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NON-CONFIDENTIAL VERSION

Consultation: The future regulation of phone-paid services

Three welcomes the opportunity to make representations on Ofcom's proposals relating to the transfer of the regulatory functions of the Payment Services Authority (PSA) to Ofcom, including associated proposed changes to the regulation of controlled premium rate services (PRS).

Three has taken part in the preparation of responses to the consultation questions through its membership of the Operators Billing Forum and the Association for Interactive Media and Micropayments (aimm). We fully endorse the responses submitted by these organisations and therefore do not repeat here the points already made in those submissions. However, we would like to take this opportunity to emphasise certain points of principle and law and to seek clarification on matters pertaining to Ofcom's proposed funding model.

Economies of scale and scope arising from the transfer of functions from the PSA to Ofcom should result in a material decrease of regulatory costs for regulated firms

Three recognises the importance of effective regulation in this market as well as the importance of ensuring that the regulator has appropriate resources in place to discharge its statutory functions. We support the transfer of PSA's regulatory functions to Ofcom. However, we are concerned that the absorption of the PSA's regulatory functions by Ofcom, and the associated economies of scale and scope that will arise as a result, may not be fully reflected in any material reduction on the regulatory fees imposed on individual networks. In this respect, it is worth noting that there will be a reduction in overheads costs relating to premises, equipment and, potentially, certain personnel. All things being

equal, proportionality dictates that these savings should be passed on to regulated entities and (indirectly) to their customers.

Need for greater transparency and stakeholder scrutiny/oversight

As mentioned above, under the current proposals, the PSA will be integrated with Ofcom thus achieving significant cost savings. However, Ofcom proposes to retain a levy on the industry similar to the current PSA funding model. For the avoidance of doubt, Three does not dispute Ofcom's statutory right to raise a levy in relation to its exercise of functions in relation to PRS. However, as a matter of law and principle, Ofcom's ability to raise a levy should be subject to certain requirements and safeguards, including the requirement to demonstrate in a transparent manner that the proposed charges are necessary to cover the costs of exercising the relevant function.

We consider that, as it currently stands, the consultation document and the Draft PRS Order provide insufficient detail on how the relevant costs will be calculated. In our view, a greater level of detail is critical to ensure an appropriate level of transparency in the calculation of the relevant charges. It should also be noted that the absence of detail in the consultation proposals and Draft PRS Order adversely impacted Three's ability to meaningfully comment on those proposals.

We are also concerned that the current proposals materially water down the current level of stakeholder scrutiny and oversight relating to the approval of the budget by Ofcom.

We address these important points of principle in more detail below.

Lack of transparency in the calculation of the proposed levy

Currently, the PSA can clearly calculate and justify the cost of discharging its statutory functions as it is a body exclusively dedicated to the exercise of PRS regulatory functions. However, the proposed transfer of functions from the PSA to Ofcom will increase the complexity in the calculation of the relevant costs, as many of these will inevitably be shared across all of Ofcom's statutory functions. Examples of such costs include costs relating to premises, personnel and equipment.

Ofcom is proposing to use the formula set out in article 14(2) of the draft PRS Order for the purposes of calculating a TCP's administrative charge. In our view the definitions of 'relevant expenditure' and 'overheads' provide insufficient detail on how the relevant costs will be calculated which, in turn, grants Ofcom an excessive degree of discretion to apportion costs based on what is, in its view, 'reasonable'.

Transparent and rigorous apportionment of costs is critical as Three is also under an obligation to pay an additional annual administrative fee to Ofcom which contributes towards Ofcom's costs of exercising its wider functions in the telecoms sector. This means that any possible lack of rigorous apportionment may result in "double counting" of relevant costs for the purposes of calculating Ofcom's regulatory charges thus unduly inflating regulatory costs for businesses. Furthermore, rigorous apportionment and passing on of any cost savings is particularly key as future fine collection under Ofcom regulation will not be used to offset the proposed levy but will instead go to HM Treasury. For these reasons, Three respectfully requests that Ofcom:

- a) confirms that the apportionment of costs will be based on objective operational and financial data and not on Ofcom's subjective view on what it considers reasonable; and
- b) explains in more detail how the collection of the proposed levy will impact and be factored into the calculation of Ofcom's broader administrative fees.

Reduction in the current level of stakeholder scrutiny/oversight

Under the status quo, there is a reasonable level of stakeholder scrutiny as the PSA is required (under paragraph 7.3.1 of the PSA Code) to publish an annual consultation on its budget and then carefully consider the responses from interested parties. While the PRS Order does require Ofcom to publish an annual statement on its expenditure, there is no requirement to consult with interested parties. Three acknowledges that Ofcom's activities under the PRS Order may be referenced in its annual Plan of Work consultation but this simply does not allow for the same level of scrutiny as the one enshrined in the PSA annual consultation process.

If it would be helpful, we would be very happy to discuss the matters raised in our response.

Yours sincerely,