Vodafone's response to Ofcom's consultation

"Simplifying non-geographic numbers"

May 2013

Contents

1. SUMMARY AND CONCLUSIONS

Vodafone welcomes the opportunity to respond to Ofcom's consultations. As an integrated business which both originates and terminates Non-Geographic Calls Services (NGCS) on behalf of millions of customers, we have a rounded appreciation of the issues at stake and a clear interest in the successful outcome of Ofcom's market reforms.

We continue to support Ofcom's headline proposals in principle, namely making Freephone universally free-to-caller in return for appropriate wholesale payments and unbundling other NGCS call charges to provide increased pricing transparency. We do, however, have substantial concerns about the implementation model outlined in the consultations. Put simply, we are concerned that Ofcom has left too much unresolved, with insufficient clarity on the mechanisms and timescales to provide all parties sufficient certainty to support a successful, timely implementation.

We recognise that implementation is a challenge for industry – for Communications Providers (CPs) and Service Providers (SPs) – as much as for Ofcom. Ofcom cannot achieve its ambition alone. But that does not take away Ofcom's pivotal role in the success of this project. Ofcom's rationale for intervention, based on its analysis of perceived market failures, is predicated on the belief that a hands-off 'laissez-faire' approach will not produce the best outcomes for consumers due to externalities, transactions costs and imbalances in market power. Yet the legal instruments Ofcom proposes do not fully address let alone overcome the very problems Ofcom has itself diagnosed in previous rounds of consultation. In their present form, we do not believe the proposals are fit for purpose, thereby putting the consumer outcomes Ofcom hopes for at risk.

A central theme in Vodafone's previous submissions, echoing concerns widely shared across industry, is that to get retail market interventions to work, Ofcom needs to be prepared to intervene firmly at the wholesale level by providing a clear, simple and stable commercial framework around which CPs and SPs can plan and invest with confidence. We see three core issues that Ofcom can and must address and resolve quickly for its current proposed implementation timetable to remain on track. These are:

- Confirmation of a single set of wholesale origination charges applied industry-wide for all Freephone traffic. There should be one rate for fixed origination and one (higher) rate for mobile origination distinguished by CLI.

- A confirmed menu of service charge price points to be supported across industry from which SPs and Terminating Communication Providers (TCPs) can choose safe in the knowledge that they apply to all consumer callers irrespective of the network to which those consumers subscribe.

- Continued regulatory oversight of the transit market for NGCS calls to ensure fair competition in the NGCS hosting market.

Ofcom's present proposals simply do not provide the necessary certainty far enough ahead for the practicalities of implementation to be accomplished within Ofcom's envisaged timetable and cost estimates. The 18 month implementation lead time needed for billing development, number migration and customer communication assumes a starting point of regulatory certainty around the wholesale commercial regime that Ofcom has not yet provided.

This gives rise to serious execution risks:

- If the timetable slips, the consumer benefits Ofcom hopes for will clearly be delayed.

- If the implementation timetable downstream of regulatory certainty at the wholesale commercial level is compressed, costs will inevitably increase from the levels assumed in Ofcom's impact assessment, eroding and possibly negating the assumed net benefits.

- However the most serious risk of all is that protracted uncertainty will create planning blight, precipitating an exodus away from NGCS altogether rather than arresting and reversing their decline. This is the very opposite of what Ofcom intends, but is a real risk that Ofcom needs to be alert to and take active steps to prevent for its overall reforms to be judged worthwhile.

Fortunately, there is still time for Ofcom to anticipate and address these risks proactively by reviewing its own approach to implementation and the framing of legal instruments. As a supporter of Ofcom's reforms in principle, we hope that on reflection Ofcom will commit itself to providing the necessary clarity and certainty up front to enable its vision to be realised expeditiously. It is only by grasping the nettle now that Ofcom can ensure the consumer benefits it expects to result from simplification are actually realised.

Critically, Ofcom needs to provide a simple, stable wholesale environment quickly for its retail level vision to succeed.

The remainder of this response is structured as follows:

In section 2 below we discuss lead times, with particular emphasis on the choices available to SPs and the baseline information they and Communications Providers (CPs) need to make decisions. We also the 'chicken and egg' problem for CP and SP negotiation that exists in the absence of regulatory certainty and the wider problems of relying on 'many to many' CP negotiations to deliver clear, simple, timely answers to key areas of contention.

In section 3 we consider transactions costs and the risks posed by co-ordination failure.

In section 4 we review the role that transit plays within the NGCS market and the need for continued regulatory safeguards to enable fair competition in NGCS hosting.

In section 5 we recap key recommendations for Ofcom to overcome these problems, through setting wholesale origination charges, confirming service charges and maintaining regulation of transit.

Annex 1 provides a more detailed critique of Ofcom's proposed approach to wholesale origination charges for Freephone, plus recommendations on the appropriate way forward.

Annex 2 considers the legal analysis underpinning Ofcom's proposed legal instruments and offers an alternative way forward that provides the necessary legal certainty for all parties from the outset.

2. LEAD TIMES AND THE NEED FOR REGULATORY CERTAINTY

Ofcom has rightly recognised that the scale and complexity of its NGCS reforms require a reasonable lead time to ensure successful implementation.

There are two key logistical factors necessitating a long lead time:

- The need for billing system development by CPs to ensure the 'pass through' model of unbundled service charges can be supported across industry
- The need to allow ample planning time for SPs to make informed decisions about future numbering choices, recognising that number migration and related communications requirements are integral to the overall success of Ofcom's reforms

Ofcom has gone some way towards confirming the parameters for OCP billing system development by setting out the minimum number of Service Charge price points it expects all OCPs to support. This is welcome so far as it goes, although the proposed model of bilateral negotiation between all OCPs and all TCPs introduces new questions about billing and commercial settlement across industry that have not been scoped – and cannot yet be scoped – in existing cost estimates.

The current problem for SPs is that critical information they need in order to make informed choices is lacking, and may be lacking for some considerable time, seriously eating into the available window for making and executing commercial decisions ahead of the 'go live' date for the new regime.

The reason SP's lack information is because TCPs also lack the same critical information, and therefore cannot set out a clear menu of options for SPs with sufficient certainty at this stage.

At a high level, the two most obvious questions for SPs are:

- What are the implications for me if I remain on my current number?
- What other options do I have?

Neither question can be answered unambiguously at present. Whatever type of NGCS number an SP customer currently uses, or is considering moving to, the key questions surround associated commercial terms and publication/communication requirements.
In the case of Freephone numbers, TCPs are not currently in a position to offer commercial terms to SPs without knowing what their future cost base will be. We illustrate below how, even on an exceedingly optimistic timetable, Ofcom's current model for resolving this issue threatens to result in protracted uncertainty for all commercial decision makers.

In the case of other NGCS numbers, there are two levels of constraint. Firstly, while SPs may have a view on their preferred SC price point within the permissible bounds for the number range in question (e.g. 084 – up to 7ppm inc. VAT, 087 up to 13ppm inc. VAT) this is not a choice that they can exercise on their own. It is not technically possible for TCPs to support different SC price points on the same 10k number block. So wherever there is more than one customer on a single 10k block, all must accept the same SC price point determined by the TCP, whatever that may turn out to be. It may, of course, be possible for an SP to secure a different SC price point by moving to a different number block. But here again, the present difficulty is that the available menu of SC price points is not yet clear. This is because, even if TCPs already knew the preferences of all existing and prospective SP customers, and had sufficient numbering capacity to support them all, they cannot guarantee that any particular price point will actually be supported industry-wide, or even by all major OCPs.

Service providers want answers now

These are not purely theoretical problems. Over the last few weeks Vodafone has engaged with a number of major SPs in the banking and insurance sectors, all of whom have been engaged with this process since 2010, and understandably expect precise information to allow their businesses to prepare for the changes. In order for commercial negotiations to commence the TCP needs certainty to present a selection of commercial options to customers which can then be converted into informed decision making. The TCP needs to be in a position to know fundamental items such as the precise level of fixed and mobile Freephone origination charges; the extent of pricing publication requirements[1], whether the ASA rules come into force in full on midnight of day one of the new regime and indeed whether they apply in business to business advertising or indeed at all in relation to 03; the availability of specific price points and the impact of the transition from POLO payments to SCs on their bespoke commercials. It is essential that all stakeholders possess this information before they can form their respective business strategies and commercial offerings.

In our discussions to date many customers have recalled the disruption resulting from past changes to the 0870 range, which they feel were underestimated in the regulatory process.[2] Given the far wider scope of these proposals customers are keen to ensure that they are only required to make final decisions on which numbers to use when they are in possession of all the facts and given sufficient time to transition the changes through their own businesses, modifying their customer contact strategies in a way that minimises the expense involved, for example by fitting in with already planned brochure-ware and website refresh dates.

Yet none of these decision points are currently available and a number have been left open to commercial negotiation which not only renders implementation timescales ambitious but makes it nigh impossible for all participants to arrive rapidly at a consistent position. Rather than providing regulatory certainty followed by an 18 month implementation period Ofcom threatens to deny the commercial freedom necessary to make informed decisions and to squander a significant chunk of the implementation

[1] We note the ASA aim to publish guidance 6 months prior to the final implementation date. However this query comes from a retail bank looking to advertise numbers on annual renewal material. In order to be compliant for January 2015, and to avoid the ASA regarding the omission of pricing information (i.e. the SC) in advertising which includes a non-geographic number as a breach of the 'misleading by omission rule' (3.1) in the Advertising Codes, the rules need to be in place and understood for renewals from January 2014.

[2] We note Ofcom adjusted its previous cost estimates in light of this feedback.

window by resolving issues which industry practitioners have consistently argued should constitute part of the regulatory framework against which implementation is to be conducted.

We note that CWW previously cautioned:

"*that Ofcom must be prepared to provide clear guidance in certain areas if it wishes to keep to its ambitious timescales. There are a number of areas… where industry is unlikely to agree. Indeed not only are a number of these entrenched positions reflecting the differing market positions of respective companies, but even during the generally constructive industry working groups it has not been possible to reach any form of consensus position. Ofcom should be under no illusion that agreement will be readily forthcoming through commercial negotiations nor that even with the best will of all parties involved should there be an expectation that Ofcom will not have to intervene through its dispute resolution powers. Accordingly final timescales for items such as making 080 truly free-to-caller must make provisions for the need for regulatory intervention and Ofcom should be prepared to intervene quickly and decisively*".

It appears to us that Ofcom has acknowledged the likely need for dispute resolution as inevitable but has chosen not to avail itself of several opportunities, as we set out below, to forestall such a necessity or to crystallise the dispute from the outset.

The limits of commercial negotiation

We have identified two areas above where greater certainty is required to facilitate a feasible 18 month implementation:

- Confirmed wholesale Freephone origination charges
- A confirmed initial set of SCs to be supported by all OCPs

Ofcom's present approach to both issues is to put them in a box labelled 'commercial negotiation' rather than to set the wholesale rates or to provide meaningful guidance based upon absolutes. But there are clear problems with such an approach:

- 'The chicken and the egg' scenario.
  There is a strong interdependency between SP and TCP negotiations, but the foundations needed for this commercial negotiation are lacking. Ofcom hasn't provided any certainty on either fixed or mobile Freephone origination rates or even the availability of SC price points; leaving the TCP unable to guarantee that any single price point will be available on all OCP networks let alone be in a position to supply meaningful commercial offerings.

- The scale and complexity of bilateral CP / CP and CP / SP negotiations means that any agreement will be a protracted affair even if Ofcom is called upon to exercise its dispute resolution powers within the three principles framework it proposes. We note that this methodology has not as yet been used to arrive at a specific rate and experience has shown it to result in “finely balanced” and inconclusive analysis susceptible to subsequent legal challenge.

- The low likelihood of swift, spontaneous agreement and converged answers

Ofcom rightly recognises that there is much to do ahead of the ‘go live’ date but has not sufficiently considered the sequence and critical path necessary for an 18 month implementation to be achievable. The 18 month period has been dictated primarily by billing development timescales and a desire to provide an optimum migration window to mitigate price publication and migration costs balanced against the need to make changes as soon as possible. The costs of transition do not only affect service providers who decide to migrate to a different number or numbers. Even those who are content to stick with their current number face new communication requirements and publication obligations that they need time to prepare for and plan.

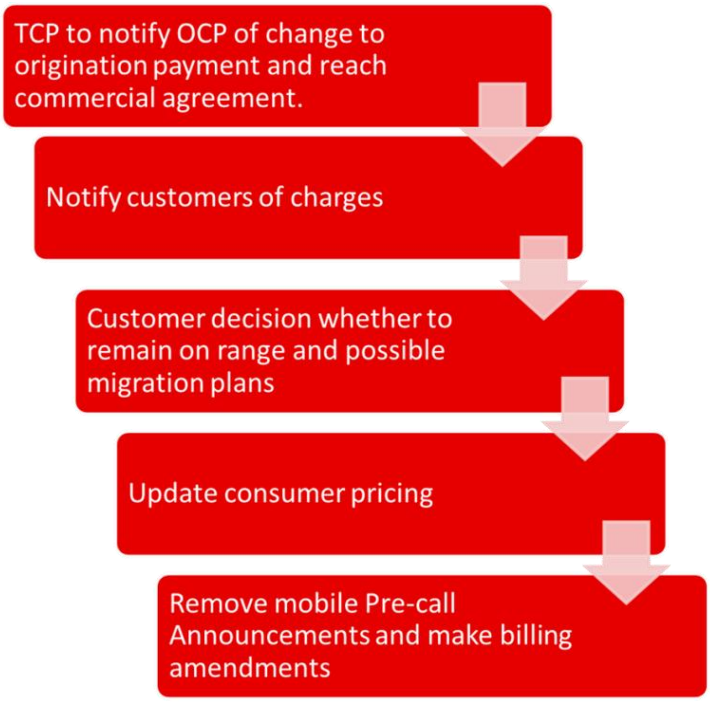
Implications for implementation timescale

We consider implementation from the view point of a Service Provider and compare and contrast Ofcom’s high-level timescale with the steps Vodafone and its customer need to take.

By way of example, the figure below delineates the steps identified by Ofcom as necessary to implement universal free-to-caller Freephone. Alongside it we have considered the realistic steps needed for Vodafone and an example Enterprise customer that has previously chosen to base its current nationwide contact strategy solely upon 080 numbers[3]. We have ignored any potential legal challenge to the proposals and assume that Ofcom achieves its proposed target for statement publication and dispute resolution.[4]

[3] We assume that the unbundled regime is implemented in parallel to time and without complication.

[4] The latter in particular we consider to be highly optimistic: of the recent ‘ladder charging’ disputes only the first was completed within the four month timeframe and we note that our analysis takes no account of Christmas within the anticipated dispute consideration period.



18 month timeframe

- Publication of Ofcom Statement July 2013.
- Internal Vodafone pricing decision on level of origination charge: 1 month.
- TCP notification. 30 days for response followed by OCP counter offer - 30 days. Agreement to disagree takes up to 3 months in total.
- Dispute submission accepted by Ofcom: 1 month.
- Dispute resolution process: 4 months.
- Translation of dispute resolution into commercial offerings and notification: 3 months.

Only 6 months remain for SPs to decide on their commercial response and the implementation of a new strategy and publication refresh.

Rather than allowing 18 months implementation for a SP using 080x numbers, the current timeline in practice allows only six months from the point at which CPs are in a position to convey to customers accurate pricing information for each of the number ranges. Ofcom is initiating a major shake-up of NGCS and has sought to provide a timescale which minimises costs by accommodating OCP billing and SP migration timescales, but this model fails to deliver the anticipated benefits. Six months may be acceptable for an organisation which decides to remain upon the 080 ranges, but it is wholly inadequate for anyone deciding to leave the range due to the (as yet unquantified) commercial impact of the Freephone origination charge upon their commercial offering.

Such SPs also face an inflated cost of change. A truncated implementation period forces them to change marketing literature outside of their typical publication cycles. The transparency benefits of Ofcom's review are also negated in the hosting market as any SP who desires to go to market for an alternative partner and commercial offering is denied the necessary period to explore the opportunity.

Vodafone's understanding from discussions with its Service Providers is that changes to promotional material, particularly print medium, typically require much longer than a six-month time period. We note that The Helplines Association (THA) reflected a similar view with its members calling for a minimum of 10 months to implement changes from the point at which the commercials were finalised. Such timescales are not achievable within the current implementation model.

Nor should it be forgotten that 'migration costs' are also incurred by those operators remaining upon unbundled 08x ranges which will have to publish pricing. The sooner the ASA can provide certainty of these requirements the better SPs will be able to minimise their costs.

Risk of uncertainty from Dispute Resolution

Ofcom's timescale is heavily reliant upon its dispute resolution powers in the absence of commercial negotiation. Vodafone sets out in detail why we believe this to be a flawed legal construct, but in terms of practical implementation it also poses a risk. Any legal dispute resolution can only bind the parties to the dispute and whilst Ofcom may have an expectation that industry will follow such precedent, the ladder charging disputes have shown that there is ample scope for individual operators to maintain positions outside of the dispute resolution based upon their unique situation.

In order to avoid the potential for delay (and in the absence of Vodafone's legal construct being adopted) Ofcom should consider:

- Framing and preparing for an industry-standard dispute now
- Agreeing with industry that the usual standard of exhaustive commercial negotiations between parties is not required to get to the point at which parties are able to agree that they are in dispute.
- Convincing other parties to join a 'super-dispute' and agree that they will be bound by the outcome

Vodafone as a major mobile and fixed line terminating operator is willing to help Ofcom and industry crystallise any dispute if required.

Dispute resolution for 080 cannot be concluded until Ofcom publishes its Fixed Narrowband Statement

The above also simplifies the situation somewhat as the fixed origination charge set out in the consultation for 080 is not really a range, but an uncertainty that arises from the range of network LRIC+ outcomes in the Fixed Narrowband consultation - see figure A26.4, where almost all the variability in the results comes from the possible variation in the network LRIC+ value that will in fact be fixed following on from the Fixed Narrowband statement.

If the Fixed Narrowband statement concludes that fixed network LRIC+ origination is at the lower number in the table, i.e. 0.23p, the fair and reasonable fixed LRIC+ range is from 0.25p to 0.31p, a much narrower range than the 0.3 to 0.6p that the table implies.

We also note that should Ofcom implement a glide-path on the introduction of pure-LRIC for geographic termination rates (which in turn is influencing the LRIC+ for call origination as the "+" includes displaced common costs from that), then the LRIC+ for fixed origination could evolve over time hence implying that the balancing mobile origination fee must similarly do so.

The methodology Ofcom has set out to determine a fair and reasonable rate means that with mobile origination being the balancing output, a TCP cannot determine the fair and reasonable mobile origination that satisfies the guidelines until the fixed origination is fixed as there is a different result when fixed origination is 0.3 than when fixed origination is 0.6.

Thus the whole dispute timetable has to move back until after the Fixed Narrowband statement and Ofcom revising its guidelines in light of the conclusion. Ofcom should look to crystallise any disputes (deemed to exist in absence of agreement) and to conclude any dispute resolution as soon as possible after the statement's publication in October 2013.

Ofcom is in danger of allowing an unregulated BT to determine industry norms.

Furthermore, there are major practical questions about how a model of bilateral negotiation between each and every conceivable pair of TCPs and OCPs could work in practice. For a start, there is the sheer number of potential bilateral negotiations to consider. Such negotiation only works where there is a direct connection and contractual relationship between the parties and that OCPs choose to utilise that connection. The industry operates in a world of cascaded commercial arrangements with extensive use of transit operators (one transit operator in particular) for NGCS.

Ofcom appears to suggest that individual bilateral negotiations between all pairs of operators might not be necessary because smaller operators can rely on larger operators to negotiate on their behalf. Yet there are major problems with this suggestion. It cannot safely be assumed that larger operators will negotiate on behalf of smaller operators. Ofcom has not created any obligation for third party negotiation on behalf of others and, more worryingly, is actually proposing to relax the remaining regulatory safeguards on BT as a transit operator. It is naïve to expect BT to act altruistically on behalf of other CPs with whom it competes directly. As Ofcom has previously identified, BT is a uniquely powerful presence by virtue of its unmatchable position in fixed wholesale call origination and in NGCS hosting. A key aim of the

NGCS policy review was to move away from a model of regulation where the world revolved around BT. Yet Ofcom is in danger of ushering in a new model in which the world still revolves around BT – but an essentially unregulated BT that is free to pursue its own commercial interests at the expense of its competitors without let or hindrance.

At the point that regulation upon BT as transit provider is removed the potential for problems increase, because Vodafone will be unable to separate what it is being charged for origination from what it is being charged for transit:

- Even if regulation on transit is retained, Ofcom's model of the TCP negotiating is problematic as many OCPs don't have the capability to differentially charge for individual TCPs, and TCPs typically don't have the ability to validate OCP bills without reliable means of knowing where the call originated. Ofcom must consider carefully a mechanism for ensuring that TCP negotiations can be conducted fairly.

- If regulation is removed, it risks handing BT the capability to use its position to manipulate the market. We cover this further below.

Against this background, we reaffirm our view that rapid spontaneous commercial agreement is extremely unlikely. If commercial negotiation has to be exhausted before Ofcom will consider intervening by way of dispute resolution (or on its own initiative) there is every chance that fundamental issues that are easily identifiable now will remain unresolved well into the 18 month implementation window. Indeed our figure above may prove to be an overly optimistic view of the situation.

Ofcom can and should resolve this by mandating appropriate wholesale charges for fixed/mobile Freephone origination respectively, and should do so as near as possible to the finalisation of the legal instruments.

3. **TRANSACTION COSTS AND RISKS OF CO-ORDINATION FAILURE**

As noted above, there are two key logistical factors that require a long lead time, but which are similarly reliant upon Ofcom providing certainty:

- Billing system development
- Number migration and planning for future SC publication requirements

We discussed number migration from an SP perspective in section 2 above. Below we expand on the potential difficulties for billing system development if Ofcom does not move quickly to ensure a simple, uniform approach across industry at wholesale level for Freephone origination and unbundled service charges.

Billing system development

Ofcom goes some way towards providing necessary parameters for the billing system development required for unbundling and has seemingly built its 18 month implementation period around anticipated billing development requirements (the number of price points OCPs need to support, light touch bill presentation etc.). This is welcome, though it unfortunately stops short of determining the actual SC price points to be supported across industry.

Unfortunately the proposed model for commercial negotiation of wholesale Freephone origination payments risks undermining the previous working development and cost assumptions that underpinned these assessments as they were based upon there being no need to differentiate, based on CLI, beyond fixed / mobile origination. The prospect of needing to support multiple bilateral commercial arrangements with no guarantee of cascade billing is completely un-scoped – and it is not possible to scope everything required within the timescales of this consultation.

The proposed regime risks inflating costs beyond those modelled by incorporating un-modelled transactions costs, un-modelled additional billing and settlement complexity if Freephone origination charges need to distinguish the identity of individual OCPs.

There is further potential complexity should the retail limitation on the regulation to ‘consumer’ callers drive a need to categorise call records by the type of caller. In the most extreme cases it may mean that the rating of calls to a SP operating 080 numbers for example would need to consider whether the call originated from a fixed line; a mobile device; a business customer (potentially distinguishing between technology) or a consumer (again on either type of device).

This is unneeded complexity that risks undermining all previous cost estimates and the prospectus on which the previous consultation was based. In order for Ofcom to realise its cost benefit analysis and to achieve its retail consumer benefit objectives practicably such wholesale arrangements need to be kept simple and uniform. Indeed at the wholesale level, apart from the necessary distinction between mobile and fixed originated calls for Freephone, a NGCS minute in each service charge price-band is identical to every other, with no distinction needed on the retail origin of the call to either the business or residential market.

Similarly, the Service Charge regime at the wholesale level needs to apply uniformly to all call termination to a given number range. Ofcom has already clarified that ‘bespoke’ termination charges based on the identity of the OCP will be prohibited. It needs also to confirm that while the retail requirement to support unbundled tariffs may be confined to consumers, the resultant wholesale service charge applies equally to all traffic irrespective of whether the caller is a ‘consumer’ or a business customer.

This underlines the importance of clarifying and confirming the *wholesale* regulatory regime at the start of the implementation project. Experience has shown that any hint of a regulatory lacuna may be exploited to impose wholly unjustified complex charging arrangements that cannot be shown to promote competition or consumer interests. Given that one of the key drivers of Ofcom’s present reforms was a perceived need to break the cycle of litigation around novel NGCS charging structures, Ofcom needs to ensure that this objective is successfully achieved. Our concern about fall-back reliance on dispute resolution is not simply that it prolongs uncertainty and threatens the implementation timetable, but that if the scope of any dispute is confined to wholesale calls that are within the scope of Ofcom’s retail intervention (i.e. limited to “consumers” as defined within the General Conditions), Ofcom cannot guarantee the simple, uniform wholesale commercial model needed to support its retail transparency objective at proportionate cost.

Ofcom can and should resolve this by mandating appropriate wholesale charges for fixed/mobile Freephone origination respectively, and should do so simultaneously with finalising the other legal instruments.

Service Provider options in the face of uncertainty

We have discussed that for SPs to make informed efficient decisions about future use of NGCS in order to assess any migration or SC price publication requirement they need their TCP to be able to provide a clear menu of *all* their future options, in much the same way that the changes are designed to deliver for consumers.

There are currently two main obstacles:

- Uncertainty around Freephone origination cost base
- Uncertainty about available SC price points supported by all OCPs

We are not calling for Ofcom to remove all commercial risk. In relation to the first issue, CPs and SPs will need to take their own view on the likely volume response of a shift to a universal free-to-caller regime and the resulting mix of fixed and mobile originated traffic. But Ofcom needs to provide certainty on the underlying level of wholesale outpayments for fixed / mobile origination respectively or at the very least allow adequate time once this level has been determined to allow informed decisions to be made. CPs and SPs can then negotiate how they share risk between them on a commercial basis.

In relation to the second issue, TCPs cannot presently offer SP customers a well-defined choice of SC price points to choose from because there is no certainty that any particular price point will be supported by all (or even most) OCPs.

Consider if you will a SP operating imported 0845 numbers on the Vodafone network. They currently have the prospect of further commercial uncertainty should they remain on 0845 until the new regime is implemented in January 2015 with worsening commercials forecasted resulting from continued BT manipulation of retail discount pricing and the NTS formula. What are their options? The unbundled tariff offers long-term certainty, but it is at a price point that will be set by the rangeholder network of their 0845 number, without any guarantee that it will reflect the SP's wishes. They may be fortunate and be able to maintain their current offering or the price point may be set at a level that requires them to change number range.

The dilemma then faced is how to assess the alternatives, even assuming that all OCPs open all 08x ranges in penny increments. Ofcom appears to assume that a SP using 0845 today will naturally migrate to 03, though it is far from clear that this should necessarily be the case:

- 084x in the unbundled regime offers price point certainty, but as yet no clarity on the applicable price point on any particular range, or the extent of SC price publication requirements;

- 080 offers universal free-to-caller, but the unit cost drivers are as yet unknown, as is the overall impact on call volumes and resultant costs and benefits to the SP;

- 03 may appear superficially attractive insofar as it is not immediately subject to the same transparency obligations as unbundled 08X numbers, but commercially it too remains uncertain and will remain so beyond the conclusion of the fixed narrowband market review. It appears that 03 has fallen between the two Ofcom projects and that certainty will not prevail until a third dispute on termination rates is brought or Ofcom intervenes (which is unlikely). Ironically calls may also prove to be more expensive for vulnerable consumers on PAYG tariffs on 03 than those offered on the unbundled 08x tariffs.

The TCP requires clarity on all of these pieces of information before it can present an informed and comprehensive commercial offering to the SP and only then can the SP turn its attention to migration and / or meeting its price publication obligations and meeting the necessary promotional material runs.

Ofcom is currently proposing to mandate the minimum number of SC price points that OCPs must support. It also proposes to set maximum price points available on particular number ranges (084 up to 7p inc VAT, 087 up to 13p inc VAT etc) and the granularity (no increments smaller than 1p). But for some reason, Ofcom is fighting shy of confirming the initial set of SP price points that all OCPs must support, even though industry has supplied information as to where the bulk of traffic volumes lie. Ofcom need not set all 80 price points, merely provide mapping and migration options for a sub-set which constitutes the bulk of call volumes to facilitate industry agreement. This can be devised in conjunction with industry but requires Ofcom to either provide a legal mechanism (akin to that proposed by Vodafone) with which to underpin the final selection or at the very least to issue clear best practice guidance to ensure that both TCPs and OCPs make the necessary ranges available.

Ofcom's stated reason for declining to mandate price points is that market players will have a better feel than Ofcom for where these price points should be set. That may well be so, but it is not an argument for Ofcom standing aloof, particularly as industry has provided Ofcom with information that allows it to construct a consolidated view; an ability which is unique to Ofcom. Ofcom can take account of industry views via consultation and industry working groups. If there is consensus, Ofcom can efficiently confirm that consensus in a way industry players cannot. Similarly, if there is no consensus, Ofcom is uniquely able to devise the best compromise taking account of the views and more detailed evidence before it. There is a clear opportunity for Ofcom to take this initial step <u>now</u> and to facilitate implementation to provide timely certainty.

Industry has raised concerns that open cross-industry discussions in relation to establishing Service Charge price points can potentially raise competition concerns. However Ofcom, as a body with competition powers itself can address this by taking a prominent visible role and by leading the relevant working groups to ensure there are no inappropriate discussions. If Ofcom polices discussions in this manner and gathers inputs through a round table approach we believe that a regulatory framework can be put in place through whatever means Ofcom determines to establish the necessary price points.. In contrast relying on the outcome of haphazard bilateral commercial negotiations, as Ofcom appears to envisage, is extremely unlikely to result in a clear industry-wide confirmed solution in sufficient time to enable implementation within 18 months and makes the model we outline above incredibly optimistic.

Ofcom therefore needs to do more than facilitate industry discussion; it needs to provide a clear regulatory framework within which the outcome of any discussion can be confirmed across industry.

Ofcom should move quickly to confirm an initial set of SC price points that will be supported across industry, prioritising 08X number ranges that account for the lion's share of call volumes

Prolonged uncertainty risks undermining expected benefits

Ofcom's stated aim is simplification, but the current approach risks making simple concepts far more complex to realise than they need to be. It is not simply a case of whether additional complexity can be resolved in a timely manner – though as we have explored above that in itself is a very real issue. The bigger risk is that planning blight causes a mass exodus away from the very NGCS Ofcom is looking to reform.

Ultimately, Ofcom's impact assessment for change rests on benefits outweighing the costs of change. The proposals have created an expectation amongst SPs that they can now select a SC at will. Unfortunately the industry linkage between number block allocations and price points suggests that only an estimated 5% - 10% (at most) of SPs will have this luxury. SPs will have a wider choice available to them, but are still likely to need to change number to satisfy their commercial needs. Even those SPs who decide to remain on their existing number have a clear need to know the associated price point in good time to meet their new publication obligations. So for those who move number and those who stay put, a lead time that allows cost-effective communication of the number and associated charge is critical if implementation costs are to be contained. This makes a universal set of 08x options for TCPs and SPs to consider imperative as there will be not be the opportunity to canvass individual SPs and to automatically satisfy all of their requirements.

Previous 'novel' billing wholesale experiments have already led to a series of disputes and legal challenges. Ofcom would do well to avoid all opportunity for the birth of a series of 'sons of ladders' disputes. Yet the decision to limit regulation to residential consumers-only leaves the door wide open to discrimination according to traffic type and origin and allows BT to position itself as a controlling billing hub by occupying the position of sole entity able to identify the origination of transit traffic. A repeat of the current legal uncertainties will only serve to exacerbate issues with planning blight.

But planning blight risk strikes at benefits too. The benefits to our 0845 SP – and ultimately to consumers - which are supposed to come from volume growth/arrest in decline due to the correction of price misperception (overestimation) evaporate in the absence of clear NGCS alternatives. The vast bulk of the benefit underpinning Ofcom's review derives from the volume on 08X ranges; this has to be preserved in order to justify regulatory intervention. There is a clear risk that protracted uncertainty will drive SPs away and further accelerate volume decline.

It is highly doubtful that the unbundled tariff can be justified as a stand-alone business case for 09X traffic. Ofcom's updated analysis effectively assumes unbundling going ahead with the costs for 09 simply supporting maintenance of the higher range of rates but if it fails to capture existing traffic there will be only a modest benefit uplift achieved and in time the unbundled tariff would risk becoming a white elephant destined only to support the rump of 09 services.

It should not be doubted that there are alternatives available to SPs or that these options are not already being considered. The risk to Ofcom's policy objectives is that the alternatives will not satisfy the 'socially important' objectives Ofcom rightly gives weight to if telephone access to contact centres is undermined.

- Online consumer facing alternatives, particularly the development of interactive and social media style interaction are very effective tools for some consumers, but Ofcom's analysis is clear that they do not cater for all, particularly the most vulnerable groups in society.

- Geographic numbers may appear to the uninitiated to offer the best consumer-friendly choice, but they can prove to be even more costly than non-geographic numbers for the most vulnerable groups who overwhelmingly use PAYG devices and may pay higher rates than to non-geographic calls. Furthermore geographic numbers are a finite resource that is already under great pressure and the allocation of swathes of scarce geographic numbers in order to satisfy the demands of call centres is unlikely to promote efficient usage. They also do not necessarily communicate a UK-wide contact strategy, unnecessarily tying users to a particular geography and creating perception problems for organisation with UK-wide reach.

- 03 faces similar challenges in terms of cost to PAYG customers and furthermore is uncertain for SPs commercially until the Narrowband Market Review is concluded. The apparent lack of comparable transparency obligations, coupled with the present lack of wholesale underpinning to support an 'as geographic' pricing convention looks increasingly anomalous against the background of wider NGCS reforms.

- Finally if SPs migrate away from 08x before the new Freephone regime kicks in they are likely to be reluctant to incur a second set of migration costs subsequently. A Vodafone SP recently quoted costs of £5M to satisfy a regulatory-induced change of literature following the change of branding from FSA to FCA. They estimate a change of numbering (or indeed of price publication requirements) to be on a similar scale in terms of cost.

Uncertainty around available SC price points and Freephone origination charges poses a bigger threat to the affordable provision of socially important service than any other factor. Ofcom should lift that threat by providing regulatory certainty.

THE CRITICAL IMPORTANCE OF REGULATED TRANSIT WITHIN THE NGCS MARKET

One of our key concerns over the wholesale arrangements proposed for the new regime relates to the potential removal of a regulated single transit service and BT's ability to leverage market power in transit to gain wider competitive advantage, particularly in the NGCS hosting market.

Purchase of Single Transit within the context of NGCS is unavoidable for most TCPs, with the notable exception of BT. Currently the charges for single transit are restrained through competition in contested higher volume geographic transit routes. Despite the best efforts of TCPs to encourage direct routeing and enable on-net routeing, the overwhelming majority of originating NGCS minutes are still default routed to BT, unless the Originating Communications Provider (OCP) happens to be an NGCS TCP themselves.

This is not inefficiency on the part of OCPs, rather it is borne out of a need to create workable routeing plans. While individual routeing plans for each number block are possible, if implemented they would result in around 22,000 routeing alternatives for 08xx and 09xx numbers, which would be costly and complicated to manage even on a small network, let alone in a large multi-switch network.

With the vast majority of OCPs having one default routeing choice for NCGS, the competitive workings of the market would still be intact if there was a genuine choice over who that default supplier should be and if the entire market was addressable, with BT itself liable to pay for transit calls to its own NGCS ranges. Indeed if different OCPs were sourcing transit from a variety of suppliers, then BT's ability to raise prices would be constrained by straightforward price competition between suppliers for transit, and if transit traffic was distributed more evenly between suppliers a countervailing buying power effect would emerge, as alternative suppliers would be able to respond to increases in BT prices for transit (for NGCS calls received by the alternative supplier) by charging more to BT for the NGCS calls it receives. However, the reality is that a competitive market does not exist on these compulsory routes as BT maintains a stranglehold on its position as the default transit carrier for NGCS due to:

- The breadth of its interconnect relationships (BT has PoIs with the overwhelming majority of CPs and in many cases has multiple PoIs at different locations, greatly reducing the need for on-net routeing on the CPs own network);
- Its ability to recover transit costs from other TCPs which it does not reciprocate (BT refuses to pay transit on calls to own NGCS numbers); and
- The fact that it is also the largest TCP, terminating more NGCS traffic than anyone else.

These factors combine to reduce the size of the addressable market for alternative transit suppliers, effectively removing approximately 30% of NGCS minutes that terminate on BT’s network and imposing a routeing choice on OCPs to default to BT for NGCS transit routeing if they wish to avoid significant network routeing complexity.

Due to the structural failings of the market, as the next largest TCP & transit provider, Vodafone is unable to supplant BT as the default routeing choice for OCPs due to our inability to recover our own transit routeing costs on calls to the largest TCP. Where we do have direct interconnects in place, we don’t typically have the same imbedded contractual relationships that BT has with OCPs, interconnecting at fewer locations, thus requiring OCPs to make more use of their own network before handing over calls.

Proposals to make the terminating communication provider responsible for transit for all NGCS traffic types will make the problem more pronounced. We anticipate that the inclusion of 0844 and 0871 calls alone will increase the number of NGCS transit minutes by a further ✂.

Impact on Freephone

The commercial and routeing implications for freephone under Ofcom’s NGCS plans illustrate clearly how market failure in transit could compromise adjacent markets where competition currently does exist.

Within the most popular 0800 freephone range, numbers are divided into 1K blocks for allocation purposes as Ofcom has successively split the range into smaller blocks to eke out supply. If OCPs were to route on individual blocks to route directly to the correct TCP, this would result in approximately 4000 separate routeing decisions: with no benefit from routeing directly, it is natural that OCPs will choose to have a single entry and route via a transit operator. Practical necessity means that BT is chosen as the default routeing supplier for all these calls. With the default supplier set at BT, BT then will be able to directly set transit fees on a bespoke basis and charging rival TCPs for routeing the traffic, thus burdening them with costs that BT’s own termination business does not face.

TCPs will not have any visibility of the transit costs imposed on competing TCPs, with BT able to discriminate between TCPs for transit for the first time. As the new regime beds in, BT will have a unique place in negotiations, being at the centre of these new NGCS arrangements and will be able to act in a way which favours its own hosting businesses. Other TCPs like Vodafone, who will never be in contention as the default transit provider, will be powerless to act as a significant proportion of its freephone costs will be set by its largest rival in termination. For example were BT to increase its pricing for transiting Vodafone freephone ranges be at a similar level as that for transit portability (which is indicative of the pricing level BT adopts in a regulatory unconstrained environment), we would be faced with our cost of origination from fixed networks being some 16%[5] higher than those faced by BT’s own 0800 line-of-business. It would be impossible to maintain a competitive service in such circumstances.

[5] Freephone origination = 0.6944ppm, NP transit = 0.1155ppm

When freephone becomes genuinely free to caller and calls from mobiles are free, we, like Ofcom are expecting a significant increase in volumes. A fourfold increase in freephone volumes would increase the number of transit minutes by ✄, making it a very significant issue in the overall workings of the market and a vital issue for TCPs trying to compete against BT in the freephone hosting market.

Impact on other NGCS number ranges

The same issues would also become apparent for other chargeable ranges such as 0845, 0844 and 0871. The only alternative would be to incentivise OCPs to route directly by allowing the TCP to charge back the transit cost to the OCP where a direct routeing option was available, but was not used. However this arrangement would be contentious and difficult to administer, giving rise to disputes and potentially leading to the short sighted removal of infrastructure to avoid being re-charged transit.

Ofcom's changes in the NGCS market are designed to promote competition, yet at a stroke the deregulation of single transit would result in an uneven playing field that favours BT. An ex-post challenge is no deterrent, being very difficult to mount due to the information asymmetry in the market, and the real possibility of BT launching a defence that as the OCP had the opportunity to route directly (however impractical that might be in reality), the service is contestable hence there is no case to answer. It would take many years and soak up massive regulatory resources to address these issues, all at a time when the new arrangements for NGCS are bedding in, giving BT an unmatchable market advantage that is unlikely to be ever unwound.

It is very apparent to us that there are significant structural failings in the market for Single transit that make it impossible for it ever to be a competitive market. As set out above, we anticipate a ✄ increase in demand for compulsory single transit in NGCS (✄ 0844 and 0871, ✄ freephone calls) due to the inclusion on 0844/71 minutes and to accommodate the expected increase in freephone traffic when it is made universally free to caller. This situation is unique in Europe and if the NGCS reforms are to be a success then it is imperative that Ofcom ensures a level playing field from the outset. Allowing BT a strangle-hold in single transit and the resulting leverage into adjacent markets is something that should be avoided if the new NGCS regime is to foster genuine competition between TCPs.

The preservation of a regulated single transit service is a very significant aspect of ensuring the success of the NGCS project and with volumes expect to grow significantly it is vital that the current light touch regulatory remedy is preserved. Indeed, BT's static pricing on regulated single transit over the past three years highlights the success of the current remedy at constraining anti-competitive behaviour by bring the benefits of competition on contested routes to significant and now growing parts of the market where market failure persists. It would therefore be completely wrong to misinterpret BT's recent pricing conduct as a signal that the market failings had in some way been overcome. The existing remedy does not disadvantage BT in any way and it offers a good replication of an outcome that a competitive market would deliver.

We are in no doubt that the most efficient regulatory approach to this issue is to retain the existing ex-ante remedy on single transit, as without it BT would be free to leverage its market position to undermine competition in the new NGCS framework, greatly increasing the need for Ofcom to intervene at a future point to preserve wholesale competition in NGCS.

OFCOM'S PIVOTAL ROLE – SUMMARY OF CONCLUSIONS AND KEY RECOMMENDATIONS

- **Ofcom should set and mandate appropriate fixed and mobile Freephone origination outpayments as soon as possible. If, for any reason, Ofcom is unable to confirm the relevant rates in the near future, it will need to pause the implementation project and adjust the timetable pending confirmation.**

- **Ofcom should utilise traffic information in order to establish a minimum starter pack set of SC price points for 08X ranges as soon as possible so that SPs can be assured of their future options in good time.**

- **Ofcom should recognise that retail interventions require wholesale regulation to support and confirm that wholesale arrangements apply to all in scope traffic regardless of whether caller is a 'consumer'.**

- **Ofcom should maintain regulation in single transit in light of the significant competition concerns around deregulation.**