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Dear Tim

It was good to see you on the 8<sup>th</sup>. I thought we had a productive discussion and hope we can use this to work towards a sensible way forward on the issues you have raised. At the meeting, I said I would write to you to outline the next steps as we see them and to respond to your letter of 4 May. This time, as long promised, I have responded to the substance.

As I said at our meeting, I believe that our discussions can be structured according to three issues raised by you, which I paraphrase below:

- “Certain types of services currently categorised as PRS should not be regulated”
- “There should be a thorough policy review of the scope of PRS regulation”:
- “Ofcom cannot enforce regulation of PRS over mobiles because the PRS Condition contains an explicit exclusion of ‘mobile services’”

I will deal with each of these points in turn.

***“Certain types of services currently categorised as PRS should not be regulated”***

In your letter you argue that the risk of consumer harm is low or non-existent in respect of your Walled Garden Content Services and that you consider that the original rationale for regulating PRS does not obviously apply to these services. In particular, you argue that H3G’s implementation is such that consumers are very adequately informed and protected. At our meeting, you also argued that H3G’s business model was such that it would have little or no incentive to do anything that might upset its customers. H3G has a wide-ranging relationship with its customers and its need to ensure retention means that it has every incentive to make sure that customers purchase content services within a framework that is

clear and above board.

The debate here is not, of course, whether H3G is carrying out its activities in a way that causes harm, or could cause harm to consumers. Rather, we need to look at whether, absent regulation, a provider of services like H3G could (and in certain circumstances would) provide those services in a way that would cause harm. For example, might it be possible that a provider like H3G but with a different business model – e.g. one that was less focused on retention and more dependent on short term cash flow – would behave less ethically towards particular categories of customers?

It might well be that this is not the case and that the structure of the market is such that providers have foolproof incentives to ensure an adequate level of consumer information and protection. However, this is a complex debate which would require detailed analysis and the involvement of a wide group of stakeholders and evidential analysis. It is entirely appropriate that the PRS regulators consider H3G's views regarding the appropriateness of the regulation of its Walled Garden Content Services. Indeed, it is Ofcom's view that the regulators should consider this in due course as part of a thorough analysis of the appropriate definition of PRS and scope of PRS regulation.

***“There should be a thorough policy review of the scope of PRS regulation”***

In your 4 May letter you say that you look to Ofcom to “fully consult on the issue of the application of the ICSTIS code to new services and then based on the outcome of that process amend the code to both clarify its meaning and limit its application to areas where there is credible evidence of risk of consumer harm.”

I agree with the broad thrust of what you are requesting of Ofcom. In a fast moving market regulation needs to anticipate future commercial developments. Given that we cannot exactly describe each service that will emerge over time, we necessarily must find more generic ways to describe those services. As such, PRS have been defined according to certain key characteristics. Walled Garden Content Services fall within this definition and, therefore, these services are considered PRS for the purposes of regulation. Nevertheless, as the market evolves, it is entirely appropriate that regulators review the effect of the regulations, how these map onto the original intent of the regulations and how they compare given up-to-date priorities. Of course reviews cannot be constant: some stability in regulatory effect is required. Nevertheless, it has been some time since the regulator launched a full review of the scope, purpose and effectiveness of PRS regulation and, given that the market has developed significantly and given the important issues raised by H3G, we consider there is strong merit in now kicking off such a review.

ICSTIS is currently consulting on a new PRS Code of Practice (the 11<sup>th</sup> Code Consultation).

As part of this consultation, ICSTIS is asking respondents about the correct scope of PRS regulation as administered by ICSTIS through the Code. At our meeting you appeared to indicate that you consider it to be Ofcom's role rather than ICSTIS's to determine the scope of PRS regulation. Ofcom and ICSTIS do not share your view. While you are correct that Ofcom will indeed define the scope of PRS regulation through its backstop powers as defined in the PRS Condition, ICSTIS also is relevant in defining the scope of PRS regulation, in its case through the administration of the ICSTIS Code, which ICSTIS prepares but which Ofcom must approve if it is to have effect. I therefore urge you to engage with ICSTIS and Ofcom throughout the 11<sup>th</sup> Code consultation process. It is quite possible that through analysis and debate H3G will be able to achieve some of its objectives through this route.

At our meeting, we also shared our view that we must complete the process leading to the approval of the ICSTIS 11<sup>th</sup> Code before Ofcom could consider the scope of PRS regulation, and the detailed policy issues raised by H3G relating to the regulation of its Walled Garden Content Services. It is simply not practical nor appropriate for both organisations to conduct reviews in parallel that may affect the scope of PRS regulation. We expect that, subject to consultation, the process of approving the 11<sup>th</sup> ICSTIS Code will be completed early next year. At this stage, I think it would be entirely appropriate for Ofcom to start to consider the justification and proportionality of various aspects of PRS regulation, and how that regulation should be applied (or not) to particular services. As discussed, it is my intention that we should carry out such a review, leading to formal consultation, during the course of 2006. I cannot give a unilateral firm commitment that this review will take place because resource allocation happens as part of Ofcom's annual planning process. Nevertheless, Claudio, who has recently been appointed Ofcom's Director of Consumer Policy, has indicated that he will be proposing that Ofcom carry out this review in 2006. Independently of our conversations with H3G, Claudio considers that we have now reached a point where such a review would be desirable. In addition, I have indicated to you that I intend supporting any plan for a review of the scope of PRS regulation in 2006 when such a plan is presented to the Ofcom Board. In short, our desire is that this review take place and I will do what I can to make sure that this happens.

***“Ofcom cannot enforce regulation of PRS over mobiles because the PRS Condition contains an explicit exclusion of ‘mobile services’”***

As explained to you at our meeting, Ofcom's policy intention behind the “mobile services” exclusion in the Controlled PRS definition in the PRS Condition was to exclude calls *to* mobiles on 077-079 number ranges. The policy behind the carve-out was not to exclude PRS accessible *from* mobiles from regulation.

Nevertheless, we accept that the Condition, as drafted, could lead stakeholders to consider that Controlled PRS do exclude PRS services that happen to be accessed via mobile

handsets. To resolve this ambiguity, we will be writing shortly to our mobile stakeholders to explain that the PRS Condition does not capture calls-to-mobiles which are not PRS, even if priced at over 10 pence per minute. We will further explain that PRS accessed via mobile handsets are covered by the definition of Controlled PRS, and that Ofcom regulation does, therefore, extend to these services.

In case there is a risk of continued perceived ambiguity as to the coverage of the PRS Condition, Ofcom will consult on amending the PRS Condition to make it entirely unambiguous in this area. Ofcom will carry out this consultation as soon as resources permit and will do so independently of the policy review of the scope of PRS regulation which it intends to carry out during the course of 2006.

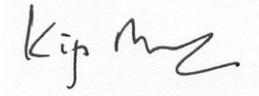
To summarise:

- Ofcom will be (i) writing to mobile stakeholders to make clear that the PRS Condition does capture PRS over mobiles; and (ii) consulting to amend the PRS Condition to make this clear.
- Ofcom agrees that there are interesting issues around the regulation of H3Gs Walled Garden Content Services but, given that there will necessarily be counter-arguments to those raised by H3G, Ofcom believes that these issues would be best considered as part of a policy review of the scope of PRS regulation.
- ICSTIS is currently consulting on its new 11<sup>th</sup> Code of Practice. As part of this consultation, ICSTIS is asking stakeholders whether they consider the existing scope of PRS regulation, as applied by ICSTIS through its Code, is proportionate and fair. I would urge H3G to engage with Ofcom and ICSTIS throughout this consultation process to make sure that its views are heard and properly debated.
- Once ICSTIS and Ofcom have finished the work required to implement the 11<sup>th</sup> ICSTIS Code, it will then be possible for Ofcom to debate and consult on the scope of PRS regulation as defined by the PRS Condition. Those involved with the regulation of PRS at Ofcom consider that a review of the scope of PRS regulation is now due and will be seeking to ensure that such a review take place during 2006. I have confirmed that I will be giving my support to those recommending a review, at the Ofcom Board and at other relevant Ofcom discussions.

I would like to conclude by discussing the matter of the ICSTIS levy. As you know I have always been keen to keep separate H3G's desire to have a policy debate on the scope of PRS regulation and H3G's decision to withhold from paying a part of the ICSTIS levy. I have now clarified Ofcom's view that PRS services accessed over mobile handsets are covered by the PRS regulations. I hope by now you are clear that both ICSTIS and Ofcom wish to have a wide ranging debate over the future scope of PRS regulation and have outlined the mechanisms for this to take place. In this context, my view is that your agreeing to settle the

levies will contribute substantially to our being able to conduct an open and constructive debate on the substantive issues.

Yours sincerely

A handwritten signature in black ink that reads "Kip Meek". The signature is written in a cursive style with a large, stylized "K" and "M".

Kip Meek

Cc: *George Kidd, Claudio Pollack*