**OFCOM'S CONSULTATION "CONSUMER SWITCHING: A CONSULTATION ON PROPOSALS TO CHANGE THE PROCESS FOR SWITCHING FIXED VOICE AND BROADBAND PROVIDERS ON THE OPENREACH COPPER NETWORK"**

**RESPONSE BY BRITISH SKY BROADCASTING GROUP PLC**

## SECTION 1: INTRODUCTION

1. This document provides Sky's response to Ofcom's consultation on proposals to change the process for switching fixed voice and broadband providers on the Openreach copper network.

2. Ofcom's consultation document reaches a preliminary conclusion that it would be proportionate to mandate the introduction of a new 'Hub + Third Party Verification ("TPV")' system for switching among suppliers of broadband and telephony services provided over BT's copper network. For the reasons set out in this response, that preliminary conclusion is not sustainable. The proposal favoured by Ofcom would be a wholly disproportionate response to the legitimate issues associated with switching process that Ofcom has identified, and, if implemented, carries with it significant risks of actually making switching a longer process for consumers, involving greater hassle. The proposal put forward by industry, on the other hand, would be an effective and proportionate response to the legitimate issues identified by Ofcom.

3. This response comprises the following sections and annexes

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| **Section 2:** | **Ofcom's duties and obligations** |
| **Section 3:** | **Reports by CRA and PwC on key issues raised by Ofcom's consultation** |
| **Section 4:** | **A new consumer survey** |
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| **Annex 1:** | **Ofcom's Impact Assessment of Changes to Switching Options for Fixed Voice/ Broadband Lines: An Economic Review, a report by Charles River Associates** |

**Annex 2:** **Ofcom's assessment of the use of reactive save activity by suppliers of fixed voice and broadband services: An Economic Analysis, a report by Charles River Associates**

**Annex 3:** **Ofcom customer switching consultation, PwC's independent cost assessment of the alternative GPL TPV model**

**Annex 4:** **Documents related to the consumer survey commissioned by BT, Sky and Virgin Media**

**Annex 5:** **Data privacy implications of a TPV process**

**Annex 6:** **There is no need for a transfer code issuing authority in the LPL processes considered by Ofcom**

**Annex 7:** **Working Line Takeover (WLTO) process and proposed new switching processes, A paper presented to the Ofcom SWG 25 May 2012**

## SECTION 2: OFCOM'S DUTIES AND OBLIGATIONS

4. As Ofcom acknowledges in Section 2 of the consultation document, any proposals for introducing regulation, including by way of a General Condition, must be in accordance with Ofcom's duties and powers – notably those set out in the Communications Act 2003 (CA03).[1]

5. In paragraph 7.10 of the consultation document, Ofcom states:

> "*by improving switching processes for consumers, and preventing processes from adversely affecting competition, we will be acting in accordance with our general duty to further the interests of consumers in relevant markets, where appropriate by promoting competition*".

6. As Sky noted in its response to Ofcom's first consultation document on consumer switching, developing and improving switching processes for fixed broadband and telephony is an appropriate issue to address. However, the approach that Ofcom has proposed in the present consultation document is neither appropriate nor justifiable: the proposed imposition on industry of an intrusive Hub + TPV process would not be in accordance with Ofcom's general duties.

7. Ofcom notes that it faces a "*complex judgment*"[2] with a wide range of factors to take into account. It is all the more important, therefore, that its decisions are reached with full regard to all of its duties and obligations. Ofcom has failed to do so, including failing to take into account a number of its relevant duties and obligations not referred to in the consultation document. A proper assessment of all of Ofcom's relevant duties, on the basis of the evidence and reasons provided throughout this response, as well as set out in the independent reports of CRA and PwC[3], demonstrates that Ofcom's

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[1] Ofcom must also comply with the requirements of s.47-51 CA03 in introducing a General Condition. We do not address those provisions specifically in this response, on the basis that the requirements posed by these sections of the CA03 (such as the need for Ofcom to ensure that a General Condition is objectively justified and proportionate) are intended to reflect Ofcom's general duties.

[2] Paragraph 7.173. All paragraph references are to Ofcom's consultation document, unless otherwise stated.

[3] Details are provided in Section 3 of this response.

proposal to favour the imposition of a Hub + TPV switching process would not, in fact, be compatible with its regulatory duties.

**Ofcom's proposal to favour the Hub + TPV system is not compatible with its general duties**

8. Ofcom's principal duty under s3(1)(b) CA03 is to further the interests of consumers (where appropriate by promoting competition). This requires Ofcom to establish to the appropriate standard that its intervention would benefit consumers. As outlined in this response, together with CRA's independent report on Ofcom's impact assessment, Ofcom has failed to do this.

9. In performing its principal duty under s3(1) CA03, Ofcom must have regard, under s3(3) CA03, in all cases, to the principles under which its regulatory activities should be transparent, accountable, proportionate, consistent and targeted only at cases in which action is needed. Under s3(3)(b) CA03, Ofcom must also have regard to best regulatory practice, which Ofcom has stated includes:

   - operating with a bias against intervention;[4]
   - striving to ensure its interventions are evidence-based, proportionate, consistent, accountable and transparent in both deliberation and outcome;
   - always seeking the least intrusive regulatory mechanisms to achieve its policy objectives; and
   - consulting widely with all relevant stakeholders and assessing the impact of regulatory action before imposing regulation upon a market.

   For the reasons set out in this response (and accompanying independent reports), Ofcom's proposals for intrusive regulation fail to meet these requirements.

10. Ofcom's proposals are not evidence-based or accountable, in that they are not supported by a compelling and cogent base of evidence which is capable of withstanding profound and rigorous scrutiny. To justify introducing regulation, Ofcom must have a strong factual basis, with the full range of relevant evidence having been assessed fully in light of submissions received, in order to reach a reliable and soundly-based decision. Otherwise its decisions risk being manifestly wrong. Ofcom has failed to meet this standard:

   - Ofcom does not pay due regard to the fact that retail markets are competitive, that consumers are well served by current switching processes which are generally straightforward, and that consumers are generally pleased with existing switching processes[5];

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[4] Ofcom also fails to have regard to its duty under s.6(1) CA03 that it must carry out its functions with a view to securing that regulation does not involve the imposition of burdens that are unnecessary.

[5] Ofcom also makes no reference to s.3(4)(k) CA03, under which it must have regard to opinions of consumers in relevant markets. As outlined in this response, it is evident that consumers are generally content with existing switching processes.

- Ofcom has identified six main "problems" with current switching processes; as a result of misunderstanding a number of critical issues, and through basing much of its assessment on unsupported assumption, it has mischaracterised issues as "problems" that require fixing – most notably in relation to reactive save activity, for which there is no credible basis for prohibition; and

- this has led Ofcom to prefer a Hub + TPV system, even though it acknowledges this as being "*more onerous to deploy*"[6]. It dismisses other options on the basis of unsupported assertions that they would not be "*effective remedies because fundamental issues* [would] *remain*" and "*could not meet future challenges*"[7].

11. Further, it is clear that, despite its assertions to the contrary, Ofcom's proposals are disproportionate to the industry-recognised problems that exist with consumer switching (as opposed to the problems as mischaracterised by Ofcom). The established approach to the principle of proportionality has been considered extensively by the CAT[8]: a measure must (i) be effective to achieve the legitimate aim in question (*i.e.*, appropriate), (ii) be no more onerous than is required to achieve that aim (*i.e.*, necessary), (iii) be the least onerous, if there is a choice of equally effective measures, and (iv) in any event, not produce adverse effects which are disproportionate to the aim pursued. This is reinforced by the requirement for Ofcom to follow best regulatory practice, *i.e.*, to operate with a bias against intervention and always to seek the least intrusive regulatory mechanisms.

12. In the sections below (and in a report prepared by CRA) it is demonstrated that Ofcom's desire to prevent the use of reactive save activity is not a legitimate aim of regulation. Accordingly, where reference is made in the remainder of this response to legitimate problems with switching processes identified by Ofcom, this does not include preventing reactive save activity.

13. A further element of best regulatory practice concerns the approach taken to consultation. Not only must Ofcom consult widely with all relevant stakeholders, but it should approach the question of consultation with an open mind. Sky considers that Ofcom has not done so.

14. Most notably, throughout the whole consultation process (including leading up to its first consultation on consumer switching), Ofcom has sought to move away from LPL-based processes as a matter of policy, rather than on the basis of analysis of evidence. It focused prematurely on the narrow question of GPL versus LPL-based processes in its first consultation document, ignoring the full dimensions of the switching process. This policy-led approach is perhaps best demonstrated by the establishment of the Switching Working Group ("SWG") shortly after the publication of its first consultation document specifically to assess GPL-based processes only. It took industry considerable efforts to ensure that LPL-based processes would also be considered

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6 Paragraph 7.173.

7 Paragraph 7.172.

8 See the recent CAT judgments in *Tesco v. Competition Commission* [2009] CAT 6, and *BAA v. Competition Commission* [2009] CAT 35.

within that group. This was at the stage that Ofcom was still considering responses to its first consultation, when its thinking should still have been at such a formative stage that favouring any particular approach to switching would have been inappropriate.

15. Similarly, in 2010 and 2011 Ed Richards gave evidence at two parliamentary hearings, before the Public Accounts Committee and the DCMS Select Committee. At both of these hearings Mr Richards stated Ofcom's preference for regulating in favour of a GPL process. At the 2010 hearing Mr Richards stated:

> "*Would we like to see more convenient, easier switching processes? Yes we would, which is why we published during the course of this year a major document on our approach to switching, arguing that we believe the system should overall move from "losing provider led" to "gaining provider led", which makes it easier and more convenient for people to switch.*"[9]

Whilst at the 2011 hearing Mr Richards stated:

> "*Our proposition on that is that we should have an approach that presumes, other things being equal, that we should have what is called gaining provider led. So the person who has won your business can run the process for you and make sure it is smooth. That is the strategic position and we are going to run that through June, the rest of this year.*"[10]

**Implementing the Universal Services Directive**

16. Under s.4 CA03 Ofcom is under a duty to act in accordance with Community requirements. In paragraphs 2.27 and 2.28 of the consultation document, Ofcom makes reference to Recital 47 and Article 30 Universal Services Directive ("USD"), which relate to changes to the European Framework that specifically concern changing providers and switching processes. Ofcom highlights that Recital 47 states:

> "*consumers should be able to make informed choices and to change providers when it is in their interests. It is essential to ensure that they can do so without being hindered by legal, technical or practical obstacles, including contractual conditions, procedures, charges or so on*".

17. Recital 47 also states (after an explicit reference to slamming):

> "*...Member States should be able to impose such minimum proportionate measures regarding the switching process ... as are necessary to minimise such risks, and to*

9 See Ev 15 of 'Ofcom: the effectiveness of converged regulation, Twentieth Report of Session 2010-11 *Report, together with formal minutes, oral and written evidence*', House of Commons Committee of Public Accounts, February 2011. (http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/688/688.pdf)

10 Transcript of oral evidence taken before the House of Commons Culture, Media and Sport Committee hearing on the work of Ofcom, Tuesday 3 May 2011. (http://www.publications.parliament.uk/pa/cm201012/cmselect/cmcumeds/uc956-i/uc95601.htm)

*ensure that consumers are protected throughout the switching process without making the switching process less attractive for them*".[11]

18. Ofcom appears to be placing reliance on Recital 47 (and Article 30 USD) for its proposal to introduce a Hub + TPV system, notably because (in paragraph 7.5) it is interpreting these provisions as providing support for its desire to ban reactive save – *i.e.*, in effect treating reactive save as a "*practical obstacle*" to switching.[12]

19. Sky does not consider that there is anything in the USD, or its implementing measures in the CA03 (or GC9), which supports Ofcom's proposal to mandate a GPL process – if anything, the legislation suggests the opposite. It is also clear from Recital 47 that slamming concerns were foremost in the EC's mind. The assessment of whether or not an activity such as reactive save should be regarded as an "*obstacle*" to switching is not a question that should be considered in isolation – it must be in the context of Ofcom's general duties. For the reasons set out in CRA's independent report, reactive save should not be considered to be against the consumer interest, or competition: it is therefore incorrect to view it as a form of "obstacle" to switching of the type envisaged by Recital 47.

20. In paragraph 7.4 of the consultation document, Ofcom states:

> "*we are **specifically required** by the Universal Service Directive to ensure that: conditions and procedures for contract termination do not act as a disincentive against changing service provider*". (Emphasis added.)

21. For the reasons set out above, even though it is clear that Ofcom does have powers to set General Conditions relating to switching, the provisions of the USD do not require Ofcom to act; they merely enable Ofcom to do so (where consistent with its general duties). It is also notable that Recital 47 does explicitly contemplate any steps taken by a Member States being able to impose "*minimum proportionate measures*". As noted above, Ofcom's proposals fail to do so.

**The need for a proper impact assessment**

22. Ofcom also has a duty under s.7 CA03 to undertake an impact assessment in relation to important new regulation. That duty derives from a broad recognition that, in order to make sound judgements in relation to the need for and form of regulation, it is necessary to develop a robust appreciation of its potential costs, benefits and risks, including via quantification as far as possible. A robust impact assessment provides a key means by which Ofcom demonstrates that its regulatory proposals meet the requirements of section 3(3) CA03. In other words, it should be how Ofcom demonstrates that each element of its regulatory proposals is necessary and proportionate.

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[11] Ofcom notes that Article 30 USD was consequently amended – and in order to implement Article 30, Ofcom amended GC9 through the introduction of GC9.3. At the time Sky argued that GC9.3 was not necessary on that basis that UK consumer legislation already adequately dealt with ensuring that CPs did not disincentivise consumers from switching providers.

[12] Plainly, reactive save activity cannot be considered a "*legal* [or] *technical … obstacle*" and is not a "*contractual condition*".

23. Ofcom's impact assessments must conform to best regulatory practice and the criteria set by case law (notably by the CAT in *Vodafone v. Ofcom*[13]*)*. Ofcom's impact assessments must be capable of withstanding "*profound and rigorous scrutiny*" by the CAT.

24. For the reasons provided by CRA in its independent report on Ofcom's impact assessment, Ofcom's approach is inadequate, fails to meet the requisite standards and is therefore incapable of forming a proper basis for a decision about the need for, and appropriate form of, intervention by Ofcom in relation to this matter. It therefore does not satisfy Ofcom's duty under s7 CA03.

## SECTION 3: REPORTS BY CRA AND PWC ON KEY ISSUES RAISED BY OFCOM'S CONSULTATION

25. Sky, jointly with BT and Virgin Media, commissioned independent experts to examine key elements of Ofcom's analysis set out in the consultation document. The expert reports are attached as annexes to this submission. They comprise:

    (i) a report by **Charles River Associates (CRA)** which examines Ofcom's assessment of the potential costs and benefits associated with the implementation of a number of possible changes to consumer switching processes for fixed voice and broadband services[14]. (Hereafter, "CRA's IA Report".) This report is at **Annex 1;**

    (ii) a further report by CRA which examines Ofcom's economic analysis of 'reactive save activity'[15]. (Hereafter, "CRA's Reactive Save Report"). This report is at **Annex 2**; and

    (iii) a report by **PricewaterhouseCoopers (PwC)** which examines the cost of Ofcom's preferred Hub + TPV system[16]. (Hereafter, "the PwC Report".) This report is at **Annex 3**.

26. CRA's IA Report finds that the impact assessment of options for intervention set out in the consultation document is deficient in numerous respects, notably (without being exhaustive) in relation to (a) Ofcom's 'traffic light' approach to its qualitative assessment, (b) analytical errors and omissions in Ofcom's quantitative assessment of the costs and benefits of different options, and (c) testing of the sensitivity of the results of the quantitative assessment of the options considered by Ofcom to plausible changes in assumptions.

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13 Paragraph 346 of the judgment of the Competition Appeal Tribunal in Case 1094/3/3/08 *Vodafone Ltd v Office of Communications* [2008] CAT 22, 18 September 2008 ("Vodafone v. Ofcom").

14 'Ofcom's Impact Assessment of Changes to Switching Options for Fixed Voice/ Broadband Lines: An Economic Review'.

15 'Ofcom's assessment of the use of reactive save activity by suppliers of fixed voice and broadband services: An Economic Analysis'.

16 'Ofcom customer switching consultation, PwC's independent cost assessment of the alternative GPL TPV model'.

27. It is particularly notable that CRA find that, even without correction of any errors or omissions, the quantified benefits of the options for intervention being considered by Ofcom:

> "*are **extremely small** – both in absolute terms, and relative to total spending by consumers on fixed voice and broadband….What is more, the "quantified benefits" are entirely dominated by the estimated benefit of addressing a single concern (slamming).*"[17] (Emphasis in the original.)

28. Overall, CRA conclude that the impact assessment conducted by Ofcom to date is not a sufficiently reliable basis to support Ofcom's preliminary conclusion that the Hub + TPV system is the most proportionate response to the problems that it has identified. CRA state:

> "*We conclude that Ofcom needs to exercise much greater caution in appraising the costs and risks of the various options that it is consulting on, particularly those that are the most intrusive and costly. The net benefits that Ofcom quantifies in this Consultation Document are entirely dominated by reducing the costs of slamming, while the qualitative assessment is dominated by Ofcom's negative view of reactive save activity. Since slamming is only one of a number of concerns with switching processes discussed by Ofcom, and the rejection of reactive save activity is not soundly based in economics, this seems an unsatisfactory basis on which to reach a policy decision.*"[18]

29. CRA's Reactive Save Report concludes that Ofcom's view that reactive save activity has detrimental effects on competition and/or consumers appeals primarily to general intuitions rather than robust economic analysis. CRA conclude that Ofcom's analysis of this issue:

> "*provides no credible basis for supporting Ofcom's negative assessment of reactive save, which in turn forms virtually the entire basis for Ofcom's broader conclusion….that LPL switching processes are generally detrimental to competition*"[19].

30. The PwC Report provides a rigorous analysis of the costs of setting up and operating Ofcom's preferred Hub + TPV system, drawing on PwC's substantial expertise in designing contact centre operations and IT solutions, and business planning. PwC's Report finds that the costs of Ofcom's preferred option are significantly underestimated in the consultation document. PwC's Report estimates that the cost of implementing and operating Ofcom's proposed system (in net present cost terms) would be between £86.9m and £190.8m over a 10 year period. The mid-point of this range (£138.7m) is around 43% higher than the 'central' cost estimate used in Ofcom's impact assessment.

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[17] Page 2 of the CRA IA Report.

[18] Paragraph 14 of CRA's IA Report.

[19] Paragraph 10 of CRA's Reactive Save Report.

## SECTION 4: A NEW CONSUMER SURVEY

31. BT, Sky and Virgin Media also jointly commissioned a consumer survey on issues raised by Ofcom's current consultation. The survey was undertaken in May 2012 by Ipsos MORI. The survey was conducted online, and covered a sample of 2,000 respondents. Documents related to that survey, including the survey script and tables of results, are attached at **Annex 4**.

32. Given that Ofcom's consumer research has focused on consumers' views about current switching processes, BT, Sky and Virgin Media were keen to assess consumers' views on the processes under consideration in this consultation, as well as a number of issues raised by the consultation on which, previously, evidence was lacking.

33. The results of the survey provide a valuable indication of consumers' views on the switching processes considered in Ofcom's consultation document, and cast significant doubt on a number of Ofcom's assumptions about issues such as the importance of switching timeframes, when consumers receive information on the implications of switching, the value of creation of a central database and consumers' willingness or otherwise to contact their current provider or gaining provider.

## SECTION 5: RELEVANT CONTEXT

34. The need for, and potential scope of, any regulatory intervention in relation to consumer switching between suppliers of broadband and telephony services offered over BT's network must be assessed with the following contextual facts in mind.

### (a) Competition among suppliers of broadband and fixed telephony services in the UK is strong

35. The markets in which the switching processes being considered by Ofcom arise are markets which Ofcom has found to be effectively competitive.[20] There is a substantial amount of readily available evidence that supports a view that there is strong competition among a significant number of large suppliers (BT, Virgin Media, Talk Talk, Sky, 02, Orange), and a substantial fringe of smaller suppliers of broadband and fixed line telephony services in the UK, resulting in good outcomes for consumers.

36. Much of this evidence comes from Ofcom itself, and is therefore familiar to Ofcom. In relation to broadband services, for example, Ofcom has stated:

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[20] In relation to fixed line telephony, in September 2009 Ofcom stated: "*Our conclusions are that most of the UK retail markets, with the exception of Hull, are now effectively competitive and, specifically, BT no longer has significant market power ("SMP") in the provision of retail fixed narrowband analogue access and retail calls markets in either the residential or business sectors.*" (Paragraph 1.2 of 'Fixed Narrowband Retail Services Markets; Identification of markets and determination of market power', Ofcom, September 2009.) In relation to broadband services, Ofcom's 2010 Wholesale Broadband Access review stated: "*We have found that there is effective competition in almost 80 per cent of the UK.*" (Paragraph 1.7 of 'Review of the wholesale broadband access markets, Statement on market definition, market power determinations and remedies', Ofcom, 3 December 2010.)

- "The *UK has one of the most competitive broadband markets in Europe, based on prices, choice and take-up."*[21]

- "*the current generation of broadband services in the UK have become a success story with competition, based largely on the use of local loop unbundling, driving choice and innovation, low prices and high take up.*"[22]

- "*Competition has also driven lower prices, more choice and greater innovation. UK broadband adoption has grown almost three-fold in five years and consumers have benefited from increasing broadband speeds at prices that have fallen steadily over time*".[23]

37. Furthermore:

- Ofcom survey evidence has found that 81% of broadband consumers are either 'very satisfied' or 'fairly' satisfied with their service;[24]

- Ofcom's most recent Communications Market report notes that:

  > "*Despite the average headline speed of a connection rising from 1.6Mbit/s to 15.5Mbit/s over the five-year period, the cost of a broadband connection in 2010 was nearly half the 2005 cost.*"[25]

  and

  > "*Consumers have a wide range of fixed-broadband packages to choose from*"

- there is substantial, ongoing investment in infrastructure (both in terms of unbundling BT's exchanges, and roll-out of fibre networks); and

- BT has the lowest market share at 29% of the retail fixed broadband market of any former incumbent within EU[26].

38. A similar situation exists in relation to the more mature fixed voice sector, where a combination of falling call volumes and intense competition, leading to falling prices,

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21 Paragraph 2.11 of 'Super-fast broadband: Context and summary for Ofcom's consultations on the wholesale local access and wholesale broadband access markets', Ofcom, 23 March 2010. (http://stakeholders.ofcom.org.uk/binaries/consultations/wla/annexes/context.pdf)

22 Paragraph 1.1, *Ibid.*

23 Paragraph 2.14, *Ibid.*

24 Paragraph 4.2.1 of 'The Consumer Experience 2011', Ofcom, 6 December 2011. (http://stakeholders.ofcom.org.uk/binaries/research/consumer-experience/tce-11/research_report_of511a.pdf)

25 Page 311 of 'Communications Market Report: UK', Ofcom, August 2011. (http://stakeholders.ofcom.org.uk/binaries/research/cmr/cmr11/UK_CMR_2011_FINAL.pdf)

26 Page 5 of 'Broadband Access in the EU as at July 2011', EU Commission Communications Committee, December 2011. (http://circa.europa.eu/Public/irc/infso/cocom1/library?l=/public_documents_2011/broadband_2011pdf/_EN_1.0_&a=d)

has led to sustained falls in revenues per fixed line over time[27]. BT's share of fixed line voice minutes is now less than 40%, and its share of exchange lines less than 50%. Again, consumers' satisfaction with the fixed voice services they receive is high, with 89% of consumers indicating that they are 'very satisfied' or 'fairly' satisfied with their service[28].

39. Indeed, it is reasonably clear from the consultation document that Ofcom accepts that the markets addressed by that consultation are competitive.[29]

40. This evidence is relevant to Ofcom's current consultation in three key respects.

41. First, it is generally accepted that regulators should proceed cautiously in relation to intervention in competitive markets. This is because, in addition to the well-known detriments of regulation (such as the deadweight burden of regulation, the risk of adverse unintended consequences, and potential distortions to competition), in such markets, problems for consumers are normally rectified via competition among firms.

42. Second, it points to a need for caution in relying on low rates of consumer switching as indicating either a lack of competition among suppliers or impediments to consumer switching. This is because low switching rates may be caused by most consumers having little incentive to switch because they are satisfied with the services offered by their current supplier, rather than impediments to them doing so.

43. Third, it points to a limited need for regulatory intervention to enhance competition in relation to these markets.

**(b) Switching by consumers among suppliers of such services is generally straightforward**

44. The processes for switching supplier of fixed line telephony and broadband services in the UK are not fundamentally broken. On the contrary, in general, switching supplier is a straightforward process and over 2 million UK households switch supplier of their broadband and/or fixed line telephony services each year. Moreover, consumers indicate a high level of satisfaction with the process. Research undertaken for Ofcom by Saville Rossiter-Base found that among consumers who had switched supplier of broadband and/or fixed line telephony service in the previous 12 months:

- between 68 – 76% of consumers who switched broadband provider regarded the process as easy, with a further 11 – 15% stating that the process was neither easy nor difficult; and

- between 73 – 79% of consumers who switched their fixed line voice provider regarded the process as easy, with a further 11 – 12% stating that the process was neither easy nor difficult.[30]

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27 See figure 5.41 of 'Communications Market Report: UK', 2011, *op. cit.*

28 Paragraph 4.2.1 of 'The Consumer Experience 2011' *op. cit.*

29 For example, the competitive nature of the relevant markets is cited by Ofcom as a reason for not being concerned about price discrimination at paragraph A7.57.

45. This is supported by the consumer survey commissioned by BT, Sky and Virgin Media. This found that when asked to rate the current switching processes that respondents had experienced on a 1-10 scale (where 1 was "poor" and 10 was "excellent") 76% of respondents who had switched their landline in the past year rated the process between 7-10 and a total of 88% rated the current process between 5-10. Similarly, for broadband switchers the figure was 73% of respondents rating the current switching process between 7-10 and 89% rating that process between 5-10.

46. Ofcom's 2010-2011 Annual Report also records that complaints in relation to migrations have fallen by 32% since the 2009/2010 report.[31] Ofcom's Consumer Experience 2011 states that "*Since the beginning of 2007 there has been a decrease in the number of complaints to Ofcom about broadband migration in general*" with the number of complaints about MACs (typically about receiving a requested MAC) falling from a high of 800 to 130 complaints per month.[32] This reduction follows Ofcom's introduction of the broadband migration rules in February 2007 and Ofcom notes that "*there has been a significant decrease in the volume of customers complaining about difficulties in obtaining a MAC code, an ISP refusing them a code, or complaints about the cost of getting a MAC code*"[33].

47. An undue focus on the 'problems' associated with switching processes can distract from the basic fact that, overall, switching processes work well, and there are indications that they are improving. To the extent that improvements to such processes are required, they are changes at the margin.

**(c) Ofcom's impact assessment shows that the quantified benefits to consumers from all the options it has considered are small**

48. Ofcom's impact assessment shows that both in absolute terms, and when considered against reasonable benchmarks (such as consumer spending on fixed telecommunications and broadband), the quantified benefits to consumers from all the interventions contemplated by Ofcom are small – at most around £5 million per annum on an annuitised basis, or less than 0.05% of retail revenues from broadband and telephony services. As CRA's IA Report indicates, given the margin of error in such estimates they are not practically distinguishable from there being no benefit at all.

49. Again, it is easy for this basic fact to get lost in a detailed and wide-ranging analysis. The small magnitude of the gains to consumers from the range of interventions contemplated by Ofcom means that it is implausible that costly, intrusive interventions are likely to be proportionate.

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30 Figure 10, 'Consumer Switching and Bundling, A report commissioned by Ofcom', Saville Rossiter-Base, September 2010. (http://stakeholders.ofcom.org.uk/binaries/consultations/consumer-switching/annexes/switching-bundling.pdf)

31 See page 103. (http://www.ofcom.org.uk/files/2011/07/annrep1011.pdf)

32 Page 131 of 'The Consumer Experience 2011', *op. cit.*

33 *Ibid.*

### (d) Ofcom has a stated policy of acting with a bias against regulatory intervention

50. As noted above, one of Ofcom's "*key regulatory principles*"[34] is that it acts with a bias against regulatory intervention. Ofcom states:

> "*This means that a high hurdle must be overcome before we regulate. If intervention is justified, we aim to choose the least intrusive means of achieving our objectives, recognising the potential for regulation to reduce competition.*"[35]

**Implications**

51. Sky acknowledges, and has acknowledged throughout Ofcom's process, that there is scope for improvements in switching processes that would reduce the number of errors that occur in relation to consumer switching, and make it easier for consumers to switch supplier of their broadband and telephony services.

52. The contextual facts set out above, however, strongly point to a need for any regulatory intervention in relation to this issue to be (a) light touch – involving making improvements to existing processes, whilst incurring as little cost as possible, and (b) focused on addressing clear, tangible problems with switching processes. They also point strongly to a lack of need for intervention aiming to stimulate competition among existing suppliers in the sector, or lower barriers to entry to encourage new entry to the sector in order to increase competition.

## SECTION 6: OFCOM'S PROPOSED INTERVENTION IS DISPROPORTIONATE

53. Ofcom's preferred option is extremely interventionist. It involves requiring those firms who utilise BT's network for the delivery of broadband and telephony services (including BT itself) to develop and maintain an entirely new centralised database of consumer information (the 'Hub'), together with a system which verifies consumers' requests to switch supplier via both call centres and online services.

54. There are numerous, substantial, and obvious drawbacks to this proposed approach:

- it would involve an enormous amount of redundancy – requiring the provision of data relating to millions of households who may never choose to switch supplier (or do so extremely infrequently), and continuously ensuring that such data is accurate and up-to-date;
- it would require a lengthy planning and development timescale, requiring a large number of CPs to:
  - agree completely new design and interface standards;
  - collectively commission the independent development and provision of the Hub, requiring the establishment of an elaborate governance structure;

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[34] Page 3 of 'Better Policy Making – Ofcom's approach to Impact Assessment', Ofcom, July 2005.

[35] *Ibid.*

    - integrate their existing disparate in-house systems with the Hub and TPV;
    - develop the new EMP interfaces with Openreach; and
    - 'clean' their customer data and upload this into the central Hub.

- it would be far more complex and expensive to implement and operate than any of the alternatives set out in the consultation document. As the PwC Report shows, the cost estimates set out in the consultation document for this option – which Ofcom acknowledged as showing that the proposed system would be "*costly*" – are significantly underestimated. Ultimately, the substantial costs of Ofcom's proposed system would be borne by consumers;

- it would take far longer to implement than any of the alternative options, thus denying consumers the benefits of any improvements to switching processes for a considerable period of time;

- it is likely to give rise to significant enforcement costs associated with ensuring that hundreds of CPs provide customer data in a suitable form, in a timely manner, and continually keep such data up to date. Ofcom's proposed approach has in-built incentives for CPs to game the system, by dragging their heels on ensuring that data provided is accurate and kept up to date, as inaccurate data would prevent loss of customers;

- the need for a substantial number of CPs to pass customer data to a third party, and continuously update that data, together with the enormous volume of data that would be required to be managed, would give rise to a significant risk of data management problems arising. Database errors could frustrate end-users and prevent them from changing provider;

- it would offer no improvement beyond today's processes in relation to erroneous transfers of a WLTO order where the CP is unable to identify the correct line through an unambiguous reference (*e.g.*, CLI or an account reference number);

- it would often fail consumers in its key deliverable – providing greater certainty and assurance – just as the TPV system in Ireland has failed and largely been withdrawn. The TPV does not have the information of either the gaining or losing provider and can offer no intelligent response to consumer queries at the critical point in the switching process. This is likely to give rise to the consumer needing to restart their switching consideration with all the associated additional costs;

- it would result in a cumbersome customer experience. Ofcom states that the review of consumer switching processes is focussed on ensuring that "*an individual consumer's experience of switching communications services is easy and hassle free*"[36] and yet the Hub + TPV process is far from hassle-free. Not only does it introduce a middle-man into the switching process but it also fails to provide customers with the implications of switching up front, with the result

[36] Paragraph 1.2.

that if the customer does change their mind, they must undo their order and cancel the switch;

- it would result in a switching process that takes far longer (a minimum of ten working days) than alternatives, when consumers have a clear preference for processes that result in shorter switching processes. The results of the consumer survey commissioned by BT, Sky and Virgin Media show that when asked how important is the length of time it takes to switch providers, 86% of respondents rated the importance between 7-10. When respondents were asked the length of time they thought would be reasonable to have to wait for their landline telephone and broadband services to be switched from one provider to another the most common response for both services was "three days", but similar numbers of responses were also recorded for both "one day" and "seven days". 80% of respondents answered "seven days" or fewer and over 90% answered "10 days" or fewer;

- it would result in a switching process in which consumers would only become aware of the implications of their actions (such as incurring early termination charges, loss of discounts or e-mail addresses) late in the process, leading to expensive cancellations, or detrimental outcomes for consumers if they proceed to switch. The results of the consumer survey show a clear preference from respondents for prior knowledge of the implications of switching providers. When asked whether respondents would prefer to have all the information about the consequences of switching before they placed the order to switch or whether they would prefer to switch and then be informed by their current provider what the consequences of the switch were a few days later, but be given the opportunity to cancel the order at no cost to them, 88% of respondents preferred to receive information regarding their switch before they placed their order and only 8% opted for receiving information after placing the order.

  It is contradictory that CPs are required by Ofcom to provide consumers with all the information they need to ensure that they can make an informed transactional decision in relation to acquisition marketing and yet, in this case, Ofcom does not consider it important that consumers should have all the relevant information to hand at the point they make the decision to switch. This is particularly incongruous when the result of not having that information may lead to customers having to go to the "hassle" of undoing their switch and indeed, could have avoided going through the whole sales process with a new provider that they would never have undertaken had they known about the implications of their switch in the first place;

- it would raise potential issues related to confidentiality of consumers' data. Sky considers that these issues have not been considered adequately by Ofcom. They are addressed in more detail at **Annex 5**, below. In relation to these issues, the results of the consumer survey commissioned by BT, Sky and Virgin Media show that when asked whether they would be happy for their personal details to be stored on a central database in order for order confirmations to be carried out, 57% of respondents said they would not be happy for their details to be stored, 28% responded that they would be happy and 15% "did not know".

55. In view of the extremely small benefits to consumers that it would deliver, and the significant costs and risks associated with the Hub + TPV proposal, it is plainly a disproportionate response to the legitimate problems with switching processes identified by Ofcom.

56. This view is supported by CRA's IA Report. CRA's Report shows that correcting the errors in Ofcom's impact assessment shows that Ofcom's preliminary conclusion, that a Hub + TPV system is a proportionate response to the problems that it identifies in relation to telecommunications switching processes, is unsafe. CRA's analysis shows that there is a range of plausible scenarios in which implementation of this option would be welfare-reducing.

**Ofcom's preference rests on an unfounded objection to reactive save activity**

57. Ofcom's preference for an expensive and burdensome intervention in relation to this issue derives from an unusual chain of logic.

58. It is apparent that Ofcom has a deep-seated (but wholly unwarranted) objection to firms attempting to retain existing customers by offering them special deals if they express a desire to cancel their subscription (*i.e.*, "reactive save activity"). Reactive save activity is positioned by Ofcom as one of the six "problems" to which its proposed interventions are directed.

59. This drives Ofcom to prefer 'gaining provider led' switching processes as, under such processes, consumers do not need to contact their existing provider in the first instance in order to change supplier, reducing the scope for consumers' current supplier to offer them a deal to stay. Ofcom, however, appreciates that such processes are far more susceptible to slamming than 'losing provider led' processes and an increase in slamming would undermine entirely any value that might arise from moving to a GPL process.[37] Accordingly, Ofcom proposes that an expensive and burdensome system should be implemented in order to limit this obvious adverse consequence of moving to a GPL process.

60. This unusual chain of logic might be justified if:

(a) the cost of measures required to prevent an increase in slamming under a GPL process were modest; and
(b) there were clear, significant benefits to consumers from lessening the extent of reactive save activity.

61. However, neither of these conditions applies. As discussed above, the costs of implementing and operating the Hub + TPV system proposed by Ofcom are both (a)

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37 As Ofcom notes, correctly: "*Slamming often creates significant harm for consumers affected, whether that is in the form of distress, time and effort trying to resolve the situation, and/or financial harm where consumers are charged an early termination charge (ETC) if they are slammed during a minimum contract period.*" (Paragraph 1.19.)

substantial and (b) significantly greater than the costs associate with alternative options. In Sections 8 and 9, below, we discuss why Ofcom's aversion to reactive save activity, and its view that there would be substantial benefits to consumers from prohibiting it, are unfounded.

## SECTION 7: THE INDUSTRY PROPOSAL IS AN EFFECTIVE AND PROPORTIONATE RESPONSE TO THE LEGITIMATE PROBLEMS IDENTIFIED BY OFCOM

62. In September 2011, following Ofcom's first consultation, a number of key industry participants (Sky, BT Retail, Virgin Media and Zen Internet), put forward a proposal for a single improved switching process for telephony and broadband services.[38] Key to the proposal were practical and expeditiously implementable improvements. The parties committed to implement those improvements that could be actioned without industry coordination within 18 months of acceptance of the proposal.

63. Key to the proposed process (which Ofcom refers to in its consultation as LPL ALT) is the requirement for a customer intending to switch, to request a transfer code directly from their existing provider. The parties consider this process has a number of key advantages for customers and providers alike, including:

- quick, reliable and cost-effective *authentication* of the customer;
- quick, reliable and cost-effective *validation* of the customer's intention to switch, thereby <u>eliminating slamming</u>;
- reliable and future-proof *identification of the customer's assets* to be switched (*i.e.*, the correct line, calls or broadband service, even where there is no CLI available); and
- provision of a timely <u>impact assessment of switching for the consumer</u> (including an accurate estimate of any early termination charges), i.e. *prior to* the customer finalising their decision (a better customer experience and much more cost-efficient for industry).

64. The above features directly address the industry recognised problems associated with switching processes in the least costly way. Recognising that some customers wish to minimise their engagement with their existing provider and not participate in a dialogue, the proposal also included a number of measures that offered this choice, including:

- explicitly being offered the opportunity to receive a transfer code without hearing a save offer;
- the automatic recording of all calls for verification of this feature; and
- the option of obtaining the TxC via their provider's web portal (where the provider used a web portal to sell telephony and broadband services).

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[38] Letter to Claudio Pollack, Ofcom, 26 September 2011. (http://stakeholders.ofcom.org.uk/binaries/consultations/switching-fixed-voice-broadband/annexes/option_proposal.pdf)

65. In addition to the process-specific benefits noted above, the proposal would also deliver greater benefit to consumers than Ofcom's preferred Hub + TPV system, by being:

- significantly less expensive to implement and maintain – by Ofcom's own assessment[39];

- quicker to implement, because:

  - most CPs today have the capability of issuing and using a MAC code and LPL ALT process simply extends the current MAC code capabilities through the use of the TxC;
  - Openreach currently generates MAC codes and has processes to tag lines with a MAC – all of which can straightforwardly be updated to use the TxC. In its consultation Ofcom mischaracterises the complexity of introducing the transfer code process in the proposed LPL ALT process, believing that this would require a Transfer Code Issuing Authority (TxCIA) to be set up[40]. This is incorrect. We address this issue in detail at **Annex 6**;
  - no new elaborate industry governance and commissioning body would need to be created in order to define and commission the highly complex centralised Hub;
  - CPs do not need to create new systems and prepare their customer data to upload and thereafter constantly maintain data in a centralised Hub;

- supportive of switching services in a matter of hours or days (likely to be dependent only on the practicalities of delivering new CPE such as a broadband router to customers or scheduling engineering resource) rather than the minimum ten days under the Hub + TPV system. This is due to the customer being informed at the time of requesting the transfer code of the impact of their intended switch – rather than having to wait to receive this advice in the post; and

- less hassle and costly for the consumer without their need to participate in a sales transaction where they are handed off to a TPV – a transaction that, as CRA identify[41], can fail for a number of technical and information reasons, resulting in the consumer needing to reinitiate their switching process.

66. Additionally, the proposed alternative switching process can usefully be extended to address the problems of home-move (associated with misidentification of lines) resulting in erroneous transfers, even though Ofcom does not consider it would effectively deal with this problem[42]. Sky is concerned that Ofcom may not have fully understood the process and opportunities for use of the TxC alongside a LPL switching process and refers Ofcom to the detailed explanation provided at **Annex 6.**

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39 Figure 38 of Ofcom's consultation document.

40 Paragraph 6.45.

41 See Section 7.3 of the CRA IA Report.

42 Paragraph 7.35.

67. CRA's analysis shows that quantified net benefits associated with this proposal are significantly greater than those of Ofcom's preferred option.

## SECTION 8: OFCOM'S OBJECTION TO REACTIVE SAVE ACTIVITY IS UNFOUNDED

68. As noted above, Ofcom's objection to reactive save activity on the part of suppliers plays a key role in its preference for requiring the implementation of a costly and intrusive Hub + TPV system.

69. Ofcom's objection to such activity is unusual. Such activity is commonplace in numerous sectors across the economy, and, *prima facie*, should be expected to work in the interests of consumers where markets are effectively competitive.

70. Ofcom believes, however, that such activity reduces competition, and therefore there would be significant gains to consumers, via an increase in competition, if 'save' offers were limited or prohibited. This purported benefit is relied upon by Ofcom as the factor which 'tips the balance' in favour of a more expensive and intrusive intervention, among options which otherwise are (at least on Ofcom's assessment) closely matched.

71. As set out in CRA's Reactive Save Report, Ofcom's arguments in relation to reactive save activity, and its description of such activity as a "problem" that needs to be addressed, are unfounded.

72. Ofcom asserts that reactive save activity reduces competition in two ways:

    (a) it raises barriers to entry, thereby insulating existing players in the market from the threat of new entry; and
    (b) it 'dampens' competition among existing firms in the market.

73. We discuss each of these in the following sections.

### The effect of reactive save activity on barriers to entry

74. The fundamental problem with Ofcom's first argument is that it fails to have any regard to real-world market circumstances, in two key respects. First, Ofcom fails to recognise that, even if its theory that reactive save activity increases barriers to entry were correct, there are other significant barriers to entry that would be wholly unaffected by a reduction in reactive save activity. Above all, entry to the market requires substantial up-front investment which is immediately sunk. Sky, for example, has invested over [CONFIDENTIAL] on its entry into the UK broadband and fixed line telephony sector.

75. Second, entry normally occurs either due to opportunities provided by poor market outcomes (such as high pricing by incumbents, or consumers being inadequately served), or the development of innovative new products or processes. It is readily apparent that the likelihood of significant new entry to the sector is low simply because it is wholly implausible that there are significant profitable entry opportunities. This is a reflection of the intensely competitive nature of this sector already, combined with declining use of fixed line telephony services by consumers.

76. The likelihood of significant, facilities-based new entry into either the fixed line telephony or broadband sectors in the UK in the medium term is extremely small. Fixed line telephony use and revenues are declining, circumstances which are not conducive to new entry. In relation to broadband services, entry would require substantial levels of investment in circumstances where the main opportunity for investing in infrastructure – via unbundling BT local loops and investing in ADSL technology – involves investing in technology that is no longer the leading technology for delivery of broadband services. Again, this situation renders the likelihood of significant new entry into the provision of broadband services in the UK extremely unlikely.

77. The key discipline on Sky's pricing, investment, customer service and product development in relation to fixed line telephony and broadband services is not the threat of additional entry to the sector, the prospect of which Sky regards as remote, but the competition it faces from other players already operating in these sectors.

78. The reality, therefore, is that even a complete prohibition on reactive save activity would have a negligible impact on the likelihood of new entry at a scale sufficient to have a significant impact on market outcomes in the UK broadband and fixed line telephony sector.

79. Ofcom's theory in relation to the effect of reactive save activity on entry – and the language used by Ofcom to set out its theory – is predicated on an industry structure that does not apply in the UK in 2012. Ofcom's theory is based on the existence of a dominant "incumbent", where the task facing a regulator is to encourage new entry to compete against that incumbent. Such new entrants will "*look to grow their subscriber bases*" principally by taking customers away from the "incumbent", over time lowering its market share. In such a setting, impediments to customers switching away from the incumbent play an important role in the likelihood of competitive entry occurring.

80. Whilst this may have been an appropriate frame of analysis five years ago, it is not relevant to current market circumstances in the UK. Instead, the relevant markets now contain four operators with substantial subscriber bases (BT, Virgin Media, Talk Talk and Sky), two large players with smaller subscriber bases (O2/Be and Orange) and a large fringe of smaller players, all of whom are 'looking to expand' their subscriber bases - largely at each other's expense.[43]

81. In these circumstances, an argument that a costly and intrusive intervention is appropriate because it results in a *de minimis* increase in the probability of significant new entry to the sector would be irrational.

[43] Whilst there is room for expansion of subscriber bases via the attraction of wholly new broadband subscribers, that is plainly not the case in relation to fixed line telephony, where usage is declining.

**Dampening competition among existing firms**

82. Ofcom asserts that reactive save activity "*is likely to dampen competition*"[44] among existing players in the market.

83. As in the case of barriers to entry, the core problem with Ofcom's position is that it fails to have regard to real world market circumstances. Instead, Ofcom relies on vague allusions to ill-suited economic theory. Ofcom offers no evidence at all that the ability to attempt to retain subscribers via special deals results, in current market circumstances, in 'dampening of competition', or any adverse effects on consumers, for example via higher prices, excess profits, lack of investment, poor standards of service or failure to respond to consumer demands. All available evidence points to the contrary: that competition to both attract and retain subscribers among BT, Sky, Virgin Media, Talk Talk, O2, Orange and a host of smaller players, is strong and results in substantial benefits to consumers.

84. Ofcom's response is to assert, in effect, that it does not need to show such evidence because it can be presumed that any increase in competition is of benefit to consumers. Ofcom asserts that competition is not a binary variable, so that even an intensely competitive market might be made *more competitive* via regulatory intervention.[45] It is self-evident, however, that there are diminishing returns from increasing levels of competition – the gains from introducing competition into a monopolistic market are obviously significantly greater than marginal increases in competition in an effectively competitive market. Even if Ofcom's theory about the effect of reactive save activity on competition among existing players were correct (which it is not), it is plain that any gains from increased competition associated with a diminution in the level of reactive save activity would be marginal, given that the relevant sectors are already highly competitive.

**The effect of reactive save activity among existing players: Ofcom's theory**

85. Ofcom advances a number of reasons why it considers that reactive save activity dampens competition among existing firms in the market. These include somewhat vague, and in places inconsistent allusions to matters such as information asymmetries among firms, the economic literature on price matching guarantees, and price discrimination.

86. Ofcom's economic analysis of this issue is considered in detail in the CRA Reactive Save Report, attached at **Annex 2.** As noted above, CRA's report concludes that "*the conceptual economic arguments which Ofcom invokes to argue that reactive save activity damages competition are not robust.*"[46] CRA also concludes that "*none of* [Ofcom's] *arguments can support, individually or collectively, a coherent case that reactive save will lead to a reduction of competition in this case*"[47].

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44 For example, at paragraph 5.24.

45 Paragraph A7.42.

46 Paragraph 194 of CRA's Reactive Save Report.

47 Paragraph 5, *Ibid.*

### The effect of reactive save activity among existing players in practice

87. In fact, Ofcom's theory is entirely the wrong way around: reactive save activity supports competition among firms in the market, rather than reducing competition.

88. Ofcom observes, correctly, the key role that 'looking to grow' customer bases plays as a driving force of competition in this sector. This is for the straightforward reason that provision of broadband and telephony services involves substantial fixed costs, and the larger a firm's subscriber base, the greater the contribution to the recovery of those costs.

89. Growing a customer base requires that the number of customers acquired in any given period exceeds those that are lost to competitors, and it is far cheaper to retain existing subscribers than acquire new subscribers due to the presence of significant subscriber acquisition costs. Accordingly, retaining subscribers is as important to existing players in the market as attracting new subscribers – if not often more important.

90. The best way of both attracting and retaining subscribers is to offer attractive, competitively priced products and services, which is the key reason that UK consumers today have a significant choice available to them of high quality, competitively priced broadband and telephony services, from a range of suppliers. Relative to such efforts, reactive save activity comprises a relatively modest component of suppliers' activities aimed at earning a reasonable return on their substantial investments in this sector.

91. Sky can confirm that, as an operator "*looking to grow*" its subscriber base, Sky does not regard the theoretical 'adverse selection' issue raised by Ofcom as having any impact at all on its incentive to win customers away from rivals such as BT, Virgin Media and Talk Talk.

### Price discrimination

92. Offering special deals to those customers who have expressed an intention to switch is a form of price discrimination. As noted in CRA's Reactive Save Report, Ofcom's position on this issue in the consultation document is unclear. In some parts of the consultation document Ofcom appears to take the view that such price discrimination is unproblematic, given the competitiveness of the markets involved.[48] In other parts, however, Ofcom appears to argue that reactive save activity allows firms to:

> "*compete by offering selective price cuts to a small part of its customer base, whilst charging higher prices to the rest.*"[49]

93. In effect, in these parts of Ofcom's consultation document Ofcom appears to believe that reactive save activity results in a relatively small number of consumers obtaining a special deal, while the majority of consumers pay more for their broadband and telephony services than either (i) they would pay if firms were prohibited from employing reactive save discounts or (ii) 'competitive' prices.

[48] Paragraph A7.57.

[49] Paragraph 5.20.

94. The first of these depends on the counterfactual – how firms and consumers would behave in an environment in which reactive save activity was prohibited – which is discussed in the following section.

95. In relation to Ofcom's second proposition, in a sector characterised by high fixed costs (as is the case in relation to fixed line telephony and broadband services), charging different effective prices to different consumers is commonly regarded as an efficient and reasonable approach to pricing. It does not mean that consumers paying a higher price are being exploited, nor that those paying lower prices – whether new acquisitions on acquisition offers, or those who have been 'saved' as a result of being offered a retention deal – are paying unduly low prices. All that it means is that different types of consumers are making different contributions to the recovery of firms' fixed costs.

**Ofcom confuses effects on the level of switching and effects on competition**

96. Ofcom asserts that its "c*oncerns about reactive save are supported by empirical evidence*"[50]. The evidence cited by Ofcom, however, is weak evidence that principally demonstrates that reactive save activity reduces the level of consumer switching among suppliers of broadband and telephony services.[51] In doing so, Ofcom falls into the obvious error of confusing the level of consumer switching in a market with the intensity of competition. In other words, Ofcom assumes, erroneously, that a market in which there is more consumer switching among suppliers is more competitive than one which exhibits less consumer switching. It is reasonably self-evident that such an assumption is unsafe. Indeed, at one point in the consultation document, Ofcom recognises this to be the case.[52]

97. Accordingly, the evidence referred to by Ofcom does not support its view that reactive save activity reduces competition. It is evidence that shows that reactive save activity reduces (by a relatively small amount) the amount of consumer switching among the suppliers of fixed line telephony services, and broadband services, not that reactive save activity reduces competition among such suppliers. Ofcom offers no evidence that reactive save activity reduces competition.

**The risks associated with inappropriate reliance on economic theory**

98. As discussed above, Ofcom's objection to reactive save activity relies almost entirely on theoretical economic arguments. Plainly, economic theory has a very significant role to play in informing regulatory policy. In order for such policy to be rational and welfare enhancing, however, it is necessary that its economic underpinnings are clearly thought through and articulated, and above all that the economic theory and models employed fit the real world circumstances of the issues being addressed. Economic theory contributes least to rational, welfare enhancing regulation when it is used in a

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50 Heading preceding paragraph 5.25.

51 Paragraph 5.25 – 5.28. The weaknesses in this evidence are discussed more fully in Section 6 of CRA's Reactive Save Report.

52 Paragraph 4.6.

vague and inappropriate way to attempt to support conclusions that have been reached on another basis.

99. In relation to the current issue, as discussed above, Ofcom's stance on reactive save activity is a prime example of an inappropriate reliance on economic theory, without proper testing of whether the theory in question is applicable to the real-world circumstances. Such an approach is bound to lead to inappropriate policy conclusions, with potentially significant adverse consequences.[53]

## SECTION 9: THE POTENTIAL EFFECTS OF PROHIBITING REACTIVE SAVE ACTIVITY

100. Ofcom takes the view that there would be potentially significant benefits to consumers from prohibiting reactive save activity, or intervening in such a way as to limit opportunities for such activity (for example, by compelling the adoption of a gaining provider led switching process). Ofcom's analysis of this issue, however, is extremely simplistic. Because Ofcom believes that reactive save activity reduces competition, Ofcom simply assumes that a reduction in reactive save activity would result in an increase competition, thereby potentially delivering significant benefits to consumers, for example via lower prices and greater levels of innovation.

101. This view is flawed for several reasons.

102. First, it is predicated on the validity of the proposition that reactive save activity reduces competition. The invalidity that proposition, as discussed above and in CRA's paper, in turn invalidates the proposition that reducing the amount of reactive save activity would result in increased competition in the UK fixed line telephony and broadband sectors.

103. Second, Ofcom gives no consideration at all in its consultation document to the relevant counterfactual of how suppliers and consumers would behave if firms were prohibited from offering potential switchers retention deals. Effectively, Ofcom's impact assessment assumes that if firms were not able to use retention offers to reduce churn, their most likely reaction would be cut prices to all their subscribers (or some corresponding action which had the same effect). This is extremely implausible.

104. Deals offered to potential switchers are part of the 'toolkit' used by firms to reduce churn, which imposes significant costs on subscription-based businesses. If firms were no longer able to use that particular tool to fight churn, they would seek the next best alternative. It is extremely implausible that the types of actions considered by Ofcom – such as across the board price cuts – would be adopted in response. Across the board

[53] For another example of such reliance, and a description of its consequences, see 'The OFT Tobacco Investigation: a case of smoke without fire', RBB Brief 38, January 2012. (Available at: http://www.rbbecon.com/publications/downloads/rbb_brief_38.pdf.) In that case, the OFT relied on an economic model of how agreements operated in relation to the supply of cigarettes to supermarkets. The OFT first issued a statement of objections in the case in 2007. During the appeal of the OFT's decision, in December 2011, the OFT conceded that its economic model did not reflect the way that those agreements operated in practice, having ignored submissions that this was the case throughout its inquiry. The appeal was halted and the fines imposed by the OFT annulled. As a result a vast amount of time, effort and money spent on the case was entirely wasted.

price cuts, for example, once matched by competitors would do little to prevent churn and would result in a significant amount of revenue being lost.

105. Instead, firms may react in ways that Ofcom has not considered. For example, firms may invest in the means of identifying 'at risk' customers and offer them deals before they signal their intention to churn, or adopt longer contract lengths. Such reactions are hard to predict and may potentially (in some cases) act against consumers' interests.

106. Indeed, Ofcom fails to consider the possibility that a prohibition on reactive save activity may itself 'dampen competition' among suppliers. A prohibition on reactive save activity would reduce average customer lifetimes, thereby reducing customer net present values ("NPVs"), in turn reducing firms' incentives to acquire new customers. Whilst a reduction in the use of reactive save activity may have an indirect effect on subscriber acquisition costs, thereby increasing customer NPVs, this reduction may be insufficient to offset the reduction in customer lifetimes. Accordingly, there is a possibility that a ban on reactive save activity may reduce firms' incentives to compete aggressively to win customers away from each other.

107. Third, as CRA show, there is in fact a significant risk that a prohibition of reactive save activity (or regulation having an equivalent effect), would make consumers worse off, because such activity increases consumer welfare.[54]

**Sky** **25 May 2012**

54 See Section 7 and the Annex to CRA's Reactive Save Report.

## Annex 1

## Ofcom's Impact Assessment of Changes to Switching Options for Fixed Voice/ Broadband Lines: An Economic Review

**A Report by Charles River Associates**

## Annex 2

## Ofcom's assessment of the use of reactive save activity by suppliers of fixed voice and broadband services: An Economic Analysis

**A report by Charles River Associates**

## Annex 3

**Ofcom customer switching consultation**
**PwC's independent cost assessment of the alternative GPL TPV model**

## Annex 4

## Documents related to the consumer survey commissioned by BT, Sky and Virgin Media

## Annex 5

### Data privacy implications of a TPV process

A5.1 Ofcom outlines in the consultation document that the data contained within the database would constitute personal data under the Data Protection Act 1998. There are a number of privacy-related issues that would need to be addressed prior to setting up the database and during its operation.

### Proper assessment of privacy implications

A5.2 Proposals for regulatory intervention that potentially impacts the use of personal data and consumers' privacy should consider fully the risks of such impacts as a potential detriment to the intervention. To assess the necessity and the privacy implications of establishing the Hub +TPV Sky would expect Ofcom to have carried out a detailed Privacy Impact Assessment as part of this consultation in accordance with guidance issued by the Information Commissioner's Office.[55]

### Assigning responsibility

A5.3 In circumstances where there are multiple data controllers using a centralised system it is an important exercise to map the potential personal data flows within the system, in order to identify where particular data protection responsibilities and obligations will lie. It is beyond the scope of our response to perform this exercise but from the description provided in the consultation documentation it appears that CPs would be data controllers in common, each processing the data contained in the database independently of the other. In this case there will need to be an agreement between the various CPs setting out the terms and conditions under which CP may process the data including:

- warranties by the parties about their compliance with the Act, and the appropriateness of their technical and procedural security; and
- indemnities by the parties designed to ensure that failures on the part of one party to the agreement will not unduly penalise the other data controllers.

### Security

A5.4 There are security risks in holding personal data on a large database and any data breach could impact several million consumers from all CPs. The risk is limited at present as the personal data is held independently by each CP and a data breach by one CP is limited to their customers and does not expose every consumer that has ever switched provider.

A5.5 Sky acknowledges that these security risks can be mitigated, but the consultation document fails to appreciate the extent of the security measures that would need to be

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55 See 'Impact Assessment Handbook'. (http://www.ico.gov.uk/upload/documents/pia_handbook_html_v2/index.html)

considered to establish and maintain such a large database accessed by various actors, potentially including a TPV provider. Such measures include:

- Personnel security
- Facilities and equipment security
- Physical security
- Incident response
- Business continuity management
- Network security
- Protection against malicious code
- Platform and application security
- System management
- Data management
- User and access management
- System change control
- Audit Rights

A5.6 It is not clear who would be responsible in practice for ensuring the security of the database and who would be responsible in the event of security measures being compromised. Assuming responsibility is assigned to a supplier to build, host and maintain the database, the supplier would need to be appointed as a data processor by each CP collectively in a multi-party agreement that passes each CPs liability under the DPA onto the supplier in the event that supplier is responsible for a data breach. Furthermore, each CP would need to satisfy themselves that the supplier is able to processes their customers' personal data securely. This may involve individual assessments by each CP.

**Administrative measures**

A5.7 As well as the security considerations outlined above, there would need to be administrative measures in place to deal with the day to day operation of such a large database including:

- a process for dealing with subject access requests made for personal data held on the database i.e. who would such requests be sent to, who would be responsible for assessing the request, who would be responsible for complying with the request;
- a process for dealing with requests for personal data from third parties such as law enforcement agencies i.e. who would such requests be sent to, who would be responsible for assessing the request, who would be responsible for complying with the request;
- a process for maintaining the accuracy of the data and ensuring it is kept up-to-date; and
- audit processes to check on-going compliance.

**Annex 6**

**There is no need for a transfer code issuing authority in the LPL processes considered by Ofcom**

A6.1 Part of the LPL processes considered in Ofcom's consultation document involves the use of transfer codes, used to facilitate switching. Ofcom takes the view that such processes would, therefore, require the establishment of a third party body to issue transfer codes (a "*transfer code issuing authority*"), which would be established and funded by CPs, and that, as a result there is some similarity between such processes and the 'Hub + TPV' option preferred by Ofcom.

A6.2 Ofcom states:

> "*Under the GPL models, the TxC is provided by a centralised Hub. Whereas, in the LPL models, the TxC would be provided to the LP's Access Operator by a TxC Issuing Authority (TxCIA) and the TxC would be passed back down the supply chain to the LP who would then pass it to the customer. The TxCIA would be a body which would be independent of Openreach. The TxCIA would potentially be able to provide TxCs across multiple infrastructure providers, if required.*"[56]

> "*The LPL options (LPL TxC and LPL ALT) would also require a new body to be established and funded (i.e. the TxCIA) which CPs/TPIs would need to interface with. However, the TxCIA would perform simpler functions relative to the hub and database required for the GPL options, and would not require CPs to upload customer information to a central database, thus the TxCIA would be likely to require less effort and co-ordination to establish overall.*"[57]

> "*The TxCIA would just issue codes and store them in a database.*"[58]

A6.3 There is, however, no good reason to require the establishment of a third party transfer code issuing authority to provide transfer codes. As a result, Ofcom's view that the LPL options it has considered are similar to the 'Hub + TPV' option, in relation to the need to set up and operate an independent third party body, is flawed.

A6.4 Part of the flaw in Ofcom's analysis appears to stem from a misappreciation of the nature of transfer codes themselves. A transfer code is simply a unique code that is generated at the request of an Access Operator following a request for a switch. That code is then able <u>subsequently</u> to be applied by the Access Operator to identify uniquely assets and services which may be switched. Accordingly, issuing transfer codes involves nothing more than creating, providing and recording a series of unique codes. It is an extremely simple function. In particular, it requires no customer information or data to be collected and managed.

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56 Paragraph 6.45.

57 Paragraph 7.146.

58 Footnote 272.

A6.5 Ofcom also appears to believe that that the generation of transfer codes in the LPL ALT process would not be undertaken in real time[59]. That is incorrect. The LPL ALT process would involve the generation of a transfer code in real time, in order to provide the code immediately in response to a request for it, made via a phone call or online by the LP's customer. There would also be fall back processes to support the generation and communication of the transfer code to a customer sometime after a request, should it not be able to be given over immediately.

There is no need for a transfer code issuing authority

A6.6 The current Ofcom consultation addresses the switching of broadband and telephony on the Openreach copper network. In relation to this issue, there is no need for a transfer code issuing authority, as all switches are from one CP operating on Openreach's network to another. Currently Openreach generates the MAC codes, which are a type of transfer code, which are used to identify the assets and services to be switched on its network. Sky is unaware of any criticism of Openreach's performance in generating MAC codes. Even when an agreed improved switching process is extended to include switching between and on the Openreach fibre network – the most logical extension of the switching process – there would still only be one Access Operator, Openreach, and hence no need for, or benefit from, transfer codes to be generated independently of Openreach by a third party "issuing authority".

A6.7 At paragraph 6.45 of the consultation document, Ofcom also refers to "*multiple infrastructure providers*", apparently in reference to potential future extensions of whatever switching option is selected by Ofcom beyond Openreach's network(s). Even in this case, however, there would be no good reason to establish a third party body to issue transfer codes. In such a scenario either:

- it would be straightforward for Openreach to issue transfer codes for all Access Operators (e.g., on an equivalence basis); or
- given the relatively small number of Access Operators, it would be straightforward for them to agree how best to develop an alternative system for issuing transfer codes. There would certainly be no need, as Ofcom suggests, for CPs to be involved in that process (in any way), and whatever process was agreed by Access Operators would bear no resemblance to the Hub + TPV system proposed by Ofcom.

59 Paragraph 7.37.

**Annex 7**

**Working Line Takeover (WLTO) process and proposed new switching processes**
**A paper presented to the Ofcom SWG 25 May 2012**

## Working Line Takeover (WLTO) process and proposed new switching processes

*A paper provided to Ofcom SWG on 24 May 2012*

1. A group of communications providers (CPs), BSkyb, BT, Virgin Media and Zen Internet (the Group), proposed to Ofcom[60] that it would be efficient for the industry to implement an improved WLTO process at the same time as making significant changes to the consumer switching process. In its latest consultation document, Ofcom has dismissed the use of the Transfer Code (TxC) process alongside a Losing Provider Led (LPL) switching process as providing any material benefit over and above the current WLTO NoT process. The Group disagree with Ofcom's assessment. This paper provides a detailed review of possible WLTO processes under consideration to illustrate the benefits of using TxC alongside an LPL switching process to facilitate WLTO.

2. The Group agree with Ofcom that WLTO processes should be aligned with switching processes so that CPs can implement improvements and changes in their systems at the same time as implementing changes necessary for a new switching process so as to achieve resulting economies of scope. We also agree that the TxC concept can readily be extended to deal with WLTOs to make them safer. However it is very important to ensure that this is done in such a way that the process is not too complex for consumers or CPs, otherwise CPs might choose to place a new provision order instead, creating inefficiencies across the industry through unnecessary Openreach engineering visits and new line installations. We would like to see a commitment by CPs to adhere to the agreed new WLTO process in any home move scenario where a working line exists.

3. We disagree that this should be characterised as a "GPL vs LPL" question. In the case of home moves, generally there is no competitive situation and no "gainer" or "loser", since the majority of consumers will not be changing their supplier but simply arranging with their existing supplier to take over provision of service on a different line. If the consumer chooses to switch

[60] Letter to Claudio Pollack, Ofcom: "An industry proposal", 26 Sepetember 2011

their provider at the time of moving home, then this would be handled by the switching process not the WLTO process.

4. With this in mind, we think that some of the pros and cons of each process have been misrepresented. We will focus primarily on Ofcom's preferred process (GPL TPV) and on the Group's proposed process (LPL TxC ALT).

**WLTO with GPL TPV process**

i. *The consumer moving into the property tells their provider the information they know about the property they are moving into (address and where available the name of the consumer moving out of the property and the CLI).*
ii. *The incoming provider queries the hub database using the information the incoming consumer has been able to provide (name, address and CLI or a subset of these) to confirm the incumbent provider, service type, access type for the target line.*
iii. *The incoming provider submits a Transfer Code (TxC) request.*
iv. *The incumbent provider should contact their customer that is moving out of the property to gain confirmation of their intention to move out and cease service at the address, and the expected date.*
v. *The provider submits the WLTO order with the TxC and target date*

*Issues:*

i. We agree that the account ref of the consumer moving out should not be disclosed, for obvious security reasons (this would allow the incoming consumer to make unauthorised changes to the outgoing consumer's account).
ii. However the lack of account number as identifier on the hub database means that the incoming provider is often searching using *no more information* (CLI, address) than is used with the existing NoT process, which we know can cause erroneous transfers. (From our investigations, we believe a significant proportion of these – more than 60% - are caused by customers or advisers using incorrect CLIs/addresses – and not just because of the lack of visibility of MPF CLIs on Openreach systems.)
iii. Only where the incoming consumer knows the *name* of the outgoing consumer will there be more information for service identification purposes than is currently available with the current NoT process. This is unlikely to be the case where the property is rented.

iv. Passing the *incoming* customer to the TPV body (as per the "mitigation" proposal) adds no value to the WLTO process, as they are not switching supplier and probably not even changing their existing package, so there is nothing for the TPV body to verify.
v. What happens if the incumbent provider cannot confirm with their outgoing customer that they are moving out (perhaps because they fail to make contact, or because they've already moved without asking for the final bill)? Bearing in mind that, as with the existing process, the incoming provider could have requested a TxC against the wrong line, we think the default position should be that no code is issued without the outgoing consumer's active consent, unless the incoming customer has been able to provide the name of the outgoing customer which matches with that on the incumbent provider's systems. Otherwise erroneous transfers will be just as likely as they are today (and could become worse as CLI/address become less reliable as an identifier of services/assets).
vi. Continued or increased levels of erroneous transfers, or inability to find the correct line, will drive inefficiencies in the form of unnecessary new provision orders.
vii. If the incumbent provider can *verify* that their customer has already left and has/is intending to default on bill payment, a TxC could then be issued to the incoming provider, or the line could be stopped/ceased (so that it is available for the incoming provider to re-use directly from Openreach).
viii. How many attempts should be made/how long should the incumbent provider wait before refusing a TxC? This is debateable…
ix. The need for the incumbent provider to contact their outgoing customer *in every case* could potentially delay things considerably and does not seem an efficient end-to-end process. But without this contact and consent, the process would be less reliable than today's WLTO process (when operated with the Best Practice Guide).

**WLTO with LPL TxC process**

*i. The consumer moving into the property needs to get the TxC from the consumer that is moving out of the property who requests this from their provider.*
*ii. The consumer moving into the property provides the TxC to their provider who submits the WLTO request with the associated TxC.*

*Issues:*

i. We believe that in by far the majority of cases, if this process becomes the norm, this should work smoothly and outgoing consumers will readily co-operate in providing the TxC along with other information often provided for purchasers (central heating instructions, guarantees for work done on the property, etc).

ii. Outgoing consumers are likely to be contacting their existing provider anyway, to arrange for service to be provided at their new address or to ask for service to be ceased (if moving abroad, say). Therefore requesting a TxC will not create any extra "hassle" for the outgoing consumer.

iii. This could also be carried out on a "reactive" basis, i.e. when an outgoing customer rings their incumbent provider to inform them that they are ceasing service and moving out, the rule could be that the provider gives their customer a TxC which they just store, ready to be given to the incoming consumer or their letting agent on request. This minimises hassle still further.

iv. The big advantage of this process is that the correct asset/service will *always* be identified and the code always issued against the right thing.

v. A further advantage is that the WLTO can be arranged quickly with no waiting for the incumbent provider to contact the outgoing consumer, so no need for the 10 day window.

vi. There will be a minority of occasions where a code cannot be obtained by the incoming consumer from the outgoing consumer (either because the latter will not co-operate, or has left the premises without telling their provider). In these cases, as a fallback, we believe the issue could be resolved by co-operation between the respective CPs:

vii. *The incoming consumer tells their provider they have been unable to get a TxC.*

viii. *The incoming provider looks up the incumbent provider on Openreach Dialogue Services, by searching on address and CLI (as for current NoT-based process).*

ix. *The incoming provider contacts the incumbent CP and requests that they raise a TxC.*

x. *The incumbent provider checks whether they have already had notice from their (outgoing) customer that they are moving. If so, they should already have issued a TxC and can pass it directly to the incoming provider.*

xi. *If no notice has been received from the outgoing consumer, the incumbent provider attempts to contact them. If confirmation/consent to the takeover is obtained, they issue a TxC. It is in the interest of the incumbent CP to undertake this action as they have an interest in understanding what the intended actions of their customer are – will their customer be moving out leaving unpaid bills or will their customer be moving and need to initiate their own WLTO?*
xii. *If no contact can be made, as with TPV process, the default should be that no code is issued unless the incoming customer has been able to provide the name of the outgoing customer, as extra verification that the correct line has been selected.*
xiii. *If the incumbent provider can verify that their customer has already left and has/is intending to default on bill payment, a TxC could then be issued to the incoming provider, or the line could be stopped/ceased (so that it is available for the incoming provider to re-use directly from Openreach).*

xiv. A further possibility would be to leave it to the incoming consumer, as to whether they choose to get the TxC via the outgoing consumer (eg where relations are good and/or time is of the essence), or whether they choose to go to their CP and ask them to liaise with the outgoing CP on their behalf (as per the "fallback" process above).

**WLTO with GPL USN process**

i. *The consumer moving into the property gets the USN from the consumer that is moving out of the property who finds it on a recent bill.*
ii. *The consumer moving into the property gives the USN to their provider.*
iii. *The provider queries the database to confirm the incumbent provider, service type, access type for the target line.*
iv. *The provider submits a TxC request as normal.*
v. *The incumbent provider should contact their customer that is moving out of the property to confirm their intention to move out of the property and the expected date.*
vi. *The provider submits the WLTO order with the TxC and target date*

*Issues*

i. This process is better than the GPL TPV process, as the correct asset to take over can be identified by the USN, but with the added problem that sharing of USNs with another consumer could create a security risk. And if the incoming customer has to get the USN from the outgoing customer, why not just get the TxC?

ii. Given that this process is not favoured by Ofcom for switching, it should also be rejected for WLTOs.

**WLTO with GPL TxC process**

*i. The consumer moving into the property tells their provider the information they know about the property they are moving into (address and where available the name of the consumer moving out of the property and the CLI).*

*ii. The provider queries the hub database using the information the consumer has been able to provide (name, address and CLI or a subset of these) to confirm the incumbent provider, service type, access type for the target line.*

*iii. The provider submits a TxC request.*

*iv. The incumbent provider should contact their customer that is moving out of the property to confirm their intention to move out of the property and the expected date.*

*v. The provider submits the WLTO order with the TxC and target date.*

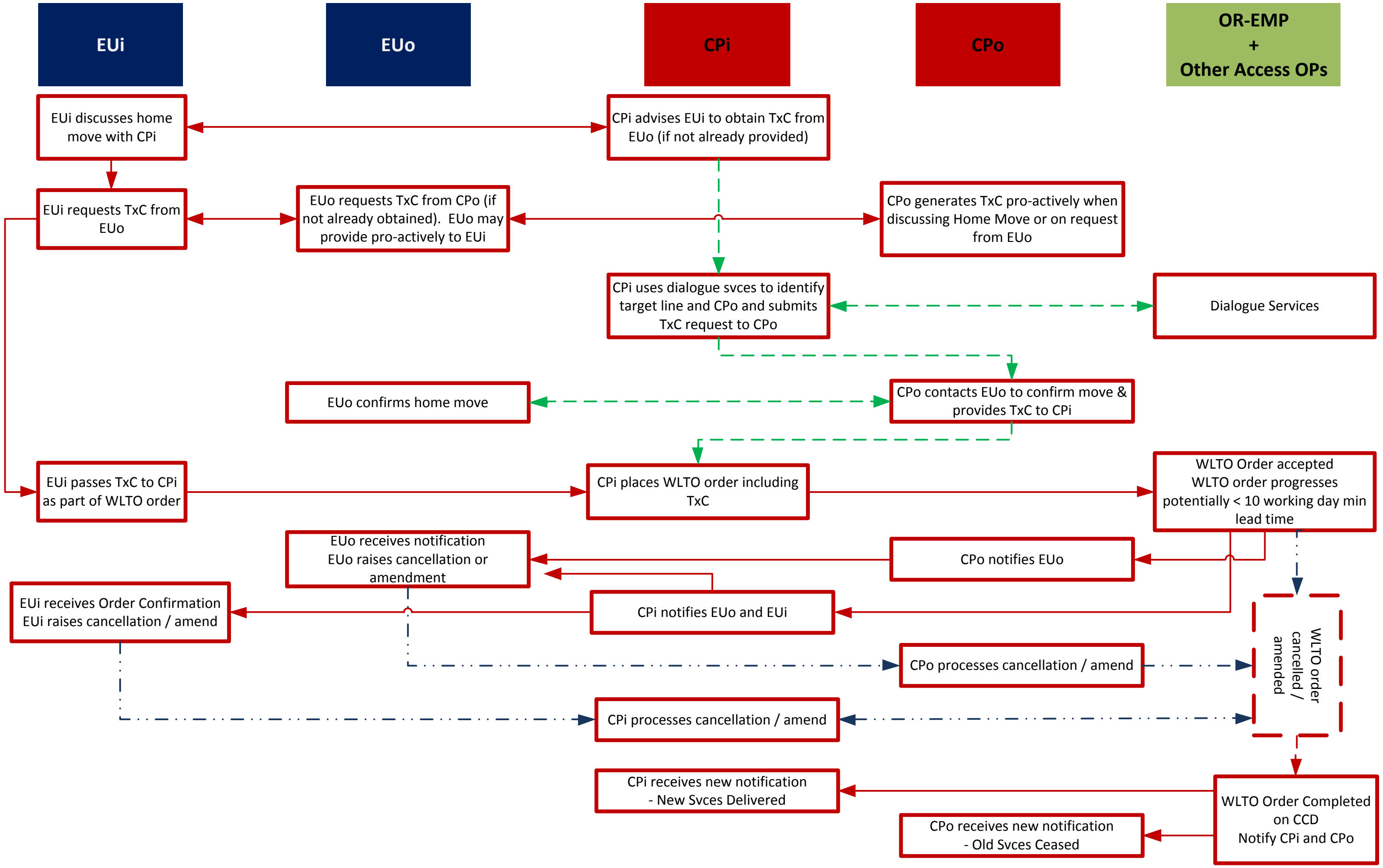
*Issues*

i. This process raises the same issues as the GPL TPV process: the incoming provider would often be searching the hub database using no more information (CLI, address etc) than is used with the existing NoT process, which we know can cause erroneous transfers.

ii. Given that this process is not favoured by Ofcom for switching, it should also be rejected for WLTOs.

# Appendix

## WLTO Process – LPL / TxC for Switching



| **Positives:** | **Negatives:** |
| --- | --- |
| • Eliminates risk of ELT's<br>• TxC from CPo underpins reliable execution<br>• Minimal risk of abuse by rogue CPi<br>• Future proof as CPo not wholly dependent upon CLI to validate EUo and their current services<br>• Opportunity to reduce lead times for WLTo<br>• Opportunities for minimal hassle factor for EUi<br>• Leverages existing processes and services, minimising additional costs | • Requires inter-CP comms<br>• EUo / CPo is on critical path (to eliminate ELTs) |

**Legend**