofcom about the price of telephone calls made by prisoners in England, Wales and Scotland. The complaint was submitted to us on behalf of the NCC, the Scottish Consumer Council and the Welsh Consumer Council, with the support and assistance of the Prison Reform Trust.
- 2.2 The right to submit super-complaints was created by section 11 of the Enterprise Act. A super-complaint is defined under section 11(1) as a complaint submitted by a designated consumer body that, "any feature, or combination of features, of a market in the UK for goods or services is or appears to be significantly harming the interests of consumers". The NCC is a designated consumer body.
- 2.3 Section 11(2) requires that, within 90 days after the day on which we receive a super-complaint, we must publish a response stating whether or not we have decided to take any action in respect of the super-complaint and what action, if any, we propose to take. Under section 11(3) of the Enterprise Act, the response must state the reasons for our proposal. This document represents our response to the NCC's super-complaint about the cost of making telephone calls from prisons.
- 2.4 In its super-complaint, the NCC states that it believes that the interests of consumers are significantly harmed by aspects of the market for telephone services from prisons and requests that we investigate the current market for telephone services in prisons. The key concerns that were raised by the NCC are:
- "the high cost of calls from prisons and the extent to which these appear unrelated to the cost of provision;
 - the continuing high level of charges during a time when most other basic telephone services, and other ICT-related products and services, have fallen significantly in price;
 - the fact that the terms and conditions of the existing service explicitly seek to prevent competition; and
 - the extent to which these issues are caused and exacerbated by the unsatisfactory and secretive nature of the contract and, the apparent arbitrariness of decisions since it came into effect, to the disadvantage of consumers."⁵
- 2.5 The NCC's super-complaint is focused solely on features of the prison calls market which the NCC considers are causing detriment to consumers of those services. However, it also acknowledges the wider public policy implications of this issue. The NCC has provided us with research which it considers shows that prisoners are less likely to re-offend if they have been able to stay in touch with their families while in prison. The NCC therefore argues that it is in the public interest to encourage rather than discourage telephone calls to family members.

⁵ http://www.ncc.org.uk/nccpdf/poldocs/NCC207_prisoner_phonecalls_supercomplaint.pdf.

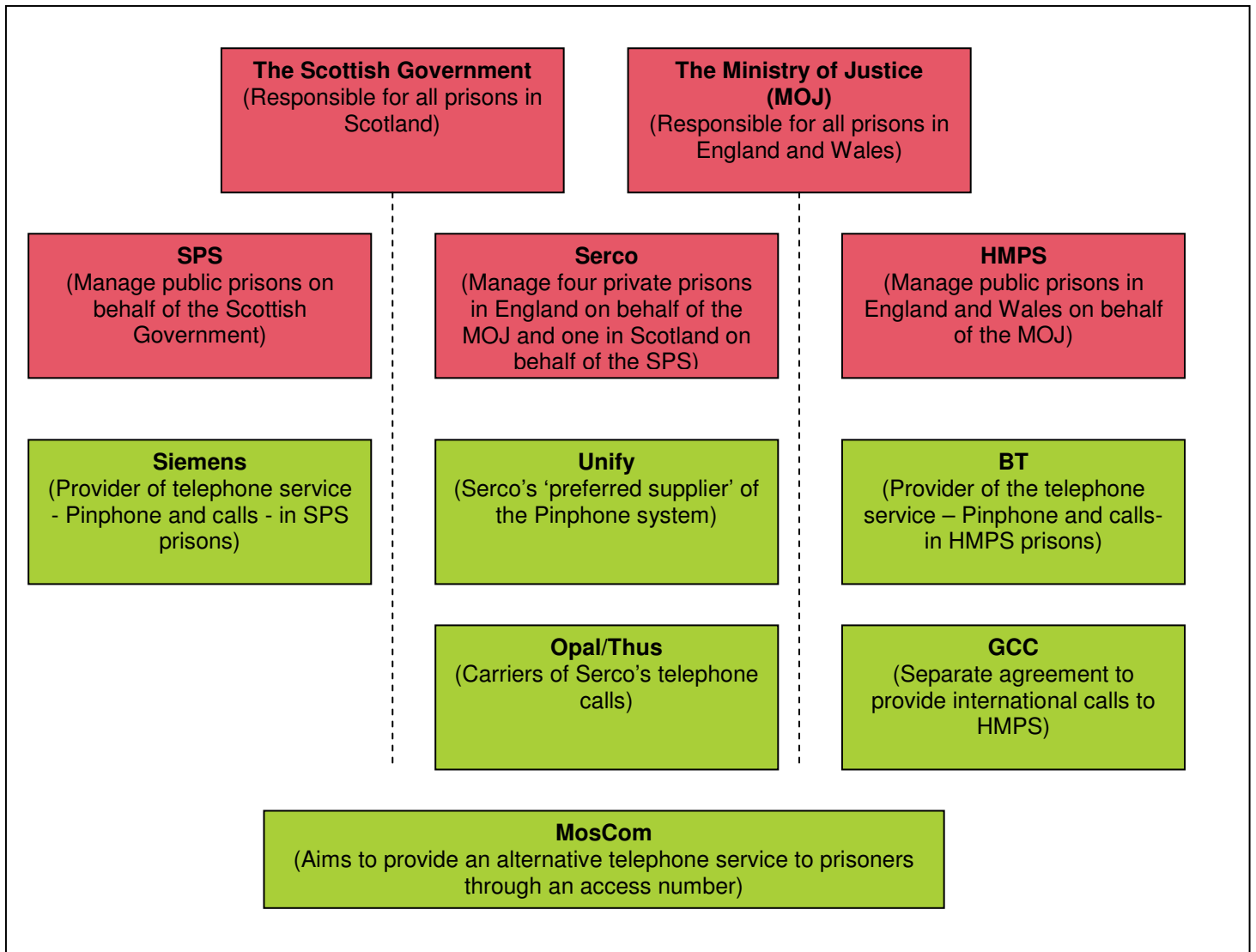
- 2.6 During the 90 day investigation period we have considered the evidence provided by the NCC in relation to the issues raised in its super-complaint. We have also met with and requested information and documentary evidence from HMPS, the SPS, Serco, BT and Siemens.
- 2.7 In addition to these parties, we have also met with, and obtained documentary evidence from, representatives from other providers of telecommunication services in prisons - Global Communications and Consulting Ltd (GCC), Unify Business Solutions Ltd (Unify), Opal Telecom (Opal) and Mosquito Communications Ltd (MosCom), and Action for Prisoners' Families and the Ombudsman.
- 2.8 A full list of the organisations that provided evidence in this investigation is included at Annex 1 below.
- 2.9 In considering this super-complaint we have sought to determine:
- whether any feature, or combination of features, of the cost of calls from prisons in Scotland, England and Wales is, or appears to be, significantly harming the interests of consumers;
 - whether any of the issues raised should be dealt with using our enforcement powers; and
 - whether other government bodies or regulators are better placed in our view to address any of the issues raised.
- 2.10 The possible outcomes of the super-complaint included:
- finding the complaint is unfounded or requires no action;
 - further investigation by us under our sectoral powers or under the Competition Act 1998 (the Competition Act);
 - making recommendations to government bodies or another regulator to take action to address issues raised; and/or
 - making a market investigation reference to the CC.
- 2.11 We have considered each of the different options available to us in order to identify which option is most appropriate and proportionate to address the problems we have identified in the provision of telephone services to prisoners.

Section 3

Telephone services in prisons

- 3.1 This section explains the telephone services offered to prisoners in England, Wales and Scotland, and sets out the tendering processes, contractual arrangements, and prices charged to prisoners.
- 3.2 Figure 1 below shows the provision of prison telephone services in England, Scotland and Wales.

Figure 1: Provision of prison telephone services in England, Scotland and Wales



Operation of prison telephone services

- 3.3 Prisoners in all prisons, public and private, whether in Scotland, Wales or England, are for security reasons not allowed to have mobile telephones and access to payphones is controlled. This is done through a system termed 'the Pinphone'.

The Pinphone system

- 3.4 The Pinphone system works in a similar manner to other telephone systems by allowing prisoners to make calls from telephone handsets located across prisons. However, there are a number of major differences between a standard telephone system and the Pinphone system. The Pinphone system has a number of additional special features (both software and hardware) designed for use within a custodial environment, as explained below.
- 3.5 Each prisoner has an individual electronic telephone account which prisoners access by using a Personal Identification Number (PIN). In order to use the Pinphone system the prisoner will need to:
- have sufficient credit in their account to make calls;
 - input their PIN on the telephone keypad; and
 - dial the number they wish to call.
- 3.6 A virtual display on the telephone handset shows the prisoner's credit balance.
- 3.7 The Pinphone system offers call enabling and call barring services, activated as appropriate for individual prisoners. Call enabling allows a prisoner to call only those specified numbers which have been approved by the prison. Prisoners are allowed 20 personal and up to 15 legal numbers on their account at any one time. In addition to this allowance prisoners have access to all globally and locally enabled numbers. Call barring allows a prisoner to call any number except those specifically barred by the prison. There is a separate process for enabling or barring numbers in all prisons and this facility is managed centrally.
- 3.8 Telephones are made available in public areas with hoods around each in order to afford a certain level of privacy. The times during which prisoners can access telephones vary from prison to prison, but the prison rules determine that they should be made available to prisoners for at least two hours in each day.⁶ Restrictions, which include the duration of each call, the number of calls that a prisoner can make in one day, and the total duration of calls that any prisoner can make each day, are determined by each prison. Only outgoing calls can be made using the system (except in two women's prisons, Askham Grange and Foston Hall, where incoming calls are allowed).⁷
- 3.9 Prisons employ Pinphone clerks to set up prisoners' telephone accounts, to input and update prisoners' chosen numbers where they have call enabling and, also, to record and monitor calls. Therefore, the Pinphone system has a significantly higher level of functionality and complexity than a standard telephone service. We also understand that there is a high level of vandalism of Pinphones in prisons.⁸ The Pinphone system

⁶ HMPS's response to the informal information request dated 8 July 2008.

⁷ NCC super-complaint at footnote 43, page 20.

⁸ Meeting between Ofcom and the Ombudsman on 15 August 2008.

was developed specifically for prisons in order to meet security and custodial requirements.

- 3.10 The procurement process, the contractual arrangements, and the prices charged to prisoners differ between publicly-managed prisons in England and Wales, publicly-managed prisons in Scotland, and privately-managed prisons. These are each considered separately below.

HMPS-managed prisons in England and Wales

- 3.11 In England and Wales the Pinphone system and call services in publicly-managed prisons are provided by BT. In order to address the issues raised by the NCC, we have considered the tendering process which resulted in BT being awarded the contract, the terms of the contract and the prices applied by BT under the contract.

The procurement process

- 3.12 For the service in England and Wales there was a competitive tender process run by HMPS which took place between 1996 and 1998. Ofcom has not reviewed the original tender document as it was not available. BT was awarded a 10 year contract in November 1998 to install and operate the Pinphone system.
- 3.13 In April 2000, OPUS Telecom, who were contracted to supply BT with the Pinphone technology, went into liquidation. As a consequence, BT decided that the development and implementation of the OPUS system was no longer viable, and instead developed a BT bespoke solution.⁹ As a consequence, full roll-out of the system was delayed to 2001, resulting in a contract end date of 2011.
- 3.14 Currently, therefore, BT has a contract to supply telephone services to HMPS prisons using a Pinphone system designed, installed and managed by BT. It provides a managed service in all of the public prisons which means that BT builds, maintains and owns the entire infrastructure at minimal cost to HMPS.¹⁰ The costs of administering the Pinphone service in the prisons (e.g. Pinphone clerks and monitoring costs) fall to HMPS.
- 3.15 The major elements of the Pinphone system supplied by BT include internal and external network infrastructure, a call management database, IT infrastructure and peripherals which includes over 4000 telephones, over 700 PCs and over 300 laser printers.

The contract in England and Wales

- 3.16 The contract between the Secretary of State for the Home Department and BT ("the BT Contract") was signed on 2 November 1998, for a term of 10 years, although a later amendment altered the BT Contract so that the term of 10 years ran from 1 June 2001. We have reviewed the BT Contract. Our understanding is that the contract does not give BT the exclusive right to provide telephone services for prisoners in those prisons covered by the contract. However, we note that there are a number of practical issues that arise from the unique nature of providing telephone services in prisons that can make it difficult for HMPS to introduce alternative suppliers of telephone services into HMPS prisons.

⁹ [3<]

¹⁰ HMPS's response to the informal information request dated 8 July 2008.

Original price of calls

- 3.17 Originally the price of calls was fixed under the BT Contract to BT's public payphone rate. BT's response to tender stated that they believed that it would be in the interests of BT and HMPS to keep the rate the same as that paid by the general public payphone user.¹¹ In its response to the invitation to tender, BT suggested that the public payphone rate should be taken as the relevant benchmark. We have not received any evidence which would suggest that other price benchmarks were considered when the contract was originally tendered.

Break of the link with public payphone charges

- 3.18 Under the terms of the original contract, the charges to prisoners for calls were the same as BT's public payphone rates. However, in May 2004 BT changed the pricing structure for their public payphones, reducing the pence per minute price from 11 pence to 2 pence, but increasing the minimum charge from 20 pence to 30 pence.¹² HMPS informed us that they considered that this change to the pricing structure, which made shorter calls more expensive but longer calls cheaper, may not have been in the best interests of prisoners who tend to make calls of short duration.¹³ In June 2004, HMPS and BT therefore mutually agreed to break the link with BT's public payphone rate. Prisoners were subsequently charged a minimum price of 10 pence¹⁴ with the call per minute price remaining at 11 pence per minute. At the time this meant that calls of less than 2 minutes 45 seconds were cheaper than the BT public payphone rate, but longer calls were more expensive.
- 3.19 We consider whether prisoners would be better off at the public payphone rate in Section 4.
- 3.20 The current Pinphone pricing structure is fixed, unless BT and HMPS agree changes to it. Calls to landlines carry a minimum charge of 10 pence for the first 55 seconds and then a charge of 1 pence per 5.5 seconds, equivalent to 11 pence per minute. Calls to mobile phones cost between 19 and 63 pence per minute.¹⁵

Call revenues and volumes

- 3.21 Under the BT Contract HMPS receives a 7% commission on revenue generated from call charges. This revenue is transferred to a general prisoner welfare fund or used to offset costs of distribution through the prison shop where that is contracted out.¹⁶
- 3.22 The revenue information provided by BT shows that in 2007/08, across all publicly-managed prisons in England and Wales, the revenue generated by call charges was [redacted] (more than £10m) and the total call volume was [redacted] minutes.

¹¹ Section 26 of BT's response to the Pinphone tender.

¹² BT had increased their minimum charge from 10 pence to 20 pence in October 2000, but the price per minute of local and national landline calls was unchanged. In November 2006, BT further increased their minimum charge to 40 pence, but increased free local and national minutes from 15 to 20 minutes. Calls in excess of 20 minutes are charged at 20 pence + 1 pence per minute.

¹³ HMPS's response to the informal information request dated 8 July 2008. The number of free local or national minutes to a UK landline increased from 55 to 110 seconds in 2000, and to 900 in 2004 and to 1200 in 2006.

¹⁴ This included 55 free seconds to a UK landline.

¹⁵ A full list of BT's Pinphone prices can be found here:

http://www.serviceview.bt.com/list/public/current/Call_Charges_bo0/0016_d0e25139.htm.

¹⁶ HMPS's additional response to the informal request for information dated 8 July 2008.

3.23 Figure 2 below shows the growth in call revenues and volumes over the last five years.

Figure 2: Call volumes and revenues in HMPS prisons

[Redacted (Call volumes and revenues have increased during the BT Contract term in line with the increase in prison population.)]

GCC and international calls

3.24 In April 2004, HMPS negotiated an agreement with GCC for the provision of international calls after agreeing GCC's introduction to the market with BT. GCC prices range from around 20 pence per minute to £1.09 per minute.¹⁷ By contrast, BT international prices range from around 66 pence per minute to £3 per minute. Table 1 below shows GCC and BT rates for a sample of countries.

Table 1: GCC and BT international call rates for a sample of countries

Country	GCC price per minute	BT price per minute ¹⁸
France	£0.295	£0.67
Ireland (Republic of)	£0.200	£0.67
USA	£0.342	£0.75
Turkey	£0.320	£1.00
India	£0.760	£2.00
Nigeria	£0.770	£2.40
Jamaica	£0.385	£1.20

3.25 GCC now provides international call services in some of the HMPS prisons and we understand that HMPS plans to roll out the GCC service to all prisons.¹⁹ The GCC service works in conjunction with the existing security measures in the Pinphone system, and allows prisoners to call approved international numbers.²⁰

3.26 GCC have told us that call volumes have averaged [Redacted (600k – 900k minutes per year over the last 36 months)].²¹ HMPS receives 6% of revenues generated by GCC calls.²² The commission is used towards other services to all prisoners either by crediting it to a general prisoner welfare fund or by off-setting costs of distribution

¹⁷ With the exception of the Islands of Wallis and Fortuna where the price per minute is £1.77

¹⁸ BT prices calculated using the BT price list which lists prices in terms of seconds per 10 pence.

¹⁹ Meeting with HMPS on 30 July 2008. At present international calls can also be made through BT.

²⁰ GCC's response to the informal information request dated 8 July 2008.

²¹ GCC's response to the informal information request dated 8 July 2008.

²² Email from GCC dated 11 September 2008.

through the prison shop where that is contracted out. We analyse the comparison between international prices at paragraph 4.31.

- 3.27 In summary, in HMPS-managed prisons in England and Wales BT is the sole supplier of calls to domestic fixed and mobile numbers. HMPS has recently introduced competition for international calls by introducing GCC as a supplier of international calls in some prisons and plans to roll out the GCC service to all prisons. Prisoners can use BT to make calls from Pinphones to both landlines and mobile phones, but can currently use BT or GCC for international calls.²³

The SPS-managed prisons in Scotland

- 3.28 In Scotland the SPS manages procurement of telephone services in publicly-managed Scottish prisons. We consider below the procurement process which led to Siemens being awarded the Pinphone contract, the terms of the contract and the prices applied under the contract.

The procurement process

- 3.29 In 2002, the SPS invited companies to tender for a prisoner telephone service. A Tender Notice was issued via the Restricted Procurement Route and the SPS received pre-qualification information from 17 firms, which included Siemens, [redacted].²⁴ Under the Restricted Procurement Route, an initial assessment is made of those who respond to the Tender Notice and only those suppliers invited to do so by the authority may submit tenders. The restricted procedure is always available to contracting authorities and allows purchasers to avoid having to deal with an overwhelmingly large number of bidders.
- 3.30 In August 2002, the SPS issued seven Invitations to Tender and in response received bids from [redacted], Siemens and [redacted]. [redacted] subsequently withdrew their bid. According to the SPS, [redacted]'s decision to withdraw was because [redacted] and there was an unfavourable change in the currency exchange rate.²⁵ This left [redacted] and Siemens as the remaining bidders for the service.
- 3.31 The evaluation was completed and the outcome based upon the best technically acceptable and commercial solution. The technical evaluation was completed against the information requested within the Invitation to Tender Document plus subsequent clarifications and site visits.²⁶ This included:
- prisoner telephone specification;
 - voice recording specification;
 - maintenance and support; and
 - funding and service levels.
- 3.32 The commercial evaluation included:

²³ Annex 2 details the general policy and operational guidance on prisoners' use of telephones which is contained within Prison Service Order (PSO) 4400 Chapter 4.

²⁴ SPS's additional response to the informal information request dated 8 July 2008.

²⁵ SPS's note of meeting on 1 August 2008.

²⁶ SPS's additional response to the informal information request dated 8 July 2008.

- prisoner call charges;
 - phone card rebate offered to prisoners at telephone system changeover;
 - level of the SPS's overall rebate offered to offset operating costs;
 - cost of additional telephone installations; and
 - the commercial effect of additional prisons opening or closing.²⁷
- 3.33 Following the tender process Siemens was awarded the contract for the Pinphone system in September 2003. Siemens was ranked higher in the evaluation on the grounds that the SPS considered that it offered the "best commercial, technically acceptable solution."²⁸
- 3.34 The contract between the Scottish Ministers on behalf of the SPS and Siemens (the Siemens Contract) was signed on 26 September 2003. The Siemens Contract has a term of five years from the date the system was accepted, meaning that the Siemens Contract will expire on 31 March 2010. The Siemens Contract is exclusive.
- 3.35 The service provided by Siemens in Scotland is similar to that provided by BT in England and Wales. Like BT, Siemens provides a bespoke system (as specified by the SPS) including all of the major elements of the Prison Pinphone system. This includes the Pinphone system, internal and external network infrastructure, a call management database, IT infrastructure and peripherals. The costs of administering the Pinphone service in the prisons (e.g. Pinphone clerks and monitoring costs) are met by the SPS.
- 3.36 In 2007/08, the call revenue generated in the SPS-managed prisons was £1.3m (excluding VAT) and the total call volume was 9.9m minutes.²⁹

Figure 3: Call volumes and revenues in SPS prisons

[✂ confidential graph removed]

- 3.37 Under the contract the SPS receives a commission of between 5% and 25% of total call revenue.³⁰ Over the contract period so far, the SPS have received 20-22% of call revenue.³¹
- 3.38 The SPS also received:
- a rebate of £93k from Siemens at the beginning of the contract;
 - A rebate of £25k paid 12 months after the completion date and then annually until the fourth anniversary of that date; and
 - £57k for the decommissioning of the previous telephone system.³²

²⁷ SPS's additional response to the informal information request dated 8 July 2008.

²⁸ SPS's additional response to the informal information request dated 8 July 2008.

²⁹ Siemens' response to the informal information request dated 8 July 2008.

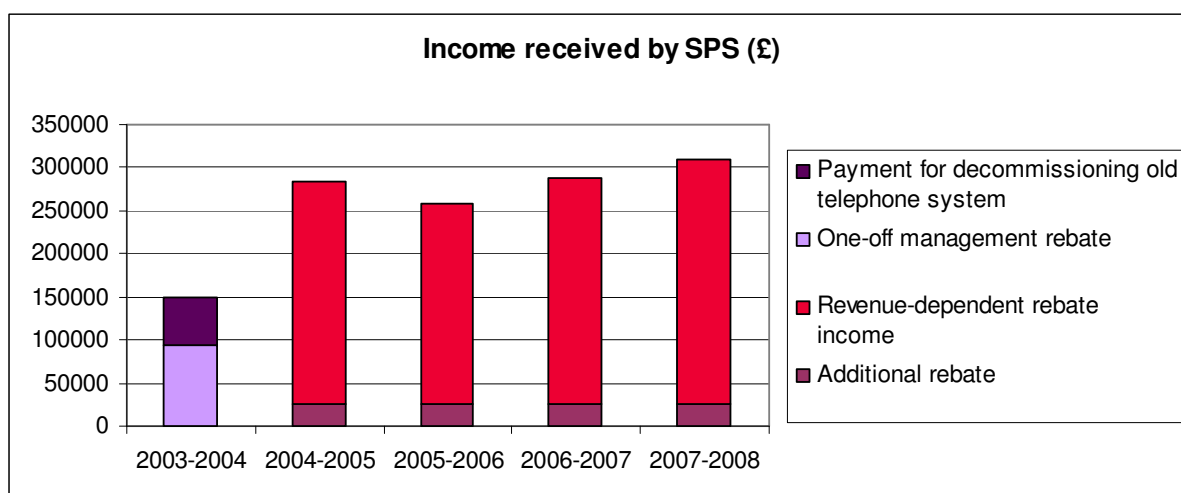
³⁰ Contract between SPS and Siemens, Schedule B.

³¹ SPS's and Siemens' response to the informal information request dated 8 July 2008.

³² Contract between SPS and Siemens, Schedule B.

3.39 The SPS have told us that all income they receive under the Siemens Contract is used to offset the costs they incur in operating the system.³³

Figure 4: Income received by the SPS



Source: SPS

3.40 The prices the prisoners pay for making telephone calls are fixed at the same rate as the BT Pinphone rate charged in HMPS prisons.³⁴ The level of the pricing was agreed as an outcome of the tender process. All three bidders based their bids on the HMPS Pinphone rates.³⁵

Privately-managed prisons in England, Wales and Scotland

3.41 Privately-managed prisons were introduced in the UK in the 1990s. At present there are 11 privately-managed prisons in England and Wales. These are managed by private companies such as GSL, Serco and G4S Justice Services. Privately-managed prisons in the UK are free to enter into separate contracts with telephone service suppliers (Doncaster is an exception; it was built by HMPS but is managed by Serco, and operates using the BT Contract for telephone services).

3.42 Serco currently runs five prisons in the UK (Ashfield, Doncaster, Dovegate, Lowdham Grange and Kilmarnock), under contract to the Home Office's National Offender Management Service (NOMS)³⁶ and the SPS.³⁷ The NCC super-complaint compared the prices applied in Serco-managed prisons to the prices applied in publicly-managed prisons. We therefore sought information from Serco on the procurement and provision of telephone services in Serco prisons.

3.43 The specification for privately-managed prisons requires that they should provide a PIN telephony service. With the exception of Serco all use the BT Pinphone system

³³ SPS's response to the informal information request dated 8 July 2008.

³⁴ For a full list of prices see:

http://www.serviceview.bt.com/list/public/current/Call_Charges_boo/0016_d0e25139.htm#0016-d0e25139 and

http://www.serviceview.bt.com/list/public/current/Call_Charges_boo/0017_d0e4852.htm#0017-d0e4852.

³⁵ SPS's response to the informal information request dated 8 July 2008.

³⁶ Lowdham Grange, Doncaster, Ashfield and Dovegate.

³⁷ Kilmarnock.

and apply the BT Pinphone rates.³⁸ Three out of the four Serco prisons use a non BT system. The other providers (GSL, Kalyx and G4S Justice Services) all use the BT system.³⁹ In total eight of the 11 contracted out prisons in England and Wales use the BT system.

- 3.44 As explained at paragraphs 3.14 and 3.35 above, in publicly-run prisons the initial capital investment was funded by BT and Siemens, who provide a managed service to HMPS and the SPS. In contrast, Serco assumed the capital investment and pays Unify and Opal/Thus for the Pinphone system and call conveyance respectively. Serco therefore manages the service itself and can set its own prices.
- 3.45 Serco introduced Pinphones before HMPS. Serco sourced a partner provider, Voice Products Ltd, in the mid-1990s prior to a Pinphone service being supplied in publicly managed prisons by BT. Serco has since reviewed the provision of its services and invited BT and Unify to bid for new Pinphone contracts. Serco considered that Unify provided the best solution at that time and Unify is now Serco's preferred supplier, providing services in three of its four adult prisons (although the Unify system will soon be installed in all four of Serco's adult prisons). Unify is able to offer various telephone solutions including the Lowdham Grange model where telephones are installed in each cell.
- 3.46 Serco has informed us that it does not profit from the Pinphone system and that any revenue in excess of the cost of the system is placed in the prisoners' amenities fund for their benefit. The fund is not controlled by Serco and any payment out of the fund is approved by the on-site representative of NOMS.⁴⁰ Serco also fund administrative costs, such as monitoring costs, and do not use the revenue generated from Pinphones for these purposes.

MosCom

- 3.47 The NCC super-complaint refers to MosCom, which has set up a service which aims to provide telephone services to prisoners. Users of the MosCom service are allocated a UK telephone number unique to that user. This number is linked to a MosCom account, which can be credited with funds by relatives or other third parties. To make a call, users dial their unique telephone number, and are then able to dial and connect to any other telephone number. However, the MOJ has informed us that it has security concerns with the MosCom system which does not incorporate the same level of security as the Pinphone system. Due to these security concerns, HMPS will not permit access to MosCom's freephone numbers from its prisons. However, we understand that MosCom may still provide the service using geographic numbers to connect to UK mobiles and all international destinations.

³⁸ HMPS's response to the informal information request dated 8 July 2008.

³⁹ HMPS's response to the informal information request dated 8 July 2008.

⁴⁰ Serco's response to the informal information request dated 8 July 2008.

Section 4

Price of calls from prisons and market structure

- 4.1 The NCC asked us to refer the current market for telephone services in prisons to the CC for a full market investigation due to features of the market which they contend appear to be significantly harming the interests of prisoners. One of the key concerns raised by the NCC is the high price of calls from prisons.

Pricing and market structure

- 4.2 We have considered a number of possible comparators to assess the level of prices of telephone calls made by prisoners in public prisons. We considered prices relative to costs, charges for prisoner telephone calls in some Serco managed private prisons, charges for international calls and BT public payphone rates. Our analysis shows that in HMPS and the SPS managed prisons, the average price of a call to a UK number is 60 pence. If the same calls were made using the rates applied in Serco managed prisons the average price would be between 48 and 51 pence.
- 4.3 Prices appear to be high on the basis of some of these comparisons. However, there could be other relevant comparisons. In addition, there are other factors which could have a bearing on the price structure within publicly-managed prisons, including public policy and security considerations.

A. Price relative to the cost of providing telephone services

- 4.4 We considered the available information on the costs of the provision of telephone services in prisons. There are two elements of costs which are relevant here. The first relates to the Prison Services and the second relates to the telephone service providers.

England and Wales

- 4.5 HMPS told us that there are "significant administration and operational costs" incurred related to providing a Pinphone system. As an example, it has estimated that salary spend on Pinphone staff amounts to around £2.5m per annum across all HMPS prisons.⁴¹ In comparison, in the last three years, HMPS has received between [X] and [X] per annum in commission revenue.⁴² Commission revenue is used towards other services for all prisoners either by crediting it to general prisoner welfare fund or by off-setting costs of distribution through the prison shop where that is contracted out. HMPS's costs would seem to be above its revenue. In the time available we have not considered how these costs were incurred.
- 4.6 We also considered BT's profitability in relation to this contract. In 2000, BT projected an internal rate of return of [X] (15-25%). It has realised an internal rate of return of [X] to date. Over the contract term, revenues have so far amounted to [X] and costs have amounted to [X]. The contract is due to run until 2011. This suggests there may have been little pressure on BT to reduce prices relative to cost over the contract term. We estimate that over the entire contract term to 2011, BT's internal

⁴¹ HMPS's additional response to the informal information request dated 8 July 2008.

⁴² BT's response to the informal information request dated 12 August 2008.

rate of return would be around [redacted] (20-30%), assuming that costs and revenues are static over the next few years. If revenues instead rose, in line with the current trend, we would expect the internal rate of return to be slightly higher.

Figure 5: BT's projected and actual cash flows

[redacted] (Confidential chart removed. Projected and actual cash flows in every year to date have been similar. We have no reason to believe that cash flows will decline over the period 2009-2010 and may increase if the prison population continues to rise.)]

- 4.7 This gives an indication that prices may be high relative to some measure of costs in England and Wales.

Scotland

- 4.8 According to the SPS's forecast costs and revenues, it projected that it would receive £1.4m in rebate income and benefits over the five year Siemens Contract⁴³ and incur costs of £395k. These forecasts did not include the significant staff costs associated with administering the Pinphone system.
- 4.9 The SPS has told us that its actual costs over the contract term have so far amounted to £2.3m⁴⁴ compared to total income of around £1.2m⁴⁵ plus £57k for the decommissioning of the previous telephone system.⁴⁶ These costs, set out in Table 2, encompassed spend on the pre-announcement message placed on all calls,⁴⁷ changes to the Siemens Contract, recurring maintenance and staff costs.

Table 2: SPS's breakdown of actual costs incurred⁴⁸

	2004- 2005	2005- 2006	2006- 2007	2007- 2008
Pre-announcement message costs (£)	39,190	37,368	38,156	37,907
Contract changes expenditure (£)	265,828	97,458	137,221	25,610
Recurring maintenance costs (£)	48,706	56,959	77,398	78,790
Staff costs (£)	328,212	338,058	348,200	358,646
Yearly total (£)	681,936	529,843	600,975	500,953

- 4.10 The SPS's costs appear to have exceeded its rebate income.
- 4.11 We also considered Siemens' profitability. At the start of the Siemens Contract, they anticipated an overall internal rate of return of around 10%. Siemens' updated forecasts in 2008 estimate an overall revenue of £6.3m (before tax) and overall costs

⁴³ SPS's response to the informal information request dated 8 July 2008.

⁴⁴ SPS's response to the informal information request dated 8 July 2008.

⁴⁵ SPS's response to the informal information request dated 8 July 2008.

⁴⁶ Siemens' response to the informal information request dated 8 July 2008.

⁴⁷ This announcement informs the recipient of the call that they are being called by a prisoner.

⁴⁸ SPS's response to the informal information request dated 8 July 2008.

of £5.9m. Costs include a contribution to Siemens' customer service division of £0.8m. We have estimated that this corresponds to an internal rate of return of 10%, assuming all capital was spent in the first year, and total capital expenditure equals total depreciation over the period.

Figure 6: Siemens' forecast and actual earnings

[X (Confidential chart removed. Actual EBIT was significantly lower than forecast in the years 2003-2005. It has been slightly lower than forecast in the years 2005-2008. Actual EBIT is however currently forecast to be much higher in 2008-2010 than in recent years.)]

- 4.12 Figure 6 above compares Siemens' forecast and actual earnings before tax and interest. The initial projections were made on the basis of a contract duration of five years. However, the contract term was subsequently changed to start from March 2005 and end in March 2010. Although actual earnings to date have, therefore, been lower than forecast, they are expected to be higher in the final year of the contract.
- 4.13 This indicates limited mark-up of prices over some measure of cost and suggests that competition in Scotland may have been stronger than in England and Wales.
- 4.14 However, generally prices for prisoners in Scotland are the same as those in public prisons in England and Wales. It would appear that increased competition for the contract in Scotland has helped fund higher rebates for the SPS of between 20 and 22% of total call revenue plus additional rebates totalling £250k over the life of the contract. We understand that the SPS has used these rebates to offset its costs of administering the Pinphone system.

B. Price of BT/Siemens Pinphone rates relative to BT public payphone rates

- 4.15 The public payphone rate could be considered to represent a reasonable comparator in that it was the price that prisoners in England and Wales paid prior to the introduction of the Pinphone system. It may also be considered to be fair in that, to the end user, the Pinphone system appears very similar to public payphones, although clearly it has additional security functionality to a basic public payphone.
- 4.16 In considering this super-complaint we have not conducted a detailed analysis of the differences in the costs of providing public payphone and Pinphone services or in the difference in call usage. But we observe that call usage by prisoners is likely to be very different to public payphones as, for example, telephones in most public sector prisons are only available at limited times of the day. We also understand that queues are often lengthy and that the average length of call is very short – 25% of calls are less than one minute, and the average call length is 4.75 minutes for a call to a UK landline from an HMPS prison and approximately two minutes for a call to mobile or an international call.⁴⁹
- 4.17 Public payphone use has declined dramatically, and the number of BT public payphones has decreased by more than 50% since 2000. Our research also found that the number of consumers who use public payphones as their primary source of making a call is now "negligible".⁵⁰ With declining numbers and reduced use, BT has also made a number of price increases for use of its public payphones. In particular,

⁴⁹ BT's response to the informal information request dated 8 July 2008.

⁵⁰ Communication Report 2006, <http://www.ofcom.org.uk/research/cm/cm06/>.

the minimum call charge was increased from 10 pence to 20 pence in 2001, followed by further increases to 30 pence in 2004 and 40 pence in November 2007. Furthermore, in May 2008 BT increased the price of off peak calls to mobile phones from payphones from 37.5 pence per minute to 67 pence per minute.

- 4.18 In contrast, the number of Pinphones in HMPS prisons has increased from 2,100⁵¹ in 1997 to 4,100 today⁵² to match the increase in the prison population, while revenues have increased from around £10m gross per year in 1997 to [£>] (more than £10m per year). It is likely that with technology improvements, the costs of provision may have fallen since the contract was signed. The economic factors – in particular, sharp reductions in usage levels - which have contributed to increases in the average price of calls from public payphones do not appear to have affected the commercial viability of providing services from prisons in the same manner.
- 4.19 Recognising its limitations, we have conducted a comparison of the prices paid by prisoners and those charged in public payphones. To make a valid comparison we believe that it is important to consider not only the price of calls to landlines but also prices of calls to mobile phones, which, since May 2008, are now unambiguously higher in BT public payphones than in HMPS and the SPS prisons. We also believe that it is more appropriate to consider whether in aggregate prisoners would be better or worse off under BT's public payphone rate by focusing on the cost of an average call, as most prisoners are likely to make a mix of both shorter and longer calls.
- 4.20 We have also assumed that prisoner call patterns would be unchanged were prisoners to be charged according to BT's public payphone rate. We accept that this does not address the NCC's point that call durations are likely to be longer if prisoners were charged at BT public payphone rates. However, by using the same call duration pattern, we obtain a clearer comparison of which set of prices is higher. To the extent that average call durations would increase following a switch to BT payphone rates then our estimates of average call prices will overstate the cost of making a call under the BT payphone rate.
- 4.21 To estimate the average price of a call we need to weight calls by duration, by time of day (peak, off-peak, weekend), and by call type (call to landline, call to mobile, international).⁵³ Where available we have used BT's call patterns in HMPS prisons as weights. Where these patterns are unavailable, we have estimated call patterns by ensuring that the estimated average call price and call duration is consistent with BT's call revenues and call minutes.⁵⁴

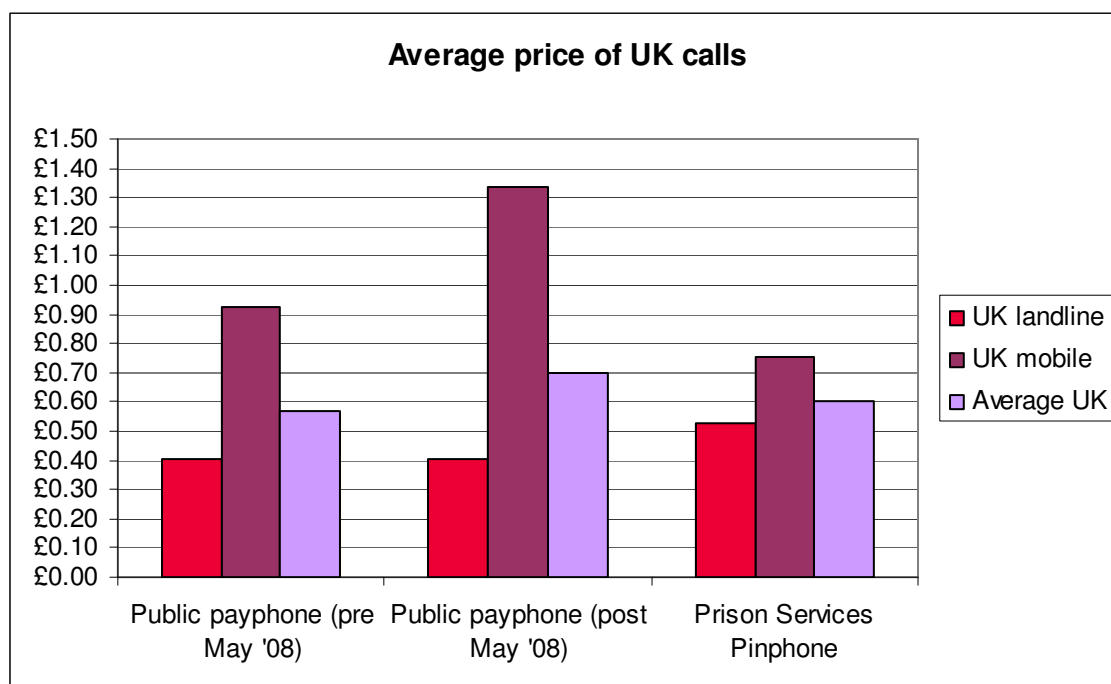
⁵¹ [£>]

⁵² BT's response to the informal information request dated 8 July 2008.

⁵³ We have excluded calls to non-geographic numbers as call revenues from these numbers are negligible.

⁵⁴ For national and local calls, we have estimated the weights based on the proportion of local to national calls averaged across all Serco-managed prisons where we have data available (BT does not distinguish between local and national calls in their charges and we do not have statistics on BT's local and national call volumes).

Figure 7: Average price of UK calls



Average price of calls to UK landlines

4.22 Our analysis shows that the average price of a landline call is 53 pence in an HMPS/SPS prison. If a prisoner was to make the same pattern of calls at BT's public payphone rates, the average price of a call would be 40 pence.

Average price of calls to mobiles

4.23 The average price of a call to a mobile in an HMPS/SPS prison is 75 pence. Prior to May 2008, if a prisoner was to make the same pattern of calls to mobiles at BT public payphone rates the average price of a call to a mobile would be 92 pence for a call to a mobile.

4.24 In May 2008, BT increased off-peak rates for call to mobiles from a BT public payphone⁵⁵. This means that now if a prisoner was to make the same pattern of calls to mobiles at BT public payphone rates the average price of a call to a mobile telephone would be £1.34 .

Average price of a call (fixed and mobile)

4.25 Overall we estimate that the average price of a call to a UK number from an HMPS/SPS prison is 60 pence. If a prisoner was to make the same pattern of calls from a BT public payphone prior to May 2008 the average price of a call would have been 57 pence. We estimate this has now increased to 70 pence. We therefore consider that prior to May 2008 prisoners would have been better off overall if they

⁵⁵ Prior to May 2008, off-peak calls to mobiles from a public payphone were charged at 37.5 pence per minute and peak calls at 63 pence per minute. In May 2008, BT changed its rates for calls to mobiles to 63 pence per minute at all times of day.

were charged at BT public payphone rates but currently they are better off on average at the HMPS/SPS Pinphone rate.

Changing call patterns

- 4.26 While call patterns in prisons may change if prisoners were charged according to BT's public payphone rates this is unlikely to alter our conclusions as, provided that the overwhelming majority of prison calls remain less than 20 minutes (only 3% of calls are currently longer than 15 minutes), the average price of a call to a UK landline at BT public payphone rates would remain at the minimum call charge of 40 pence irrespective of the call pattern.

Summary

- 4.27 This suggests that prior to May 2008, in aggregate prisoners may have been better off if they could have made calls at BT public payphone rates. Indeed, at the time the decision was taken to break the link to the BT public payphone, the BT public payphone rate was less than it is now (due to the 30 pence minimum charge). The proportion of prisoners making calls to mobile phones was also lower, so that there was less of a benefit to prisoners from the lower mobile call charges in prisons at that time.
- 4.28 Currently, with increasing BT public payphone call rates, particularly the price of calls to mobiles, prisoners may be benefiting from the decoupling of Pinphone rates from BT public payphone rates. However, it is not clear that prisoners derived any immediate benefit from the change in pricing and it is possible that prisoners may have been better off under BT payphone rates until as recently as May 2008.
- 4.29 As noted earlier, however, the economic factors which have contributed to higher charges from public payphones have not affected calls services for prisoners in the same way. As a consequence it is not necessarily the case that current public payphone rates are the most appropriate benchmark when assessing the relative competitiveness of the prices set for calls from prisons.

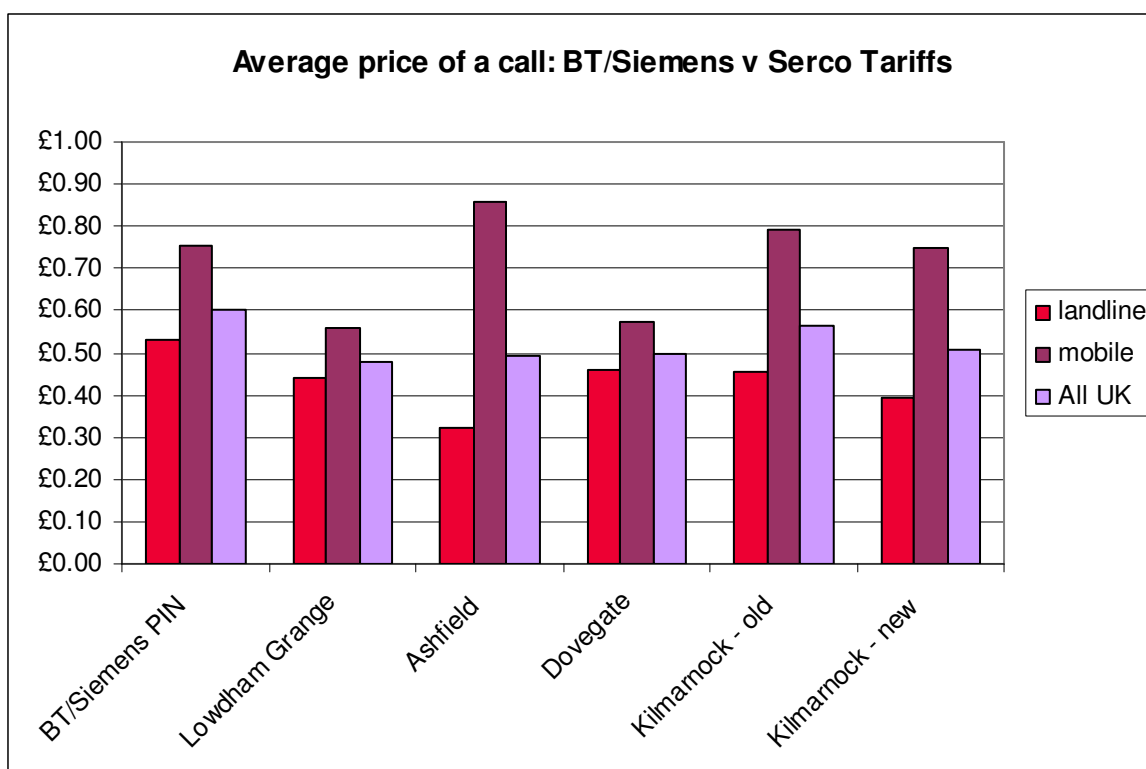
C. Comparison with rates in private Serco-managed prisons

- 4.30 An alternative benchmark for prices is the charge made to prisoners using the Pinphone system in Serco-managed prisons. We consider this to be the closest comparator to the price available to prisoners using Pinphone system in public prisons. However, we recognise the problems with this comparison, including:
- The prices charged to prisoners in Serco-managed prisons may be a reflection of how Serco chooses to spend its budget. For example, it could choose to spend more of its budget in providing subsidy to prison calls; and
 - Serco takes the revenue risk: it pays Unify and Opal/Thus for the system and call carrying respectively and sets prices itself. Serco's ability to take on the risk rather than allowing its suppliers to do so may have allowed it to secure lower cost products and services. This may have allowed it to set lower prices for prisoners.
 - Serco's prisons tend to be new-build prisons and therefore may not have the same infrastructure and installation costs as some of the older publicly-managed prisons.

4.31 Price comparisons are more difficult to perform due to the added complexity of rate structures (Serco-managed prisons often distinguish between local and national calls and rates vary between weekdays and weekends and days and evenings). To estimate how the price of individual calls should be weighted we have used BT call patterns where available as this allows us to directly compare prices in BT and Serco-managed prisons. Where BT call patterns are unavailable, we have estimated them by assuming that they are the same as the average pattern of calls in Serco prisons.

4.32 Figure 8 below compare the average price of a call under BT/Siemens Pinphone rates with the rates in Serco prisons.⁵⁶

Figure 8: Average price of a call – public compared to private prisons



Average price of calls to UK landlines

4.33 On the basis of our analysis, the average price of a UK landline call is more expensive in HMPS and the SPS prisons than in any Serco-managed prison⁵⁷. BT's Pinphone price of 53 pence compares to the next closest Serco price, Dovegate, at 46 pence, and the cheapest, Ashfield, at 32 pence.

Average price of calls to mobiles

4.34 BT Pinphone calls to mobile phones are closer to the average at Serco prisons. The average price of a call to a mobile from an HMPS/SPS prison is 75 pence. This

⁵⁶ To allow BT and Serco rates to be compared we have estimated average call charges by assuming that calls have the same pattern of duration and the same mix between local, national and calls to mobile as in HMPS prisons.

⁵⁷ Excluding Doncaster, which uses the BT Pinphone system

compares to the most expensive Serco prison, Ashfield (86 pence) and the cheapest, Lowdham Grange (56 pence).

Average price of a call (fixed and mobile)

- 4.35 Overall, we estimate that the average price of a call to a UK number under BT/Siemens Pinphone rates is 60 pence compared to the most expensive, Serco prison, Kilmarnock, now at 51 pence⁵⁸ and the cheapest, Lowdham Grange, at 48 pence. We therefore consider that prisoners in HMPS/SPS prisons would be better off if charged using Serco prison rates.

Average call revenue

- 4.36 Table 3 below shows the average call revenue per prisoner per annum for prisons where we have been able to obtain data, and contrasts this with the average price of a call.

Table 3: Average call revenues per prisoner

[✕ confidential chart removed]

- 4.37 The average spend per prisoner is higher in the three Serco prisons where prices are lowest. These figures must be treated with the caution due to the very small number of private prisons where we have data. For example, Lowdham Grange is exceptional as each cell has its own telephone. The conditions of access to telephones may also be better in Serco-managed prisons, which tend to be newer. Nevertheless, these figures perhaps suggest that prisoners may well make more calls and increase their expenditure on telephone calls if call charges are lower.

Comparison with international calls

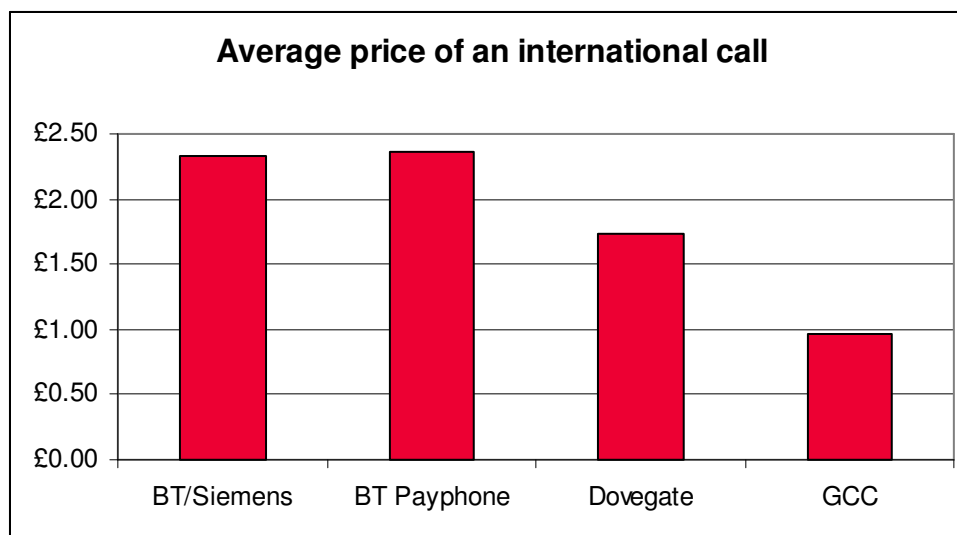
- 4.38 We have also attempted to compare BT and Siemens prices for international calls with possible comparator products, specifically, those provided by GCC (available in some HMPS prisons), prices for international calls in Serco-managed prisons and BT public payphone rates for such calls.
- 4.39 GCC rates to individual counties are on average 60% lower than the equivalent BT rates. However, we recognise that GCC's calls are carried over the BT Pinphone system and therefore GCC may have had lower capital costs.
- 4.40 The international call rates in Serco-managed private prisons are likely to be a much more appropriate comparator. We have only been able to obtain data from one private prison (Dovegate) making it difficult to make robust conclusions. However, for Dovegate, rates are lower than BT/Siemens rates for calls to 18 out of the 21 BT country chargebands.⁵⁹
- 4.41 BT Pinphone rates are broadly comparable to BT public payphone rates, although there are some countries where it is cheaper and some where it is more expensive.

⁵⁸ The average price of a call at Kilmarnock has decreased since 2007 as illustrated in the chart above. Prices were reduced at Kilmarnock because Serco believed that surpluses generated from the telephone system were not required for the general amenities fund.

⁵⁹ BT Pinphone rates are cheaper than Dovegate for most calls to the Caribbean and some calls to the Middle-East.

- 4.42 To look at these various comparisons in more detail we have attempted to estimate the average price of making an international call on BT Pinphone, GCC, Dovegate, and BT public payphone rates. We have adopted the same broad method as we used to estimate average UK prices by applying weights to different calls to different countries in line with BT Pinphone call patterns.⁶⁰

Figure 9: Average price of international calls



- 4.43 We estimate that the average price of an international call at Dovegate is £1.73 compared to £2.34 on BT/Siemens Pinphone rate, £2.36 at BT Public Payphone rates, and £0.97 under GCC rates.
- 4.44 It is not necessarily appropriate to look at international call charges in isolation given the relatively high fixed costs of operating and maintaining the Pinphone system and the different call patterns in different prisons (which is often quite marked for international calls). We note however that Dovegate's UK call charges are 17% lower than the equivalent BT/Siemens rate as well as their international rates being 26% lower. This provides some, albeit limited evidence, that BT/Siemens call charges may be high relative to the comparators we have considered.
- 4.45 Given our findings on the level of prices, we have considered possible sources of market power.

Market Power

- 4.46 Our detailed market definition and market power assessment is contained within Annex 3 below. In summary, there are two relevant markets: the market for the supply of telephone services to Prison Services; and the supply of telephone services to prisoners. There are different relevant markets for England and Wales and Scotland.
- 4.47 Insufficient competition in the tender process could result in telephone providers having some element of market power in bidding, which may be reflected in the terms of the contracts. This could have led to higher prices (to the Prison Services and/or prisoners), longer length of contract, a lower quality service or the imposition

⁶⁰ Where BT call pattern data is incomplete we have estimated country weights by ensuring that the weights are consistent with BT average call duration and average price data.

of contract terms that limit competition or limit the ability of the Prison Services to regulate the service provider.

- 4.48 It is also possible that in the tender process the Prison Services could secure higher rebates and commissions than would be required to cover any efficiently incurred Pinphone-related costs. There will in addition be public policy and other non-competition linked constraints which limit the ability of Prison Services to raise prices to prisoners. We also recognise that these same public policy and other non-competition (specifically security) issues will also play an important part in setting up any system providing telephone services to prisoners.

England and Wales

- 4.49 HMPS is the only supplier of telephone services to prisoners in publicly-managed prisons. There is no evidence that commission received by HMPS exceeded costs and we understand that this commission is used towards other services to all prisoners either by crediting it to a general prisoner welfare fund, or by offsetting costs of distribution through the prison shop where that is contracted out.
- 4.50 From the information made available to us about the procurement process that resulted in BT being awarded the contract to provide telephone services; and the review that took place following OPUS going into liquidation and BT's amended proposal, there is some evidence that BT may have had market power at the time of the HMPS tender. Competition from other suppliers appears to have been limited, BT may have enjoyed some incumbency advantages, and the duration and expected returns of the contract may have been greater than in a situation where BT faced more effective competition.
- 4.51 [REDACTED] (Prior to the BT Contract, revenue per annum was in excess of £10m and this was forecast to increase per annum throughout the 10 year contract to reflect the increase in prisoner numbers)].⁶¹ From this, BT estimated that the internal rate of return was [REDACTED] (15–25%). [REDACTED] (BT's internal rate of return was higher than BT's own estimated cost of capital)].⁶² This could indicate that the HMPS tendering process may not have been competitive enough to ensure that prices were driven down to the competitive level. Figure 10 below shows the operating profit that BT projected in 2000, covering the period 1998-2009.

Figure 10: BT's forecast operating profit, 1998-2009

[REDACTED Confidential graph removed]

- 4.52 In addition, as noted below, BT was initially able to negotiate a long contract length of 10 years from 1998 to 2008. Following the liquidation of OPUS, BT's supplier, full roll-out was delayed to 2001, resulting in a contract term end date of 2011. [REDACTED]. This may be an indication that at the time of the 1998 tender, there may have been limited competition.

⁶¹ [REDACTED].

⁶² The regulated cost of capital for BT established by Oftel in 2000 was around 12.5% (pre-tax nominal). This reflected the risk of BT as a whole and is not a project specific risk but still provides a useful benchmark; it is lower than the internal rate of return forecast by BT in 2000.

- 4.53 During the life-time of the BT Contract, HMPS was able to introduce GCC for international calls and this suggests that HMPS does have the ability to introduce competition into the market in some instances. HMPS has told us that it has tried to renegotiate prices downwards on other occasions but has been unsuccessful.
- 4.54 The MosCom system would potentially allow prisoners to bypass the Pinphone security system. To date, however, there is no authorised access to the MosCom service as we understand that HMPS has security concerns. Therefore currently BT and GCC are the only providers of telephone services in publicly-managed prisons in England and Wales.

Scotland

- 4.55 The SPS is the only supplier of telephone services to prisoners in publicly-managed prisons in Scotland. Our understanding is that the SPS receives a higher level of commission on calls than HMPS. We have seen no evidence that the commission received by the SPS exceeded costs and understand that it is used to offset costs that the SPS incurs in operating the system.
- 4.56 Siemens is unlikely to have had market power at the time of the SPS tender. This is supported by Siemens' limited returns, the shorter duration of the negotiated contract (five years compared to BT's ten) and the greater competition Siemens faced to secure the contract (it had to displace BT).
- 4.57 Siemens made forecasts based on several demand scenarios, and based its decision on anticipated call volumes of between 8.6m minutes and 12m minutes.⁶³ In the lowest demand scenario (8.6m minutes), it expected overall revenue of [redacted] compared to overall costs of [redacted]. We have estimated that this would correspond to an internal rate of return of around 5%, assuming all capital was spent in the first year, and total capital expenditure equals total depreciation over the period.
- 4.58 In the highest scenario (12m minutes), Siemens expected to make overall revenue of [redacted] compared to overall costs of [redacted]. We have estimated that this would correspond to an internal rate of return of 18%, assuming all capital was spent in the first year, and total capital expenditure equals total depreciation over the period.
- 4.59 Siemens anticipated an overall internal rate of return of around 10%. Figure 11 below shows Siemens' forecast earnings before tax and profits during the five years of the contract in two scenarios.

Figure 11: Siemens' forecast earnings

[redacted confidential graph removed]

- 4.60 The contract length of five years, together with the data on profitability, and the projections outlined in the graph above, would appear to show that there was sufficient competition in the Scottish tender.

Public policy considerations

- 4.61 There are a number of public policy considerations, some of which we understand have been taken into account in setting up the contracts for supply into publicly-managed prisons and which may also impact upon the price.

⁶³ Siemens' response to the informal information request dated 8 July 2008.

- 4.62 Some activities may contribute to other public policy objectives. Monitoring calls, for example, may be used for intelligence gathering.
- 4.63 Prisoners may attempt to use the telephone system for purposes not consistent with public safety such as to harass witnesses or victims, or to engage in criminal activities. Indeed this was one of the main reasons for the Prison Services choosing a more sophisticated and secure telephone system which is now capable of preventing these abuses, for example through call monitoring and call barring.
- 4.64 Phones in prisons may help maintain family contact, improve behaviour in prisons and, it has been suggested, reduce re-offending. Lower-priced calls may also reduce the incentive for prisoners to use illegal mobile phones and the consequent risk of increased calls to victims and witnesses.
- 4.65 The NCC has cited research that suggests that prisoners are six times less likely to re-offend if they have a supportive family network to return to when they come out.⁶⁴ However, we are not aware of any research on the direct link between telephone usage, telephone prices and re-offending rates.⁶⁵
- 4.66 These public policy issues are questions for government policy which are more appropriately dealt with by the MOJ and the SPS as the government bodies responsible for managing the Prison Services.

⁶⁴ The NCC cited a report by the Social Exclusion Unit, *Reducing Re-offending by Ex-Prisoners*, 2002.

⁶⁵ Meeting with Ombudsman on 15 August 2008.

Section 5

Options and conclusions

- 5.1 The NCC asked us to investigate the current market for telephone services in prisons. In its super-complaint, the NCC states that it believes that the interests of consumers are significantly harmed by aspects of the market for calls from prisons. The key concerns that were raised by the NCC and that we have considered are:
- “the high cost of most calls from prisons and the extent to which these appear unrelated to the cost of provision;
 - the continuing high level of charges during which time most other basic telephone services and other ICT – related products and services have fallen significantly in price;
 - the terms and conditions of the existing service explicitly seek to prevent competition; and
 - the extent to which these issues are caused and exacerbated by the unsatisfactory and secretive nature of the contracts and, the apparent arbitrariness of decisions, since they came into effect, that disadvantage the consumers.”⁶⁶
- 5.2 Based on our assessment of the available evidence within the 90 day period of this investigation, we consider that there is some evidence that the price of telephone calls made by prisoners in England, Wales and Scotland appears to be high, in particular relative to some measure of costs or compared with the price of prisoner telephone calls in some Serco managed private prisons.
- 5.3 We recognise, however that prisons are a unique environment for the provision of telephone services. There are many important public policy and security issues which impact upon the nature of the service and do not enable complete flexibility over how and by whom the service is provided.
- 5.4 We have considered several different options in order to address these issues. These include further investigation by us under our sectoral powers or under the Competition Act, making recommendations to government departments or another regulator to take action to address the issues raised and a market investigation reference to the CC. These options are explained in greater detail in Annex 4.
- 5.5 We consider that the issues raised by the NCC would be most appropriately and effectively addressed, at least in the first instance, by the government bodies responsible for prisons: the MOJ (which encompasses HMPS) and the SPS. These bodies are responsible for procuring and managing the contractual arrangements for the provision of telephone services in prisons in England, Wales and Scotland, and our view is that the issues we have highlighted would be most effectively addressed by considering possible changes to the current contracts and careful design of the tendering processes for the future contracts. Indeed, we recognise that the government bodies responsible were already taking steps to make improvements prior to Ofcom's receipt of this super-complaint.

⁶⁶ http://www.ncc.org.uk/nccpdf/poldocs/NCC207_prisoner_phonecalls_supercomplaint.pdf.

- 5.6 We recognise that the contracts in place are nearing their end and that the Prison Services have established comprehensive procurement programmes to build on best practice and to reflect changes in legislation since the original contracts were negotiated. We understand that since the original contracts were agreed, the NAO has carried out two reports into the procurement of goods and services by HMPS. According to the NAO's 2003 report,⁶⁷ between 1995 and 1999 a series of reviews sought to improve Government procurement and this led to the establishment of the Office of Government and Commerce (OGC) in 2000.⁶⁸
- 5.7 The NAO's most recent report published on 23 July 2008 concluded that:
- “the Prison Service has made major progress in achieving better value for money in procurement since we last reported in 2003. Through substantial recruitment and training of qualified staff, investment in supporting information technology and adopting centrally controlled contracting the Prison Service has realised steadily increasing and significant savings”.⁶⁹
- 5.8 We understand that a further internal review by the OGC into the MOJ's procurement processes is currently being drafted.
- 5.9 Following an investigation into the price of calls from prisons in England and Wales in August 2006 the Ombudsman (whose jurisdiction does not include Scotland) recommended that:
- “[W]here future contracts or services are being procured that will directly affect the costs paid by prisoners or their families, an impact assessment is carried out, and used as a factor in negotiations to ensure that prisoners are not unduly disadvantaged”.⁷⁰
- 5.10 Following that report the MOJ agreed to implement the Ombudsman's recommendations in the next tendering process. The MOJ has informed us that in May this year a project team was established to run the re-tendering process. That team will be focusing on prisoner welfare, reducing the costs of prisoner telephone calls, and taking into account the changing nature of the prison population (i.e. the need to call abroad and calls to mobile phones).⁷¹ We therefore expect that HMPS will fully implement the Ombudsman's recommendations in England and Wales, both in any renegotiation of the current contracts and in future tendering exercises.
- 5.11 The SPS does not fall within the jurisdiction of the Ombudsman and therefore was not included within the Ombudsman's review. However, the SPS may also wish to consider whether to conduct an impact assessment on the effects of call charges on prisoner welfare as part of the next tendering process.
- 5.12 We welcome these advances and expect that best practice will be built upon in the next tendering rounds. Best practice should consider:

⁶⁷ NAO, *Modernising Procurement in the Prison Service*, 4 April 2003, available at: http://www.nao.org.uk/publications/nao_reports/02-03/0203562.pdf.

⁶⁸ The OGC brought together the Treasury Procurement Team, the Buying Agency, Central Computer and Telecommunications Agency and Property Advisers to the Civil Estate.

⁶⁹ NAO Report, *The Procurement of Goods and Services by HM Prison Service*, 23 July 2008, available at: http://www.nao.org.uk/publications/nao_reports/07-08/0708943.pdf.

⁷⁰ Report compiled following the investigation into the cost of calls by the PPO dated 26 August 2006

⁷¹ MOJ internal memorandum dated 15 May 2008 provided as additional information to Ofcom by e-mail dated 1 August 2008

- undertaking a full assessment of the costs of telephone provision and where possible that prisoners share in the benefits of increased competition for telephone provision taking into account the impact of lower prices on prisoners' welfare. This may include an assessment of which costs should be recovered through telephone call revenue;
- ensuring that any long term contracts include suitable review clauses and technological advancements are taken into account throughout the life of the contract with any resulting cost savings being passed onto prisoners in the form of lower prices;
- considering whether restrictions on competition during the contract are necessary to address security concerns; and
- seeking transparency in future contracts.

5.13 We understand that the MOJ and the SPS have already discussed the possibility of working together in the next tendering round if the timing of that process makes co-ordination possible.

5.14 In order to address the NCC's concern about the current level of call charges, we would invite the MOJ and the SPS to consider whether it would be appropriate to open negotiations with BT and Siemens to reduce the cost of telephone calls under the current contracts.

5.15 Renegotiation or re-structuring the current contracts may have implications for the prices charged by the service providers and/or the commission structure received by the SPS/MOJ which we have not considered in detail in this investigation. We recognise that there are wider public policy and security issues involved which may need to be taken into account in any renegotiation.

5.16 If the MOJ and the SPS decide that renegotiations were not appropriate, or if the negotiations were not successful in securing reduced charges, we may reconsider this matter.

5.17 However, at this stage we consider that it would be premature to refer this to the CC prior to inviting government bodies to take further steps (see Annex 4 for further detail).⁷²

5.18 We consider that an early renegotiation of the current contracts and the adherence to best practice for the procurement of any new contracts should address the concerns raised by the NCC in its super-complaint.

⁷² We note that a reference to the CC may take up to two years from the date of reference. In any event, the BT Contract terminates on 1 June 2011 and the Siemens Contract on 31 March 2010.

Annex 1

Stakeholder contact

Stakeholder	First information request	Second information request	Date of meeting
NCC	Request sent 8 July 2008 Information received 15 July 2008	N/A	Met 16 July 2008
HMPS	Request sent 8 July 2008 Information received 15 July and 30 July and 1 August 2008	Request sent 12 August 2008 Information received 20 August 2008	Met 30 July 2008
SPS	Request sent 8 July 2008 Information received 15 July 2008 Confidential information provided at meeting on 1 August 2008	Request sent 12 August 2008 Information received 15 August 2008	Met 1 August 2008
BT	Request sent 8 July 2008 Information received on 18 July 2008	Request sent 12 August 2008 Information received on 18 August and 20 August 2008	Met 15 July 2008
Siemens	Request sent 8 July 2008 Information received on 18 July 2008 and Monday 21 July 2008.	Request sent 12 August 2008 Information received 14 August 2008	Met 29 July 2008
GCC	Request sent 8 July 2008 Information received on 15 July 2008	N/A	Telephone call to follow up on information request
Serco	Request sent 8 July 2008 Information received 15 July 2008	N/A	Met 17 July 2008
Opal	Request sent 8 July 2008 Information received at meeting on 15 July 2008	N/A	Met 15 July 2008
Unify	Request sent 8 July 2008 Information received 24 July 2008	N/A	Conference call 15 August 2008
MosCom	Request sent 8 July 2008 Response received 18 July 2008	N/A	Met 5 August 2008.
Action for Prisoners' Families	Request sent 8 July 2008 Information provided at meeting on 16 July	N/A	Met 16 July 2008
Prisons and Probation Ombudsman	Request sent 8 July 2008 Information received 17 July 2008	N/A	Met 15 August 2008
Leigh Day & Co	Request sent 8 July 2008 Information received 16 July 2008	N/A	N/A

Annex 2

Regulation of prisoner communications

The regulatory framework in England and Wales

A2.1 The regulatory framework for prisons and prisoners in England and Wales is based upon the Prison Rules 1999⁷³ (the Rules), which is a statutory instrument made under the authority of section 47(1) of the Prisons Act 1952. Further detail on prisoner communications is set out in Prison Service Order 4400 (the PSO). Prisoners retain civil rights that are not expressly or by implication limited by legislation, and are entitled in any case to their human rights under the Human Rights Act 1998 and the European Convention on Human Rights.

Prisoners' right to communicate

A2.2 The European Court of Human Rights (ECtHR) has held prisoners have a right to receive visits and to engage in written correspondence under the right to private and family life (Article 8). However the ECtHR has also found that there can be no guaranteed right to make or receive telephone calls (under Article 8).⁷⁴ In *R (on the application of Davison) v Secretary of State for the Home Department*⁷⁵ the Court of Appeal also doubted whether a prisoner's access to telephone calls could engage Article 8, and found against his claim that allegedly excessive call charges breached Article 8.

A2.3 Regulation 4⁷⁶ of the Rules creates a duty on prisons to encourage positive contact between prisoners and the outside world, and regulation 35 grants an express right to receive visits and to engage in written correspondence. The Rules do not grant an express right to make or receive telephone calls.

Limitations on right to communicate

A2.4 The Rules create limitations on prisoners' right to communicate. Regulation 34 provides that no prisoner is entitled to communicate with any person outside the prison without the authorisation of the Secretary of State. It further empowers the Secretary of State to place limitations on communication with persons outside the prison provided certain conditions are met. "Communications" in this context includes telephone calls. Regulation 35A makes further provision for the Secretary of State to give directions concerning the interception of communication.

⁷³ SI 1999/728.

⁷⁴ *AB v the Netherlands* [2003] 37 EHRR 48, para 92. "In respect of the telephone facilities, the Court considers that Article 8 of the Convention cannot be interpreted as guaranteeing prisoners the right to make telephone calls, in particular where the facilities for contact by way of correspondence are available and adequate."

⁷⁵ [2008] EWCA Civ 676.

⁷⁶ "4(1) Special attention shall be paid to the maintenance of such relationships between a prisoner and his family as are desirable in the best interests of both.

(2) A prisoner shall be encouraged and assisted to establish and maintain such relations with persons and agencies outside prison as may, in the opinion of the governor, best promote the interests of his family and his own social rehabilitation."

Prison Service rules on telephone calls

- A2.5 The PSO provides detailed rules governing prisoners' use of the Pinphone system. Rule 2.8 of the PSO requires prisoners to sign a terms of use agreement before being granted access to the telephones. Breaches of this agreement may be charged as an offence against discipline under regulation 51 of the Rules, which can carry a range of sanctions, and may include being barred from using the telephones.
- A2.6 The terms of use include prohibitions on calling unauthorised telephone numbers, using another prisoner's PIN number, and making credit card, collect or diverted calls via other telecommunications providers.
- A2.7 The PSO also sets out rules for prisons, relating to the use of call enabling and call barring systems (which determine which numbers prisoners can call), the categories of person that prisoners are prohibited from calling, the monitoring of calls, access to telephones, the provision of international calls (including in some cases the mandatory provision of free calls), and the provision of additional telephones.
- A2.8 The charges for making calls are agreed under the contracts between HMPS, BT and GCC.

The regulatory framework in Scotland

- A2.9 The regulatory framework for prisons and prisoners in Scotland differs from the framework in England and Wales in the following respects. It is based upon the Prisons and Young Offenders Institutions (Scotland) Rules 2006⁷⁷ (the Scottish Rules), which is a statutory instrument made under the authority of section 39 of the Prisons (Scotland) Act 1989. Further detail is set out under the Prisons and Young Offenders Institutions (Communication by Telephone) (Scotland) Direction 2008 (the Direction). There are also local Directions, relating to individual prisons, which set out the times at which the telephones are to be made available in those prisons.⁷⁸

Prisoners' right to communicate

- A2.10 Prisoners have rights to receive visits and engage in written correspondence in a similar manner to prisoners in England and Wales, and have additional rights to maintain their contact with current affairs, for example by having access to newspapers. Under regulation 62 of the Scottish Rules prisoners also have an explicit right to use a telephone subject to any Directions issued by Scottish Ministers. Scottish Ministers have the power to issue Directions concerning the groups or categories of prisoners to be granted the use of a telephone, the times of day and circumstances when telephones should be available for use, the conditions applying to the use of telephones, and the logging, monitoring and recording of telephone conversations.

The SPS rules on telephone calls

- A2.11 The Direction provides detailed rules on prisoners' use of telephones in the SPS prisons. It sets conditions on prisoners' use of the telephones, breach of which may

⁷⁷ SI 2006/94.

⁷⁸ For example the Greenock Prison (Communication by Telephone) Direction 2008.

give rise to disciplinary action under Part 11 of the Scottish Rules. The conditions include restrictions on who the prisoner can call, the types of number that they can dial, and prohibits the use of call routing services. The Direction further provides rules relating to the monitoring of calls by the SPS officers and the circumstances in which prisoners' rights to use a telephone can be withdrawn.

A2.12 The Direction entitles the SPS to set the cost of telephone credits. Call charges are contractually agreed between the SPS and Siemens.

Annex 3

Market definition and market power

Market definition

- A3.1 The main purpose of market definition is to identify the competitive constraints that act upon a supplier of goods or services. The identification of the relevant economic market, and the calculation of market shares, is also an important first step in the analysis of whether suppliers are likely to possess market power. Market definition is also required in order to determine whether particular behaviour or agreements falls within the scope of competition rules.⁷⁹
- A3.2 Competition concerns could arise if it is established that BT and/or Siemens have market power as suppliers of telephone services (equipment, access and calls) to Prison Services,⁸⁰ or because HMPS and/or the SPS have market power in the procurement and supply of telephone services to prisoners. We have considered the supply of telephone services to the Prison Services, and the supply of telephone services to prisoners.

Supply of telephone services to HMPS/SPS

- A3.3 The Prison Services have in the past chosen to invite tenders for a managed solution, under which BT and Siemens obtained contracts to supply services to the Prison Services. There are other possibilities for the provision of such services in, for example the arrangements adopted by Serco under which it obtains services in this market and supplies call services itself to prisoners. In general however, the nature of competition has been competition for the market through tenders to the Prison Services, not competition between different suppliers *in* the market for the supply of calls to prisoners. The exception is the introduction by HMPS of competition between GCC and BT for international calls (see paragraph 3.24 above).
- A3.4 The provision of telephone services in prisons is seen by all parties as being very important in meeting the welfare needs of prisoners and society more generally.⁸¹ We have not seen any evidence to suggest that the Prison Services would reduce their demand for telephone services significantly were the cost of providing calls to prisoners to increase.
- A3.5 If higher costs are passed on to prisoners then they are likely to make fewer calls. This may indirectly affect the ability of telephone service providers to raise prices to the Prison Services. However, this is likely to be limited as prisoners have very little alternative but to use the telephone services provided by the Prison Services.

⁷⁹ OFT, *Market Definition* (OFT403), December 2004, available at:

http://www.ofcom.gov.uk/shared_ofcom/business_leaflets/ca98_guidelines/oft403.pdf.

⁸⁰ HMPS, SPS, or the private contract suppliers e.g. Serco.

⁸¹ The NCC cited Social Exclusion Unit, *Reducing Re-offending by Ex-Prisoners*, 2002, which suggested that prisoners are six times less likely to re-offend if they have a supportive family network to return to when they are released.

- A3.6 Prisons have specific security requirements and accordingly require specialised telephone systems. This is likely to restrict the potential for alternative means of providing calls to prisoners.
- A3.7 The first relevant market is therefore likely to be the supply of call and access telephone services to the Prison Services.
- A3.8 Suppliers competing for the prison telephone contract could be based in the UK or overseas. However the Prison Services, which run the procurement processes, are specific to geographic areas. Therefore it is possible for there to be different competitive conditions between geographic areas covered by the respective Prison Services. It is likely that there are two separate markets, one for England and Wales, and one for Scotland.
- A3.9 We recognise that the technological alternatives today are likely to be very different to those that could have been considered by the Prison Services ten or even five years ago. There have been since then significant advances both in technology and in procurement techniques. Such developments may also mean that there are likely to be more potential providers of telephone systems to prisons in the future than in the past and there is likely to be greater scope for competition in any future tender process.

Supply of telephone services to prisoners

- A3.10 In the market for the supply of calls from prisons, there is limited ability for prisoners to contact friends and relatives other than by using the telephone system provided by the Prison Services. For security reasons, prisoners are not allowed to bypass the Pinphone system to make calls by any other means. Prisoners cannot use mobile phones. In addition, visits from family are restricted⁸² and email is not available. Prisoners can communicate by letter, but may be hindered by low literacy levels. Half the prisoners screened at prison reception are at, or below, Level 1 in reading (the level expected from an 11-year-old); two-thirds are below Level 1 in numeracy and four-fifths in writing.⁸³ Incoming calls are generally not allowed which means that prisoners cannot avoid the cost of using the Pinphone system by asking friends or relatives to call them instead.
- A3.11 In relation to opportunities for other providers to enter the market, this is limited because of the necessary security arrangements required by the Prison Services, who may for legitimate security concerns consider it necessary to prevent or limit access to the markets.
- A3.12 Therefore the relevant economic market is likely to be the supply of telephone services to prisoners in publicly-managed prisons.
- A3.13 Prisoners have no option other than to use the telephone service that is made available to them. This means that there are likely to be separate markets, one for England and Wales, and one for Scotland.
- A3.14 We note that it may be possible for the Prison Services to separate out the supply and maintenance of the telephone equipment from the supply of access and calls in such a way that prisoners could in future be able to choose between competing

⁸² Convicted prisoners are allowed a visit on reception and then one visit at least every two weeks- see PSO 4410.

⁸³ <http://www.homeoffice.gov.uk/about-us/freedom-of-information/released-information/foi-archive-offender-management/200-literacy-numeracy-prisoners?view=Html>.

providers. However, Ofcom recognises that the Prison Services have structured the provision of telephone access and calls in a particular way to meet their security concerns and a different structure may not meet these concerns.

Market Power

Market for the supply of telephone services (equipment, access and calls) to the Prison Services

England and Wales

- A3.15 As competition is through the tender process, market power will depend largely upon the extent of competition for the market at the time of the tender.⁸⁴ Having market power may also allow the telephone service suppliers to negotiate better contract terms (e.g. longer contract terms and lower commissions).
- A3.16 BT appears to have faced limited competition at the time of the HMPS Pinphone tender in 1998. It is plausible that BT may have enjoyed some incumbency advantages as the supplier of the previous prisoner telephone system in England and Wales. In addition to the existing relationship, BT also had a limited number of prisoner telephone contracts with HMPS under the previous cardphone system, some of which were not due to expire until 2003. BT had also conducted a pilot study of the PIN system in HMPS prisons.⁸⁵
- A3.17 HMPS's choice of technology for the supply of the telephone system also appears to have been limited at the time as no other technology appeared to have been proposed.
- A3.18 Although HMPS invited bids from a number of suppliers, we understand that BT was the only supplier to meet the technical specifications for the contract.⁸⁶ This does not necessarily imply that BT had market power. For example, if BT believed there to be credible alternative suppliers then this could result in them offering competitive terms, even if they were the only actual bidder.
- A3.19 The apparent lack of alternative suppliers or technologies suggests that BT may have had some degree of market power at the time of tender. Further evidence of market power may be apparent in the relatively long contract (10 years, extended to 12.5) agreed between BT and HMPS, and [redacted] (BT's internal rate of return was higher than BT's own estimated cost of capital)].

Scotland

- A3.20 Competition for the SPS's Pinphone tender in 2002 appears to have been more effective. A number of companies responded to the tender including [redacted] and Siemens who provided bids. In part this is likely to be due to the contract being tendered at a later date by which time there had been advances in technology and experience in operating Pinphone systems in prisons. The Pinphone system was more widely established, the costs of provision of both equipment and calls had fallen, and projections of the prisoner population had increased. This is likely to have increased the potential profitability of the Pinphone system and possibly

⁸⁴ The winner of the contract may have some market power after the contract has been awarded if they have a degree of exclusivity and if their behaviour is not effectively regulated by the procurer.

⁸⁵ [redacted]

⁸⁶ Meeting with HMPS on 30 July 2008.

reduced the risks associated with the investment, and therefore encouraged greater competition for the tender.

- A3.21 The SPS was able to obtain a commission structure which they forecast would generate 17% of revenue from call charges (with a maximum rate of 25%), together with other contributions to their costs totalling £250k. This is a higher commission rate than in England and Wales (6 or 7%). However, the SPS agreed to pay for some of the new additional equipment should new prison facilities be built.
- A3.22 The SPS negotiated a five year contract compared to the longer contract agreed by HMPS.
- A3.23 In winning the tender, Siemens replaced the incumbent BT, who had a track record both of operating the previous card phone system in Scotland for the SPS, and of delivering the Pinphone system in England and Wales. Siemens does not seem to have had market power at the time of the SPS tender.

Market for the supply of telephone services to prisoners in publicly managed prisons

- A3.24 Ultimately the Prison Services have the ability to specify the suppliers and set the price of telephone services to prisoners in publicly run prisons, either directly or through the contracts with the telephone service providers. Prisoners do not have any possibility of switching to an alternative provider of telephone services.⁸⁷ Therefore, the Prison Services have 100% share of the markets for the supply of telephone services to prisoners.

⁸⁷ Although it might be argued that high prices might increase the illegal use of mobile phones in prisons.

Annex 4

Options considered

A4.1 As noted in Section 5 above, our assessment of the available evidence suggests that certain features of the market may give rise to concerns. We have considered several different options in order to address these issues. These include a market investigation reference to the CC, the use of sectoral powers, opening an investigation under the Competition Act and making recommendations to government bodies. These options are explained below.

Market investigation reference to the CC

A4.2 Part 4 of the Enterprise Act confers powers on us (concurrent with the Office of Fair Trading (OFT)) to investigate markets, and to refer the market to the CC for a second stage investigation if we identify any competition problems. The CC is able to impose a number of remedies to resolve these problems.

A4.3 In order to make a reference we must be satisfied that the section 131 threshold test has been met. We should then consider whether it is appropriate for us to exercise our discretion to refer the market to the CC. In particular, we should first consider whether other sectoral powers (for example whether we should address any problem through General Conditions or Significant Market Power (SMP) Conditions) or Competition Act powers (investigating potential abuses of a dominant position or anti-competitive conduct/agreements) are more appropriate to address any competition problems.⁸⁸ Given the public policy issues (in particular prisoner welfare) raised in this case and the involvement of Government in the contracts, we have also considered whether it is more appropriate and proportionate to make recommendations to government bodies.

The s131 threshold test

A4.4 Under s131 of the Enterprise Act we have the power to make a market investigation reference to the CC where we,

“have reasonable grounds for suspecting that any feature, or combination of features, of a market in the United Kingdom for goods or services prevents, restricts or distorts competition in connection with the supply or acquisition of any goods or services in the United Kingdom or a part of the United Kingdom.” (**‘the s131 test’**)

A4.5 Were we to make a reference to the CC we would expect first to examine in more detail and consult on:

- a) whether we have reasonable grounds to suspect that competition is prevented, restricted or distorted in some market in the UK or in a part of the UK; and
- b) whether it is a feature, or combination of features, of a market that gives rise to this adverse effect on competition.

⁸⁸ See OFT, *Market Investigation References* (OFT 511).

A4.6 We note that the threshold here is relatively low because it is a “*reasonable grounds to suspect*” test and because the distortion of competition element requirement is to be interpreted broadly.⁸⁹

Factors relevant to exercising discretion if s131 test is met

A4.7 In deciding whether it is appropriate to make a reference, the OFT's guidelines state that we would have to be satisfied that each of the following five criteria were met before exercising our discretion:

- a) It would not be more appropriate to deal with the competition issues identified by applying other competition law powers. Under the OFT guidelines this would only be if either (i) there are features distorting competition but there is no breach of competition law; or (ii) action under competition law is unlikely to be effective for dealing with the adverse effect on competition identified (e.g. because a structural remedy would be required);
- b) It would not be more appropriate to deal with the competition issues identified by applying our sectoral powers;
- c) It would not be more appropriate to address the problem identified by means of undertakings in lieu of a reference;
- d) The scale of the suspected problem, in terms of its adverse effect on competition, is such that a reference would be an appropriate response to it;
- e) There is a reasonable chance that appropriate remedies will be available to the CC.

Relationship with the Competition Act and sectoral powers

A4.8 In deciding whether to make a market reference we note the OFT's guidance “Market Investigation References”.⁹⁰ The guidance indicates that market references are designed to address market-wide competition problems. They should therefore be used when Competition Act or sectoral powers are insufficient to resolve problems in the market. For example, sectoral powers may not be sufficient to resolve the problems because they cannot be applied to the relevant parties. Competition Act powers may not be sufficient because there are insufficient grounds for establishing a breach of the Competition Act prohibitions, or because a Competition Act investigation would be unlikely to resolve the problems in the market. A market reference might be made where there is a lack of competition as a result of a number of companies operating independently of each other but together wielding significant power in the market, whereas, if one company abuses a dominant position in a market, it is likely to be dealt with under the Competition Act.

A4.9 The potential use of our sectoral powers is addressed at paragraphs A4.15-A4.21 below. The potential use of our competition law powers is addressed at paragraphs A4.22-A4.35 below.

⁸⁹ *Association of Convenience Stores* [2005] CAT 36.

⁹⁰ Available at: <http://www.of.gov.uk/>.

Scale of the problem

A4.10 To make a reference we must be satisfied that the adverse effects on competition of features of a market are significant. We may consider whether the adverse effects are likely to significantly increase prices, or reduce the quality, choice or innovation in the market. We will also have regard to the size of the market, the proportion of the market affected by the feature giving rise to adverse effects on competition, and the persistence of any such feature.

Availability of appropriate remedies

A4.11 Where we believe that the CC will be unable to impose appropriate remedies to remove or mitigate the adverse effects on competition we may decide not to make a reference. This might be, for example, where a market is global and action by UK competition authorities is likely to have little effect on it, or where adverse effects on competition arise primarily from laws, regulations or Government policies which the CC cannot directly control.

Process

A4.12 We must consult (giving reasons for the proposed decision) all persons likely to be substantially impacted by a proposed decision to either make a market investigation reference or accept undertakings in lieu of a reference. We must also publish, together with our reasoning, any market investigation reference which is made.

A4.13 We note that following a market investigation reference by Ofcom the CC's investigation and report may take a period of up to two years with significant public and stakeholder costs.

Result of a market investigation reference

A4.14 Should it conclude following its investigation that there are competition problems in a market, and that it is necessary and appropriate to do so, the CC has the power to make orders against or accept undertakings from relevant persons to tackle those problems. The content of orders that the CC is entitled to make is set out in Schedules 8 and 9 of the Enterprise Act. The potential content is very wide-ranging, for example an order might require a person to terminate an agreement, withhold goods or services, sell off business divisions, and/or publish information. There is no limitation on the content of undertakings, if they can be agreed between the CC and the relevant person(s). Alternatively the CC might make a non-binding recommendation to other bodies, such as Government.

Sectoral powers

A4.15 Our sectoral powers include the power to set General Conditions that would bind all communications providers or a class of communications providers, or SMP Conditions that would bind particular persons specified in the condition. We do not consider that the use of our sectoral powers would be an appropriate remedy in this case for the reasons set out below.

A4.16 The subjects that can be addressed within a General Condition are exhaustively defined in Annex A to the Authorisation Directive.⁹¹ Annex A includes a range of subjects, some of which are defined by reference to specified provisions of the

⁹¹ 2002/20/EC.

Framework Directive,⁹² the Universal Service Directive,⁹³ and the Access Directive,⁹⁴ together with a number of other Directives.⁹⁵ The potential issues raised in prison calls would not appear to be easily addressed by a new General Condition (assuming we even have the power to impose one in this case).

- A4.17 In addition we do not consider that imposing SMP Conditions on the parties would be an appropriate remedy.
- A4.18 SMP Conditions can only be applied where we have determined, following a market review, that a provider is dominant within a market. We can only conduct a review into markets not listed by the European Commission (the EC) in Recommendation 2007/879/EC, if the market satisfies a set of stringent criteria. These are:
- the presence of high and non-transitory barriers to entry. These may be of a structural, legal or regulatory nature;
 - a market structure which does not tend towards effective competition within the relevant time horizon. The application of this criterion involves examining the state of competition behind the barriers to entry; and
 - the insufficiency of competition law alone to adequately address the market failure(s) concerned.⁹⁶
- A4.19 If we wish to conduct a review we must follow a set procedure, including notifying the EC of our intention to review the market.
- A4.20 From our 90 day investigation, the markets would not appear to be suitable for review for the purposes of imposing SMP Conditions. In addition there are limits to the types of companies on which SMP Conditions may be placed and there are limits on the types of SMP Conditions that can be applied which we consider mean that we are unlikely to be able to impose a suitable SMP Condition in this case.
- A4.21 In summary, we do not consider sectoral powers are appropriate in this case.

Competition Act investigation

- A4.22 We have also considered whether we should launch an investigation under the Competition Act into suspected breaches of the prohibitions contained in Chapters 1 and 2 of the Competition Act and/or Articles 81 and 82 of the EC Treaty.

⁹² 2002/21/EC.

⁹³ 2002/22/EC.

⁹⁴ 2002/19/EC.

⁹⁵ Directive 97/66/EC concerning the processing of personal data and the protection privacy in the telecommunications sector, Directive 2000/31/EC on the certain legal aspects of information society services, Directive 89/552/EC on the co-ordination of certain provisions laid down by law, regulation or administrative action in Member States concerning the regulation of television broadcasting activities, Directives 97/66/EC and 95/46/EC on the protection of individuals with regard to the processing of personal data and the free movement of such data, Directive 89/336/EC on the approximation of the laws of Member States relating to electromagnetic compatibility, Directive 1999/5/EC on radio equipment and telecommunications terminal equipment and the mutual recognition of their conformity

⁹⁶ Article 2, Recommendation 2007/879/EC.

Chapter 1/ Article 81 prohibition

- A4.23 Chapter 1 and Article 81 prohibit, in certain circumstances, agreements between undertakings which have as their object or effect the prevention, restriction or distortion of competition. Chapter 1 prohibits agreements that have these effects within the UK and which may affect trade within the UK. Article 81 prohibits agreements that have these effects within the common market and which may affect trade between Member States.
- A4.24 As a preliminary issue in a Competition Act investigation we would need to consider carefully whether there is or has been an agreement between "undertakings". The ECJ has held:
- "the concept of an undertaking encompasses every entity engaged in an economic activity, regardless of the legal status of the entity and the way in which it is financed."
- A4.25 It has defined economic activity as:
- "any activity consisting of offering goods and services on a given market".⁹⁷
- A4.26 We note that the contracts here are between the Secretary of State for the Home Department and BT and the Scottish Ministers and Siemens. We consider that it is open to considerable doubt that the relevant Secretary of State and/or the Scottish Ministers would fall within the definition of an undertaking for the purposes of their agreements for providing telephone services into prisons. However, we have not fully investigated this issue as we consider there is a more appropriate and proportionate response as set out in Section 5 above.

Chapter 2/ Article 82 prohibition

- A4.27 Chapter 2 and Article 82 prohibit, in certain circumstances, conduct by one or more undertakings which amounts to an abuse of a dominant position. The prohibitions are contained in section 18(1) of the Competition Act and Article 82(1) of the EC Treaty.
- A4.28 A similar preliminary issue arises if we were to launch an investigation into the relevant Secretary of State or the Scottish Ministers under Chapter 2 or Article 82, namely whether they are acting as undertakings.
- A4.29 We have also considered whether we should launch an investigation into BT and/or Siemens for abuse of a dominant position. If we were to open a Chapter 2 or Article 82 investigation we would also expect to investigate the extent to which BT and/or Siemens' conduct could be considered to be unilateral in the context of Government policy and regulation of prisons.
- A4.30 If we were to open an investigation under Chapter 2 or Article 82 we would have to undertake the following analysis:
- we would define the relevant market or markets;

⁹⁷ *Federacion Espanola de Empresas de Tecnologia Sanitaria (FENIN) v European Commission* Case C-205/03 [2006] All ER (D) 140 (Jul), para 25.

- we would then assess whether either BT or Siemens were dominant in the relevant market or markets;
- if we found that BT and/or Siemens were dominant, we would then consider whether they had abused their dominant position.

The concept of abuse

A4.31 In *Hoffman – La Roche*, the ECJ, in describing the test that it was applying to the conduct in issue in that case stated that “[T]he concept of abuse is an objective concept relating to the behaviour of an undertaking in a dominant position which is such as to influence the structure of a market where, as a result of the very presence of the undertaking in question, the degree of competition is weakened and which, through recourse to methods different from those which condition normal competition in products or services on the basis of the transactions of commercial operators, has the effect of hindering the maintenance of the degree of competition still existing in the market or the growth of that competition”.⁹⁸

Excessive pricing

A4.32 We note that, on the basis of our investigation within the 90 days available to us, the prices charged to prisoners under the BT Contract may be high. In *United Brands*, the ECJ set out a two-step process for identifying excessive pricing, stating that the questions to be determined were:

“whether the difference between the costs actually incurred and the price actually charged is excessive, and, if the answer to this question is in the affirmative, whether a price has been imposed which is either unfair in itself or when compared with competing products.”⁹⁹

A4.33 If we were to open a Competition Act investigation based on Chapter 2 or Article 82 we would, therefore, consider two broad areas in determining whether the prices charged by BT are excessive. First, we would examine whether BT's prices were excessive compared to costs (i.e. “the difference between the costs actually incurred and the price actually charged”); and second, if this were found to be the case, whether the prices charged by BT were “unfair in themselves or when compared with competing products”.

A4.34 The *United Brands* two-stage test was recently applied by the Court of Appeal in the *BHB* case, where the Court of Appeal noted that:

“exceeding cost + is a necessary, but in no way sufficient, test of abuse of a dominant position.”¹⁰⁰

⁹⁸ Case 85/76 *Hoffman – La Roche v Commission* [1979] ECR 261, [1979] 3 CMLR 211, para 91.

⁹⁹ Case 27/76 *United Brands v Commission* [1978] ECR 207, para 252 (the ECJ went on to point out in the following paragraph that there were other ways “of selecting the rules for determining whether the price of a product is unfair”).

¹⁰⁰ Case No: A3/2006/0126 [2007] EWCA Civ 38, para 209.

Is a Chapter 2/ Article 82 investigation appropriate?

A4.35 At this point, we do not consider that it would be an appropriate and proportionate response to the super-complaint to open a Competition Act investigation under the Chapter 2/ Article 82 prohibition for the reasons set out in Section 5 above.