Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential

8 May 2012

Three.co.uk

1. Executive Summary.

1.1. Three welcomes the opportunity to comment on Ofcom's consultation on proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper networks, published on 9 February 2012 (the "**Consultation**").

1.2. Ofcom proposes harmonising switching processes for fixed voice and broadband services. Where there are currently losing provider led ("**LPL**") systems, such as when switching broadband suppliers on Openreach's copper network, Ofcom proposes moving to a gaining provider led ("**GPL**") system that will be subject to third party verification.

1.3. Three strongly supports Ofcom's proposal to move to a GPL system and would urge that this is not further delayed. A GPL system will:

- better align the incentives of operators and customers under the switching process;

- promote self-regulation and reduce Ofcom's enforcement burden;

- reduce the time taken for consumers to switch providers;

- reduce consumer hassle;

- address sub-optimal competitive effects that are intrinsic in LPL systems;

- reduce the complexity of switching, thereby reducing barriers to switching; and

- tackle the harm resulting from losing providers' ("**LP**") aggressive reactive sales activity when a customer requests an authorisation code, such as a migration authorisation code ("**MAC**") for broadband services.

1.4. Three is disappointed, however, that the Consultation focuses on switching fixed services and that Ofcom has de-prioritised consideration of switching in the mobile sector. The deferral of

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   1

consideration of switching in the mobile sector and the introduction of a more effective means for consumers to switch mobile network operator, further delays mobile subscribers realising the benefits listed above. In particular, Three notes that:

- Ofcom undertook a cost benefit analysis of GPL switching in the mobile sector in 2009 but suspended further consideration of GPL switching in 2010, pending the outcome of the consumer switching review. The de-prioritisation of mobile switching means that Ofcom's review of the mobile sector has already been suspended for more than two years;

- whilst Ofcom has suspended its review, mobile consumers continue to be subject to the current inefficient and burdensome LPL switching system, including the risk of aggressive save tactics from LPs; and

- the implementation of a GPL system for the mobile sector is central to ensuring compliance with Article 30 of Directive 2002/22 on universal service (as amended) (the "**Universal Service Directive**"), which requires number portability to be carried out in the "*shortest possible time*".

1.5. Although the Consultation focuses on the fixed voice and broadband sectors, in which Three has no activities, Three has a vested interest in the outcome of it. The outcome of the Consultation will directly affect consumer switching practices for mobile services where mobile services are bundled with fixed voice or broadband services. Further, Ofcom's aim to implement a harmonised and technology neutral switching solution means that Ofcom will be predisposed to implementing a switching solution in the mobile sector that is similar to the solution that will be implemented for fixed voice and broadband following the Consultation. This expectation is in line with Ofcom's comments in its Annual Plan 2011/2012 (the "**Annual Plan**"), where Ofcom states that it "*believes that harmonised switching processes … could provide significant additional benefits to consumers*" (Annual Plan, §A1.64).

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   2

1.6. In this submission, Three sets out its general concerns with LPL switching processes and relates these concerns to specific issues that Three has experienced in the mobile sector. Three sets out a background to its involvement in Ofcom's previous consultations on switching processes (section 2), before addressing specific concerns with LPL systems (section 3). Three then addresses some of the arguments against LPL systems, which are typically raised by incumbent operators whose incentives are not aligned with consumers (section 4) and finally concludes by responding to five specific problems identified by Ofcom in the Consultation (section 5).

1.7. Given that Three is a mobile operator and the Consultation addresses fixed voice and broadband services, Three has not responded directly to the 44 questions posed in the Consultation. In the Annex, Three references those paragraphs in this submission where Three responds to certain of Ofcom's questions.

Contents.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   4

2. Introduction.

2.1. Ofcom notes in its Annual Plan that it is focussing on delivery of an "*easy and convenient consumer experience of switching*" (Annual Plan, §3.24). Three agrees with Ofcom's view that cumbersome switching processes, particularly LPL processes, inhibit competition resulting in higher prices and less choice and innovation. It is perverse to expect that an operator who has just successfully persuaded a customer to switch, should then encourage that customer to make contact with their current operator to move their number or otherwise initiate a switch. The current situation is unsatisfactory and not working well for consumers.

2.2. Number portability is central to the ability for consumers to switch voice service provider. Certain mobile numbers included in Ofcom's UK National Telephone Numbering Plan can already be ported using a fast GPL system. In relation to mobile numbers, the Channel Islands adopted GPL mobile number portability ("**MNP**") on 1 December 2008, and the Isle of Man adopted a similar system on 29 June 2009. That this should happen constitutes a striking paradox, and we urge Ofcom to push ahead with the adoption of a similar system in mainland UK as soon as possible. Other jurisdictions, including Ireland, have also moved ahead and adopted GPL MNP systems.

2.3. In fact, Three is aware of no other major economy or European jurisdiction which requires its mobile consumers to contact their current operator to ask permission to move their number to a new operator. Yet most of these jurisdictions, if not all, introduced their porting systems after the UK. They each chose not to follow the example of the existing UK LPL system, but instead adopted GPL systems.[1]

2.4. By contrast, as Ofcom's own thorough research has demonstrated, there are serious flaws in the current UK system, which is operating against consumers' interests, hindering effective MNP and switching in the UK and thereby impeding

---

[1] With the exception of France, which in any event has since moved to a system equivalent to a GPL system.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 5

competition. The current system suffers from delays. It relies on complicated messages being communicated to customers in a manner which is confusing and on occasion leads to misinformation. It facilitates so-called "reactive save activity". Ofcom's findings support Three's long held view that the current system is not fit for purpose. Indeed, the current UK system places no incentive on operators to raise consumer awareness of portability: this is one of the most striking features of the UK market.

2.5. Three is especially disappointed that the Consultation does not cover MNP. The issues with LPL switching are acute in the mobile sector, where number portability is a priority for consumers that are switching. Unlike in relation to broadband, consumers do not have the option of following a cease-and-provide system as they must call the LP to obtain a porting authorisation code ("**PAC**") if they wish to retain their number.

2.6. Ofcom initially proposed a move to GPL MNP in its concluding statement on *Telephone number portability for consumers switching suppliers*, dated 29 November 2007. Following Vodafone's challenge before the Competition Appeal Tribunal, Ofcom's proposal was not implemented.

2.7. Ofcom subsequently opened a consultation on moving to a GPL system in its August 2009 consultation on Mobile Number Portability (the "**2009 MNP Consultation**"). In a statement on Changes to the Mobile Number Porting Process in April 2010 (the "**2010 MNP Statement**"), Ofcom stated that it would suspend consideration of moving to a GPL system, pending the outcome of the consumer switching strategic review ("**CS Strategic Review**"). The de-prioritisation of mobile number portability in the CS Strategic Review means yet further delays to implementing a GPL system for mobile switching. Based on the current roadmap tabled at the Switching Working Group meetings, Ofcom will only review the switching processes for mobile services some six years after it originally proposed the solution, with implementation occurring in

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 6

2015 at the earliest.[2] These significant delays exacerbate the problems faced by consumers and the competitive harm caused by the current LPL MNP process. Regulatory improvements that would reduce barriers to entry and ease consumers' ability to switch are urgently required.

2.8. The research Ofcom has carried out in recent years has, time and again, highlighted the significant deficiencies in the current MNP process, in particular the method which consumers have to follow to obtain their PAC from their old provider. We have previously presented evidence to Ofcom showing that the current LPL process enables LPs to engage in unwanted save activity and misinformation causing harm to a significant minority of consumers and anti-competitive effects. Ofcom's interim decision in the 2010 MNP Statement did nothing to address these systematic flaws.

2.9. As set out in this submission, the compelling arguments for moving away from an LPL system for mobile switching apply equally to the fixed voice and broadband sectors. The move to a GPL system is instrumental in addressing the adverse effects of consumer hassle and unwanted save activity. Such a move would also speed up the porting process and reduce the enforcement burden on Ofcom.

---

[2] http://stakeholders.ofcom.org.uk/telecoms/groups/switching-working-group/

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   7

3. Losing provider led inefficiencies.

3.1. LPL switching processes are inherently inefficient. This has been recognised by BEREC which published its report on best practices to facilitate switching in 2010.[3] In that report, BEREC recommended the following best practices, which relate to supporting a positive consumer experience (best practices 1 to 4) and to encouraging a positive impact on competition and welfare (best practices 5 and 6):

1. *minimisation of unnecessary switching costs/barriers, both for individual services and for bundles, so that there should be minimal effort on the part of the consumer in order to switch, and a specified maximum time for the switch;*

2. *minimisation of instances of mis-selling/slamming and other unfair practices;*

3. *accurate information on switching to be given to consumers, before and during the switching process, and also immediately after it is concluded, with information being presented clearly and in an easily accessible format;*

4. *publication of guidance by national regulatory authorities ("**NRAs**") that aims to ensure that service providers are aware of, understand, and comply with all obligations relating to national legislation and best practice principles that apply to them;*

5. *support for competition in retail markets; and*

6. *support for cost efficiency of the switching process.*

3.2. These principles broadly align with those proposed by Ofcom, but Three would highlight BEREC's principle 4 exhorting NRAs to publish further guidance for use by service providers. We agree that this is an area where further materials from Ofcom would be very beneficial to providers, especially once the current switching review is completed and its findings are implemented.

---

[3] BoR (10) 34 Rev1 published October 2010, available at: http://www.irg.eu/.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   8

3.3.	BEREC also notes as part of principle 1, that *"in the context of switching to, from and between, bundled services, the most effective method of facilitating switching between service providers, based on the available evidence, is where the process is managed by the new service provider as the primary contact point (GP-led)".* This supports Ofcom's initial findings regarding switching of bundled services. Three welcomes Ofcom's initial findings and BEREC's recommendations. Further Three notes that the wide adoption of GPL systems throughout the EU demonstrates that the UK is lagging behind in implementing effective switching procedures for the benefit of consumers and competition. The UK is now the only EU Member State where LPL MNP is exclusively used. The UK's MNP process is clearly out of step.

3.4.	Three summarises the key inefficiencies with LPL MNP below. Although the focus is on mobile and on LPL MNP, these key inefficiencies are also present in the current broadband MAC switching process, and to a more limited extent in the fixed voice notification of transfer ("**NoT**") process, and need to be considered in the context of the Consultation.

(i) Unwanted save activity

3.5.	LPL processes expose consumers to the hassle and annoyance of unwanted save activity, thus deterring consumers from switching provider.

3.6.	The ability to engage in unwanted save activity is a key area of difference between LPL and GPL processes. Under a LPL process, consumers are forced to contact their existing network to request an authorisation code (e.g. a MAC or a PAC) before they can switch operator. This request provides an opportunity for the existing network to engage in save activities. This "win-back" or retention activity is common-place, as demonstrated by the Synovate mystery shopping research in April 2009, where 60% of those who requested their PAC experienced retention

activity.[4]

3.7.   In comparison, under a GPL process, the consumer is able to make the switching or porting request directly to the gaining provider ("**GP**") and there would be no opportunity for the LP to engage in aggressive save activity.

3.8.   Under a GPL system, consumers will be able to avoid win-back activity entirely. Of course, customers that wish to negotiate their existing terms would still be able to call the LP to discuss alternative offers but would ultimately have more control over the process because they can still walk away and port their number independently if they are not interested in the offer made.

(ii) Losing providers have little incentive to make the porting process work

3.9.   The LPL system is heavily reliant on regulation to force LPs to allow their leaving customers to switch. As Ofcom has now recognised, a LPL system requires operators to work against their commercial best interests. Donors are afforded an opportunity to engage in save activities, such as those highlighted in Ofcom's 2009 mystery shopping research for the 2009 MNP Consultation.[5] These activities included refusal or failure to issue PACs to consumers despite receipt of valid requests and delays that extend the length of end-to-end porting processes.

3.10.   Ofcom has increased regulatory obligations on LPs. For example, Ofcom has addressed concerns regarding failure to supply PACs and MACs, through GC23 and revisions to GC18. Similarly, Ofcom has addressed concerns that authorisation code requests were used to engage in aggressive sales tactics by stating that LPs should not discuss retention activity where customers have made it clear that they do are not interested in discussing retention (2010 MNP Statement). Three appreciates that GC23 and the revisions to GC18 have gone some way to

4 Synovate PAC Mystery Shopping research, commissioned by Ofcom, April 2009.
5 Synovate, PAC Mystery Shopping research, commissioned by Ofcom, April 2009.

reducing these activities. However, moving to a process which aligns the interests of consumers with those of the operator controlling the switch would address such concerns via a long-lasting structural solution, we the effect of reducing the regulatory burden on operators and, as a consequence, reducing the enforcement burden on Ofcom (see paragraph 3.11 below).

(iii) Policing burden

3.11.   Ofcom is required under s.3(4)(c) of the Communications Act 2003 to have regard to *"the desirability of promoting and facilitating the development and use of effective forms of self-regulation".* Therefore, Ofcom must have a natural preference for a switching mechanism that encourages self-regulation, as opposed to intervention and "policing" by Ofcom.

3.12.   LPL processes are heavily reliant on regulation and require greater policing efforts from Ofcom. Moving to a process which aligns the interests of consumers with those of the operator controlling the switch is likely to reduce the enforcement burden on Ofcom, remove the opportunity for LPs to frustrate the switching process and improve the consumer experience overall. Such an approach is consistent with Ofcom's legal duties under the Communications Act 2003.

(iv) Speed of switching

3.13.   Switching takes significantly longer in an LPL system than a GPL system. As more particularly seen below, a LPL system relies on both the LP and the customer to move the switching process along. The customer needs to engage at multiple 'touch points': he or she must contact both the GP and the LP to ensure that the switch takes place. This means that the customer is responsible for ensuring that the switching process operates smoothly and efficiently. Further, as the LP's incentives are not aligned with the customer's, the LP can delay the switching process by encouraging the customer to consider alternative service packages even after the customer has initiated the switching or porting procedure.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   11

3.14.   Using MNP as an example, significant delays arise as the consumer must call the LP to request a PAC. Consumers may then be subject to retention efforts by the LP. Once the LP has agreed to send the PAC to the consumer, the consumer must wait up to two hours for the PAC to be received. The consumer must then provide the PAC to the GP. This may not be on the same day that the PAC is received and may be significantly later, as the PAC is valid for thirty days. Only once the GP has obtained the PAC can it proceed to complete the port.

3.15.   It is clear that any system which requires consumers to obtain actively a PAC or MAC rather than empowering the GP to activate the switch on their behalf will always be prone to delays.

3.16.   The revised Universal Service Directive requires that EU Member States mandate porting within the shortest possible time, and in any event, within one working day. However, the changes to GC18, as implemented in 2011 neither achieve one working day porting nor allow for porting within the shortest possible time. These changes were implemented following consultation on four options for MNP in the 2009 MNP Consultation. In fact, of the four options which Ofcom identified as "possible" and likely to produce a positive economic case over time, Ofcom subsequently chose to adopt the slowest option: a LPL system requiring porting within one working day. Moreover Ofcom failed to give any further consideration to the option that would have resulted in the fastest porting experience for the customer: GPL porting within two hours.

3.17.   The CS Strategic Review and Consultation provides an opportunity to undertake a wholesale review of switching procedures and develop an effective, harmonised procedure that will not need to be continually reviewed. It will enable the UK to catch up with the rest of the EU by adopting a fast, effective GPL system.

3.18.   In Three's view, a move to GPL procedures must be considered as a matter of urgency, to ensure the UK's full compliance with the revised Universal Service Directive.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 12

(v) "Hassle" factor

3.19.   The LPL MAC process for broadband switching can be compared with the LPL PAC process for MNP. In both processes, the customer is responsible for driving the switching process, even though it is counter-intuitive for a consumer to lead the initiative in such a complex procedure. Three strongly agrees with Ofcom's findings that LPL processes lead to a *"higher level of hassle"* (Consultation, §4.173).

3.20.   Three considers that simplification of the switching process, particularly by reducing the number of touch points that a consumer must have with each operator in order to perform the switch, would significantly reduce the level of consumer hassle. The number of touch points under an LPL process will be at least two or three, because the customer needs to contact their LP to obtain a PAC/MAC before giving this to their new operator. Customers may also make an initial call to their new operator, if they think that the process is GPL. In comparison, the GPL process need only have one touch point, and in fact this could be incorporated into the existing sales process by the GPL to further minimise hassle.

3.21.   Ofcom noted that from its research in 2010, 23% of broadband switchers found the MAC process difficult, compared to 8% for the NoT process. Perhaps even more pertinent is the finding (not reported in the Consultation) that 42% of switchers using the MAC/PAC process considered that switching suppliers seemed like *"too much hassle"* compared to 22% for the NoT process.[6]

3.22.   These hassle factors raise switching costs (considered in the next section below) and lead to consumer inertia.

3.23.   If the level of hassle is acting as a barrier to switching, there will be a knock-on effect on competition in the market: consumers will not be able to get the best deals and smaller operators will be restricted in growing their market share. The hassle caused to

---

[6] Ofcom consumer research 2010, fieldwork carried out by Saville Rossiter-Base in February to March 2010.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   13

consumers is exacerbated when consumers are switching to a bundled service and have multiple touch points for each service that they are switching (see further paragraph 3.35 to 3.38 below). Therefore, hassle for consumers is a key issue that Ofcom should tackle as a matter of priority.

(vi) Sub-optimal competitive effects – switching costs

3.24.   Three agrees with the evidence found by Ofcom that the existing LPL MAC process tends to be associated with higher switching costs than the existing GPL NoT process (Consultation, §4.170). These higher switching costs, together with save activity, increase the acquisition cost for GPs.

3.25.   Switching costs have been regarded an important factor for consumer retention. For example, the presence of switching costs may mean that some seemingly loyal customers are actually dissatisfied but do not defect because of high switching costs. Thus, the level of switching costs moderates the link between satisfaction and loyalty.

3.26.   Specifically in relation to the UK market:

- NERA[7] (1997) studied fixed-line number portability for OFTEL and found that Type 2 benefits (mostly resulting from improved efficiency of BT) had a NPV of £1.280m, and constituted 70% of estimated benefits; and

- While emphasising that their calculations were purely illustrative and that there was much less rigour attached to the quantification of Type 2 benefits than of other benefits, Ovum (1998) found (in a study for OFTEL) that the NPV of Type 2 benefits was £360m, and exceeded the NPV of the other benefit categories.

3.27.   Specifically for mobile, the rational consumer will not switch to a new supplier offering the lowest price if the switching costs in

---

[7] NERA and Ovum findings can be found in Oftel's online archives. See for example:
http://www.ofcom.org.uk/static/archive/oftel/ind_info/numbering/ovumapp2.htm#Benefits

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 14

terms of monetary cost, effort, time, uncertainty, and other reasons, outweigh the price differential between the two suppliers. If this happens, the consumer is said to be "locked-in" to the supplier. If a supplier manages to lock-in consumers, the supplier can increase prices to a certain point without fear of losing customers because the additional effects of lock-in (time, effort, etc.) prevent the consumer from switching. Three believes that this adversely affects competition in the market.

3.28. Making it easier for consumers to port their number when they switch operators would significantly reduce switching costs. For instance, prior to introducing number portability, it might have been impossible for new entrants to compete for some customers (e.g. people who do not want to switch unless they can take their number with them), while competing for other consumers might have involved increased marketing expenditure. Moving from a lengthy LPL number portability (or other switching) process to a much shorter, stream-lined GPL process has qualitatively similar effects as introducing number portability in the first place.

3.29. Inefficiencies in the MNP process increase switching costs, thus decreasing the level of competition between providers. It is worth noting that when the MNP porting timescales were reduced from five days to two days in April 2008 there was only a negligible increase in the number of overall ports recorded on the Syniverse system. Similarly, Three understands that the reduction of porting timescales from two working days to one working day in April 2011 has not had a significant effect on the number of ports. This implies that high switching costs remain, and are unlikely to be addressed by simply reducing the time taken to port. Instead, a systematic change is required to the switching and porting process, simplifying the process for consumers, as well as making it quicker.

3.30. Three has previously provided Ofcom with examples of studies that show the quantitative significance of reducing switching costs (Three's response to the 2009 MNP Consultation, §4.2).

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 15

As set out in that response:

- Switching costs, including "search costs",[8] are a very significant category of costs. Knittel[9] (1997) finds that the benefits of introducing competition in the US long-distance market between 1984 and 1995 were almost entirely negated by the existence of search and switching costs.[10] A study from Hungary[11] found that switching costs might be as high as one third of annual expenditure on mobile telephone service.[12] Grzybowski and Pereira[13] (2008) found that eliminating all switching costs would mean a welfare gain of 45% to Portuguese mobile consumers.[14]

- Number porting is an important element of switching costs. NERA (1998) in its cost-benefit analysis of MNP for OFTA in Hong Kong found that 60% of users said that the lack of number portability was the greatest barrier they would face if they switched operators.[15] Srinuan and Bohlin[16] (2009) estimate switching costs in the Swedish mobile market, and find that these switching costs have fallen by more than 60% for customers of the incumbent (Telia) since MNP was introduced. Lyons[17] (2006), finds that MNP has a significant effect in increasing churn rates (the long-term increase in churn rates is 35%).

---

[8] Search costs refer to the time spent acquiring sufficient information about alternative calling plans, data packages, etc. Such costs are likely to be significant in the mobile industry, which features a bewildering array of tariffs.
[9] Interstate Long Distance Rates: Search Costs, Switching Costs, and Market Power, Christopher R. Knittel, Department of Economics, University of California, Berkeley, CA, U.S.A., 1997.
[10] During the period that Knittel's study covered, there was actually a switching fee in place for changing operators. This fee was around $5. There was no number portability available at the time.
[11] Switching costs in telecommunications: conclusions from a Hungarian survey, László Lőrincz and Péter Nagy, Hungarian Competition Authority, 2007, available at http://infrapont.hu/dokumentumok/switching_costs.pdf
[12] However, the authors report that Hungarian switching costs are likely to be significantly higher than UK switching costs, at least if switching costs are (as they must be) correlated with the perceived difficulty of switching.
[13] Subscription Choices and Switching Costs in Mobile Telephony, Lukasz Grzybowski (Competition Commission, UK) and Pedro Pereira (Autoridade da Concorrencia, Portugal), NET Institute Working Paper #07-12, September 2007
[14] Their results, however, may reflect a failure to fully capture brand preferences and unobserved product differentiation, although they make efforts to incorporate these factors into their econometric modelling. At any rate, it is not likely that the welfare gain from eliminating all switching costs in the UK is likely to be this large as the UK market has higher switching rates and greater competition than the Portuguese market.
[15] See http://www.ofta.gov.hk/en/tas/mobile/ta980609.pdf
[16] Mobile Number Portability: Evaluating the Swedish Mobile Market, Pratompong Srinuan, Erik Bohlin, Division of Technology and Society Department of Technology Management and Economics Chalmers University of Technology, Göteborg, Sweden 19 March, 2009. We note that they do not use an econometric methodology to separate out the impact of MNP versus the impact of changes in market structure or the impact of other policy instruments. Therefore, it is not possible to attribute all of this gain to MNP itself, nor is it possible to isolate the impact of MNP from other factors, much less gauge the impact of different MNP processes
[17] Measuring the Benefits of Mobile Number Portability, Sean Lyons, Department of Economics, Trinity College, 27 July 2006.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   16

3.31. All of these studies suggest that reducing switching costs could have a significant effect on consumer welfare. Number portability is an important dimension of switching costs, and that MNP appears to be an effective policy instrument in reducing switching costs and increasing churn.

(vii) LPL systems are inherently complex and cause a barrier to switching

3.32. As previously stated, LPL systems, by their nature, are designed to achieve a result contrary to the commercial interests of the party driving the process, i.e. the LP. Even putting this aside, the system is complicated and some of the information which operators need to pass on to customers to ensure that they are properly informed is prone to cause confusion. Three understands that there is additional scope for confusion in the fixed sector, where different methods of switching are used depending on the type of services provided and the technology used. Operators must take account of home movers, NGA services, fibre to the cabinet and fibre to the premises.
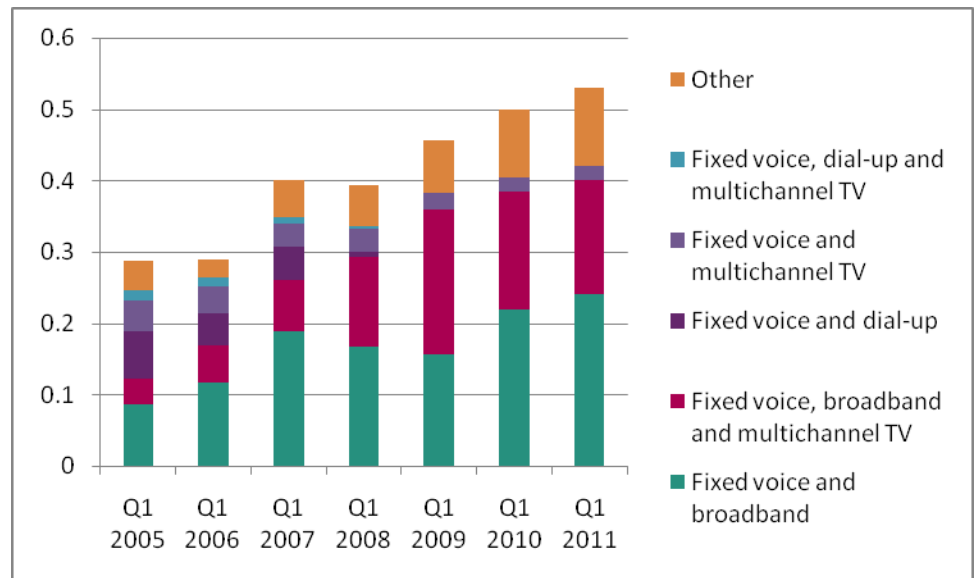
3.33. Under the current system for MNP, activation of a PAC cancels the customer's contract with the LP. If a customer ports within a minimum term contract, activation of the port will cancel the contract and trigger a requirement to pay an early termination charge. Ofcom's Guidance on Additional Charges requires the LP to advise the customer of any early termination charges that are due when the customer requests a PAC, and indeed, this is a requirement of the current Industry Manual. In passing on this message, the operator is explaining the consequence of cancelling early, and not seeking to require the customer to pay an early termination charge in order to have the right to port. However, the distinction is a subtle one and may not be clear to all customers.

3.34. In comparison, under a GPL system, no such confusing messaging would need to be passed on. There would be no question of an upfront payment of an early termination charge for the right to port because the porting process would be

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 17

undertaken by the GP. Of course, the customer would still need to be told that porting would cancel any existing contract and to contact its current operator about the financial consequences of that. This could easily be addressed by requiring GPs to include a prominent statement to the customer on a porting form (which they are required to complete) stating that they may face continuing liabilities to their old supplier and requiring GPs to inform customers expressly at the point of porting that they may face continuing liabilities and should contact the LP if they are in doubt. Three is aware that these methods are successfully applied in Ireland, Australia, the Channel Islands and the Isle of Man.

(viii) LPL systems as a barrier to switching in bundled services

3.35.   The inherent complexity of LPL systems is exacerbated by the complexity of switching multiple services in a bundle using different processes. Multiple switching processes over different service providers will not only increase switching costs for services but also hinder competition through fewer operators offering bundled services in the market. As the complexity and choice of product offerings increases, so do potential switching and "search" costs for consumers. Therefore, we believe that Ofcom should take a holistic view when looking at switching processes for providers and making sure all operators, products and services have a harmonised switching process. For this reason, Three urged Ofcom in its response to the CS Strategic Review not to exclude the mobile market from the next round of industry consultation as excluding mobile operators would weaken their position to compete in the bundling market.

3.36.   The chart below, which is taken from Figure 1.5 of Ofcom's Market Communications Review 2011, illustrates that the take-up of bundled services is growing in the UK and in Q1 2011, 53% of households purchased some kind of bundled service.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   18

3.37. Ofcom's Market Communications Report 2010 showed that mobile customers are more satisfied with value for money and customer service when purchasing a bundle as opposed to when purchasing a stand-alone product (Figure 1.49, p.65).

3.38. In the current challenging economic climate, where consumers are ever more "deal savvy", we expect this trend to continue. Ofcom needs to devise a single switching process for all service providers and undertake the necessary coordination required for a single combined switching process. In establishing general conditions for switching under s.45 of the Communications Act 2003, Ofcom must, in accordance with s.4(6) of the Communications Act 2003, bear in mind the fourth EU principle: namely Ofcom must not favour one electronic communications service over another (so far as is practicable). Therefore, Ofcom must refrain from adopting differing and potentially discriminatory regulatory rules in relation to mobile operators, which affect their ability to compete in the bundled market.

(ix) LPL processes restrict ability to compete on a level playing field

3.39. Emphasis on customer retention is especially important in industries such as the communications sector where the market is saturated and the rate of subscriber growth has begun to slow.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   19

In these industries, securing new customers becomes more difficult and costlier in terms of marketing because there are fewer first time buyers and the market increasingly focuses on replacement demand. Therefore, incumbent operators have strong incentives to engage in 'save' activity when customers indicate an intention of switching mobile service provider.

3.40.   Reactive save activity is detrimental to competition. It enables incumbent operators to be insulated from competition and maintain high prices. LPL switching mechanisms provide an incentive for incumbent operators to focus on "harvesting" their customer base rather than winning new customers. They are alerted when a customer intends to switch to an alternative service provider and only then offer that customer a more competitive tariff. These bespoke "under the counter" deals are not usually available to the market as a whole. No matter how empowered, other consumers cannot currently get the "best deal" as mobile operators reserve these for customers who have already indicated their decision to switch. In effect, LPL systems disincentivise providers from putting their best deals on the market, thus creating a barrier to switching and, ultimately, hindering effective competition.

3.41.   Ofcom supports this position in its CS Strategic Review, in which it states that *"incumbents with a large customer base will likely opt for 'harvesting' their customer base and not engaging in competition for new customers"* (§5.21).

3.42.   Reactive save activity not only affects the incumbent operators' pricing strategy, but also has a direct impact on new entrants: the acquisition cost of a new customer is higher as a number of customers who are about to switch will be 'saved' by their existing provider in a non-transparent manner.

3.43.   Ofcom recognises that *"customer acquisition costs are higher when customers are acquired under a LPL process because a number of customers who are initially prepared to switch end up staying with their current provider (i.e. they are saved)"* (Consultation, §4.38). Further, Ofcom recognises that reactive

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   20

save activity is detrimental to competition as it favours incumbents over new entrants (Consultation, §5.18). Plainly, therefore, it is imperative to move away from an LPL process, which increases switching costs, to a GPL process that promotes transparency and enables consumers to compare tariffs and make an informed decision when selecting provider.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   21

4. Arguments typically used to support losing provider led switching.

4.1. Incumbent providers benefit from LPL systems. LPL switching systems enable the LPs to frustrate the switching process and to compete less aggressively by only offering cheaper or more flexible tariffs to customers that threaten to leave. Operators that focus to a greater extent on "harvesting" existing customers rather than winning new business typically argue against a GPL system. Four common arguments used to support LPL are: (i) lower implementation costs; (ii) slamming; (iii) bill shock through early termination charges; and (iv) using PAC request as a means of arbitrage. As set out below, these arguments should be discarded.

(i) Costs

4.2. Ofcom's preliminary view in the Consultation supports a GPL system with third party verification. Three notes that this system has the highest implementation costs of the options considered by Ofcom. However, it is important to note the following specific benefits that mitigate the costs of implementing a GPL system:

- there will be economy-wide efficiency benefits realised from greater competition, lower barriers to entry, lower call prices;

- these benefits must be considered specifically in light of vulnerable customers who are affected to a greater degree by the hassle of an LPL system and aggressive save activity; and

- in the context of a strategic review where Ofcom proposes a harmonised switching solution, there would be implementation costs associated with adopting an LPL system in respect of fixed voice services.

(ii) Slamming

4.3. Slamming arises where a provider switches a consumer without the consumer's explicit knowledge or consent. In practice,

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   22

slamming in the mobile sector has much more to do with the sales process than the porting process. This is because, unlike other utilities such as gas and electricity, switching between mobile providers inherently involves a change of handset or SIM card, and receipt of a welcome pack from the new service provider. Therefore, it is not possible for a customer to be switched from operator to another without discovering the switch has taken place.[18]

4.4. Three agrees with Ofcom's statement in its concluding statement on Telephone number portability for consumers switching suppliers, 29 November 2007 (the "2007 Statement"), which states, *"Ofcom does not consider a near-instant recipient-led process for porting mobile numbers will necessarily give rise to more slamming and mis-selling"* (§1.22). Further, the risk of slamming is addressed through sales and marketing codes that providers must adopt in accordance with GC23 and GC24.

(iii) Bill shock and early termination charges

4.5. Three is aware that there is a perceived link between porting and contractual liabilities. However, this link is incorrectly perceived, because porting is incidental to the decision to switch and does not create or add to the contractual liabilities owed to an old supplier. Furthermore Ofcom already regulates to ensure that consumers are informed of early termination charges both through enforcement of GC23 and Ofcom's Guidance on Additional Charges.

4.6. The fundamental requirement (as also explicitly stated by Ofcom in the 2007 Statement) of a porting process should be that customers are made aware that they may face continuing contractual liabilities to their old supplier even after porting away. Three believes that this could be effectively achieved under a GPL process through the following simple and technology-free methods:

---

[18] For instance, GPL porting is in place in Ireland, the US, Canada and Brazil, and we understand that mobile slamming is not a problem in those jurisdictions, for these reasons. Nor are we aware of it being a problem in any other GPL jurisdiction.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 23

- a prominent statement to the customer on a porting form (which they are required to complete) stating that they may face continuing liabilities to their old supplier; and

- a requirement at the point of porting to inform customers explicitly that they may face continuing liabilities to their old supplier and advising them to contact their existing supplier if in doubt.

4.7. Three is aware that these methods are successfully applied in Ireland, Australia, the Channel Islands and the Isle of Man.

4.8. In addition, a LP would also be able to inform the customer of their exact liabilities by using technology which is already available, for example by:

- sending a standard SMS notification to the customer;

- showing the remaining term on the contract each month on the customer's bill;

- highlighting, in the terms and conditions in service contracts, that customers transferring their number to another supplier will continue to be liable for fulfilling any contractual obligations.

4.9. This experience would be in line with other retail experiences, for example, when a consumer remortgages or takes a finance agreement for a new car. It is particularly interesting to note that this is in line with what happens when a customer takes out a new mobile contract without porting their number.

4.10. Further, as noted by Ofcom in the 2007 Statement (§3.123), even though the current MNP process could be seen as an opportunity for the LP to inform customers of their existing contractual liabilities, this advantage is only incidental to the purpose of the PAC process, i.e. to accept validly or reject a port request. The PAC request conversation is now increasingly used by the LP to reject invalidly or frustrate port requests by misinforming the customer of their contractual liabilities.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 24

Examples of such misconduct include misinforming the customer that they cannot port until the end of their minimum contract term, or that they cannot port unless they pay upfront the remaining liabilities. A move to a GPL process would bring significant consumer benefits by eliminating such opportunities to engage in such misconduct.

(iv) Using a PAC request as a means of arbitrage

4.11.　In a LPL process, the customer initiates the switching process by calling the LP, e.g. in the case of MNP this is to request a PAC. LPs use these calls as an opportunity to retain the customer. Customers are offered better deals through this 'save' activity. However, this save activity results in better tariffs being unavailable to new customers and operators "harvesting" subscribers, rather than competing to expand their customer base.

4.12.　This save activity causes hassle for consumers, particularly where the consumer has no interest in hearing 'save' offers. Consumers who do wish to hear save offers and use the switching process as a means of arbitrage to negotiate with their operators can continue to do so. These consumers will still be able to call their existing operator to negotiate a more favourable package before deciding to switch supplier.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential　25

5. Issues in the fixed voice and broadband sectors identified by Ofcom.

5.1. As set out above, MNP is different to switching in fixed voice or broadband markets, and the process for switching in the mobile sector urgently requires detailed consideration by Ofcom. There should be a separate consultation on MNP, proposals for which should not be based on the outcome of the Consultation.

5.2. However, as Ofcom has indicated that the outcome of the Consultation will impact on Ofcom's proposals for MNP and as Ofcom intends to harmonise switching processes, Three addresses the five problems relating to switching in the fixed voice and broadband markets that are identified in the Consultation. These five problems are set out below, with an explanation of how they relate to the mobile sector.

(i) Multiple processes for switching the same service / bundle of services

5.3. Three agrees that multiple processes for switching can cause customer confusion and delays. Although the factors relevant to fixed voice, broadband and mobile services must be considered separately.

5.4. Mobile is being increasingly incorporated into bundles and there is merit in adopting a similar system for switching, where possible (see paragraphs 3.35 to 3.38 above).

(ii) Back end system deficiencies

5.5. Ofcom sets out in the Consultation the issues caused by back end deficiencies when switching in the fixed voice and broadband sectors. These issues would not typically occur in the mobile sector due to technological consistency between the mobile operators' networks.

(iii) Insufficient customer consent

5.6. As set out in paragraphs 4.3 and 4.4, insufficient consumer consent and slamming are issues to do with mis-selling, rather than porting or switching processes.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 26

(iv) Lack of awareness of the implications of switching

5.7.   Ofcom considers that consumers may not always be aware of the implications of switching and, as such, may face early termination charges if they cancel a contract with their existing provider within the minimum term. As set out in paragraphs 4.5 to 4.10, a GPL switching system can easily be established with sufficient safeguards to ensure that consumers are sufficiently aware of the implications of switching. Such a system operates well in Ireland, Australia, the Channel Islands and the Isle of Man.

(v) Unnecessary switching costs/hassle

5.8.   Switching costs are higher in LPL processes and the LPL switching gives the LP an opportunity to frustrate the process (Consultation, §4.170). That, together with save activity, increases the acquisition cost for GPs.

5.9.   As set out in paragraphs 3.24 to 3.26 above, these switching costs lead to sub-optimal competitive effects. Reducing the number of touch points for consumers from two (LP and GP) to one (GP only) would significantly reduce hassle to consumers and moving to a GPL switching system would address the adverse effects of unwanted save activity on competition.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   27

Annex - Responses to specific Consultation questions.

As noted at paragraph 1.7 of our response, Three's position as a mobile operator means that many of the Consultation questions are not relevant to it.

Three has addressed certain of the specific questions posed by Ofcom in the Consultation in its response, as indicated below.

Question 2: Are gaining providers currently able to correctly advise consumers at the point of sale on the correct switching process to follow (e.g. do agents have access to and the ability to use Dialogue Services and have access to information on which technology will be used to supply the service to the customer)? Please provide any evidence you have to support your views.

In the case of mobile services, yes, GPs are able to advise consumers of the correct switching process to follow. As set out in paragraph 2.3, Three is not aware of any major economy or EU jurisdiction other than the UK where LPL procedures are used for MNP.

Question 5: Do you agree with our assessment of Problem 1: Multiple switching processes? If not, please explain why you disagree.

Yes, Three agrees with this assessment. See paragraphs 5.3 and 5.4.

Question 7: Do you agree with our assessment of Problem 2: Back end system deficiencies? If not, please state why you disagree.

These issues would not typically occur in the mobile sector. See paragraph 5.5.

Question 11: Do you agree with our assessment of Problem 3: Insufficient customer consent? If not, please explain why you disagree.

No, Three considers that insufficient consumer consent is an issue to do with mis-selling, not switching. See paragraphs 4.3, 4.4 and 5.6.

Question 12: Do you agree with our assessment of Problem 4: Lack

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential 28

of awareness of the implications of switching? If not, please explain why you disagree.

Three considers that a GPL switching system can easily be established with sufficient safeguards to ensure that consumers are sufficiently aware of the implications of switching. See paragraphs 4.5 to 4.10 and 5.7.

Question 13: Do you agree with our assessment of Problem 5 Unnecessary switching costs/hassle? If not, please explain why.

Three agrees that unnecessary switching costs are higher in LPL processes. See paragraphs 3.24 to 3.26, 5.8 and 5.9.

Question 15: Do you agree with our assessment that a prohibition on reactive save activity under the LPL process would be difficult to enforce effectively? Can you suggest how enforcement of a prohibition on reactive save may be made effective?

Yes, this would be difficult to enforce. Further, it would be contrary to Ofcom's duties under the Communications Act 2003 to not have regard to less interventionist, self-regulatory measures. See paragraphs 3.11 and 3.12.

Three response to Ofcom's Second Consumer Switching Consultation: proposals to change the processes for switching fixed voice and broadband providers on the Openreach copper network

Non-confidential   29