
Three's response to Ofcom's proposals to reform switching of mobile communications services

Non-confidential

30 June 2017



Three.co.uk

Executive Summary

This document sets out Three's response to Ofcom's consultation on its proposals to reform the switching of mobile communications services.

Three support's Ofcom's overall objective of reforming the switching process to make it quicker and easier for customers to exercise choice. Seamless switching processes are vital to helping promote competition. If switching is easy, providers are faced with strong incentives to provide good value and high quality services, both in order to win new customers, and to retain existing subscribers.

However, Ofcom's analysis is fundamentally deficient in failing to consider the detriment arising from Reactive Save, a ubiquitous practice across the industry that is both:

- (a) harmful to consumers;
- (b) harmful to competition (and therefore ultimately consumers); and
- (c) inconsistent with Ofcom's own strategic objectives.

As a consequence, neither of Ofcom's reform options adequately remedy this very material source of harm. Ofcom must therefore amend its switching proposals to impose a ban on Reactive Save activity under either option.

Secondly, Three disagrees with Ofcom's provisional conclusion that Auto-switch is the most proportionate reform option. Ofcom has erroneously based this conclusion on:

- a process design that fails to consider the most cost effective implementation of GPL: and
- an impact assessment approach that systematically understates the relative benefits of GPL.

Ofcom must therefore revisit its process design and proportionality assessments to ensure that it selects the reform option that delivers the greatest net benefit to customers.

The remainder of this document explains and evidences these points in more detail. In the final section we provide answer's to Ofcom's specific consultation questions.

Contents.

Executive summary	1
1. Ofcom's options fail to address consumer harm from Reactive Save.	3
2. Ofcom has understated the net benefits of GPL.	11
3. Answers to Ofcom's specific consultation questions.	17

1. Ofcom's options fail to address consumer harm from Reactive Save.

1. Ofcom's proposals fail to address the consumer harm from Reactive Save

- 1.1. Ofcom's 'Auto Switch' proposal allows porting and non-porting consumers to request their code (PAC or N-PAC) by text or online, in addition to the existing route of calling the losing provider. Ofcom suggests that these alternative routes will remove the need for consumers to speak to their old provider in order to switch.
- 1.2. However, Ofcom's preferred option ('Auto Switch'), and its alternative GPL option, continue to allow Reactive Save. This refers to the practice of losing providers offering targeted discounts to those customers who have indicated their intention to switch via the switching process.
- 1.3. Therefore, both options fail to prevent losing providers from using information obtained as part of the switching process to contact customers with Reactive Save offers. Like today, the losing provider would immediately learn about a customer's intention to switch upon receipt of the text or online request for a code (under 'Auto Switch'), or as soon as the CPS contacts the losing provider to check that the consumer is authorised to switch (under Ofcom's GPL option).
- 1.4. The losing provider would then be free to call customers who explicitly do not wish to be contacted (and therefore have requested a code automatically by text or online under 'Auto Switch', or have asked the new provider to arrange the switch on their behalf under GPL).
- 1.5. The main difference with the status quo is therefore that existing providers would have to call customers wanting to switch with Reactive Save offers, instead of waiting for those same customers to call for a PAC or cancellation themselves before 'pestering' them with those offers as is currently the case.
- 1.6. In this section, we explain why Ofcom must impose a ban on Reactive Save under either of its reform options. In summary, Ofcom must distinguish between Reactive Save and other save activity. Reactive Save i) is harmful to consumers and ubiquitous across the industry; ii) is harmful to competition; and iii) is inconsistent with Ofcom's own strategic objectives.

Ofcom must distinguish between Reactive Save and other 'save activity'

- 1.7. Reactive Save arises when losing providers are able to: i) systematically identify customers who positively want to switch from the information provided by the switching process (e.g. a PAC or cancellation request); and ii) can then target those customers with special offers and 'under the counter' deals which are not made available to the generality of customers.
- 1.8. With Reactive Save, customers who have already made up their mind and positively want to switch are still subjected to unwanted retention offers. This is fundamentally different from other types of 'save activity', where losing providers make a counteroffer to consumers who contact them in order to get a better deal or simply explore their options.

- 1.9. Ofcom is right to allow customers wanting to haggle to do so under the options it has considered. Three recognises that many consumers actively seek retention offers and value the opportunity to have a channel through which to haggle with their existing provider. Three therefore supports a switching process that continues to allow customers to choose to engage in this bargaining process.
- 1.10. Equally, however, consumers wanting to switch without contact from their provider – by either requesting a code automatically by text or online under ‘Auto Switch’, or by asking the new provider to arrange the switch on their behalf under GPL – should not have to endure unwanted calls and Reactive Save offers from the losing provider.
- 1.11. This is not currently the case under Ofcom’s options. Neither ‘Auto Switch’ nor Ofcom’s version of GPL address the problem of Reactive Save. This is surprising given that Ofcom has itself identified ‘provider persuasion to stay’ as a key obstacle affecting half a million switchers in the UK (as explained below).
- 1.12. Promoting the interest of UK consumers requires a ban on Reactive Save under both options considered by Ofcom, as is currently the case in relation to fixed switches on the Openreach network. Such a ban would also improve competition in the mobile market, as we explain in greater detail below.

Reactive Save is harmful to consumers and is ubiquitous across the industry

- 1.13. Ofcom has found that many UK consumers believe that switching takes too long and experience unnecessary difficulties in the process, for example dealing with a provider’s attempts to persuade them to stay.¹ According to Ofcom, both obtaining a PAC and cancelling the old service can be difficult when consumers encounter unwanted persuasion to remain.²
- 1.14. Ofcom’s research also shows that save activity can be a problem when it is unwanted and where consumers have to navigate it in order to progress a switch. For example the research found that 7% of switchers cited ‘your previous provider trying to persuade you to stay’ as a major difficulty when switching, rising to 14% among switchers who experienced provider persuasions to stay. Some respondents also reported a sense of awkwardness and hassle during cancellation and retention discussions, with some feeling daunted and obliged to defend their decision to leave.³
- 1.15. Data provided to Ofcom by the mobile operators and complaints made to Ofcom regarding the mobile switching process confirm this. For example, Ofcom has estimated that consumers spend on average 15 minutes on a call when calling to request a PAC. Furthermore, around two fifths of the 1,000 or so complaints made annually to Ofcom regarding change of mobile provider concern difficulties in requesting or obtaining the PAC.⁴
- 1.16. The reason is not hard to seek. Reactive Save is a routine practice across the industry and forms a standard part of operators’ retention procedures.
- 1.17. Figure 1 summarises the retention process of Three’s customer contact centre [3<].

¹ Consultation, paragraph 1.10

² Consultation, paragraphs 3.11 - 3.13, 3.66

³ May 2016 consultation, paragraph 4.21

⁴ May 2016 consultation, paragraph 4.23

Figure 1 Overview of Three customer contact centre retention processes

[3<]

1.18. This shows that [3<].

Reactive Save accounts for a material proportion of save activity

1.19. While Three does not separately record retention outcomes by entry point into the contact centre, data for the period January 2017 to May 2017 shows that [3<].

1.20. Ofcom's consumer research conducted for the purposes of its switching consultation [3<] provides an indication of the prevalence of Reactive Save activity. This research found that 61% of customers that actively considered (but ultimately did not switch) indicated that the negotiation/acceptance of a deal was a factor in deciding to stay with their current provider.⁵

1.21. While it is not possible to determine whether this was proactive or Reactive Save activity Ofcom notes that just under a fifth of this subgroup of customers contacted their existing provider for reasons which are likely to indicate their intention to switch, and therefore induce a Reactive Save offer.⁶

Reactive Save is harmful to competition

1.22. Reactive Save is harmful to competition, and ultimately consumers, for two key reasons:

(a) Reactive Save raises barriers to entry and expansion by:

- facilitating an adverse selection of customers between large and small providers; and
- raising the cost of customer acquisition, which disproportionately effects smaller providers.

(b) Reactive Save dampens competition between all operators by providing a mechanism for operators to price discriminate between active and inactive customers.

We explain each of these sources of harm below.

Reactive Save raises barriers to entry and expansion

1.23. In saturated markets such as mobile telecoms, smaller operators and potential new entrants must win customers from existing providers in order to enter or expand. In the absence of Reactive Save activity operators must advertise a price that is cheaper than the prevailing market rates (less an additional reduction to compensate customers for any switching costs).

1.24. However, Reactive Save gives operators an in-built opportunity to identify customers wanting to switch via the information provided by the switching process. The incumbent provider then has the opportunity to offer a discount exclusively to those customers which have indicated an intention to leave (while continuing to advertise a higher price to all other customers).

1.25. In such a context, the new entrant must now advertise a price that is not only cheaper than the prevailing market price, but also cheaper than the Reactive Save offer of the incumbent (less any switching costs incurred by the customer).

⁵ Paragraph A12.15, Consumer Switching - proposals to reform switching of mobile communications services, Ofcom, May 2017

⁶ For example to obtain a PAC code, cancel their service, obtain information on their early termination charges, discover what they need to do to switch provider.

This increases cost of customer acquisition which disproportionately disadvantages smaller operators/new entrants.

- 1.26. A second effect on entry and expansion arises from the ability of providers to exploit information on the profitability of their existing customers. This allows them to tailor the value of their Reactive Save discounts, for example, by offering a lower (or even no) save discount to lower profitability customers. Such information is not available to the gaining provider. This will therefore lead to an adverse selection effect whereby new/smaller operators are only able to acquire those customers with the lowest (or even negative) net margins.
- 1.27. Both mechanisms compound to raise barriers to the entry and expansion of new and smaller providers. If a new or disruptive provider is unable to acquire customers from an incumbent operator, then it will not exercise a meaningful competitive constraint. Reactive Save therefore not only reduces customers' choice of credible providers but ultimately leads to worse market outcomes in terms of higher prices, reduced innovation and lower quality.

Reactive Save leads to a dampening of competition between all mobile operators

- 1.28. Reactive Save also insulates operators from competition and prevents them from keeping headline prices competitive for the majority of customers, who are typically inactive.
- 1.29. If a provider is unable to determine which of its customers are likely to switch then it will need to advertise as low a price as possible⁷ across the entirety of its customer base in order to acquire and retain customers. It is through this mechanism that the entire customer base (including the inactive) benefits from the alertness and propensity to switch of active customers, who are sensitive to price and choose provider based on the price on offer. In this way a particular customer enjoys the benefits of competition regardless of whether they themselves are active or inactive.
- 1.30. However, if a mobile operator is able to determine exactly which customers will switch it does not need to advertise its best price. It needs only offer a selective discount to those customers which are about to switch. The result is that while the small proportion of customers who attempt to switch may benefit from a price reduction, the much larger proportion of customers in the market will be paying more than they otherwise would. Essentially, the switching activity of a minority of active customers fails to discipline providers and protect the rest of the customer base.
- 1.31. Reactive Save provides a near perfect mechanism for providers to engage in this type of price discrimination. This is recognised by UKRN (the UK Regulators Network) which noted in its statement on customer engagement and switching that Reactive Save “may reduce the incentives on incumbents to provide good value to existing customers. If the Losing Provider can make selective counteroffers to each switching consumer, then its incentives to price competitively to its entire customer base may be reduced.”⁸
- 1.32. Reactive Save therefore softens price competition between all providers and, in doing so, leads to worse outcomes for the vast majority of customers which do not regularly switch.

Evidence that Reactive Save can raise barriers to entry and expansion and lead to a dampening of competition between all mobile operators

⁷ Subject to recovering its efficiently incurred costs, including its cost of capital.

⁸ Consumer Engagement and Switching Statement, UKRN, December 2014

- 1.33. [redacted]
- 1.34. This demonstrates that active customers are currently paying lower prices than inactive customers. It also illustrates the level of discount (and corresponding acquisition premium) that a competing provider is required to advertise to successfully acquire customers from an incumbent provider. [redacted]
- 1.35. In addition to the standard retention procedure described above [redacted]. This is consistent with an adverse selection theory of harm in which smaller providers tend to acquire the lowest value customers (see below).
- 1.36. Three [redacted] but understands that other MNOs [redacted] practice this sophisticated form of Reactive Save activity.

Reactive Save is inconsistent with Ofcom's own strategic objectives

- 1.37. Ofcom's proposals also appear inconsistent with Ofcom's own strategic objectives and priorities. Ofcom has recently identified price transparency and the use of selective discounts as a key area of concern. For example, in its 2016/17 Annual Plan Ofcom set out its view that all consumers, not just those engaged with the market and actively switching supplier or tariff, should receive value for money from their communications service provider.⁹
- 1.38. Ofcom has decided to publish annual Pricing Trends in order to monitor the evolution of fixed and mobile prices and the prevalence of selective discounts. The report for 2017 has found that engaged customers can pay significantly less than those who do not look around for the best deals and who do not benefit from service discounting, instead paying standard prices for services.¹⁰
- 1.39. By failing to ban Reactive Save, however, Ofcom is in fact encouraging non-transparent pricing, perpetuating the use of selective discounts and failing to ensure that all customers share in the benefits of increased competition. Under either of Ofcom's options, operators continue to have an in-built opportunity to identify customers wanting to switch via the information provided by the switching system. This provides operators with an incentive to "hide away" their best deals until customers threaten to leave, which makes it more difficult for consumers to compare deals across the market and exercise meaningful choice of provider.
- 1.40. By contrast, banning Reactive Save would encourage greater pricing transparency and proactive save offers from operators. Operators could not wait until a customer expresses a desire to leave before putting their best offers on the table. Customers that request a code or cancellation would be lost because the operator would be prohibited from contacting those customers at that point.
- 1.41. This would force providers to proactively contact customers before they leave, for fear that they may switch to rivals at any point. Moreover, providers would no longer have an in-built opportunity to identify individual customers wanting to switch and would have a greater incentive to advertise their best offers more uniformly across their customer base in order to acquire and retain customers.

Ofcom must impose a ban on Reactive Save activity

- 1.42. Regardless of which switching reform option Ofcom decides to implement, a prohibition on Reactive Save activity is required to ensure that all customers benefit from the reduction in barriers to switching, increased competition in the marketplace and greater pricing transparency.

⁹ Annual Plan 2016/17 - Making communications work for everyone, Ofcom, March 2016.

¹⁰ Pricing trends for communication services in the UK, Ofcom, March 2017.

- 1.43. This would bring mobile switching in line with fixed line switching between providers on Openreach copper network, for which Ofcom previously concluded that Reactive Save is harmful, and accordingly implemented a ban.¹¹

A Reactive Save ban can be easily implemented

- 1.44. A Reactive Save ban can be implemented under either reform option. Under GPL it could take the form of a prohibition on the losing provider contacting the customer once it has received a request from the CPS to generate ETC information.
- 1.45. Under the Auto-switch process a prohibition could be put in place on losing providers contacting customers with save offers once they have text for their PAC/ N-PAC code (or requested it online). For the customer contact centre switching channel there should be a requirement that the losing provider maintains a separate line (and contact number) for customers to obtain a PAC/N-PAC codes than it has for customers seeking a better deal. The losing provider would be limited to supplying codes automatically and would be prohibited from engaging in any save activity on the former line.
- 1.46. To minimise any incidences of non-compliance with this ban, an automated IVR service could be used to initiate the request for their termination information. We note that the use of separate lines would mean that customers who choose to do so will still be able to proactively contact their existing provider to request an upgrade or haggle for a discount.
- 1.47. Ofcom may formally implement such a ban through a specific amendment to the General Conditions of Entitlement, for example as under GC 22.15 which applies to providers of fixed services on the Openreach/KCOM networks. This condition prohibits a losing provider, where it is required to communicate with a customer as part of the switching process, from making any “marketing statements or representations in the communication which may induce the Customer to terminate their contract with the Gaining Provider and/or remain in a contract with the losing provider”.
- 1.48. Alternatively Three notes Ofcom’s clarification in its recent review of the General Conditions that GC 1.2 (now re-numbered as GC A1.3), which requires CPs to “treat any information obtained in confidence before, during or after negotiations for network access as confidential and to use such information solely for the purpose for which it was acquired”, would apply to Reactive Save activity by the losing provider which is initiated as a result of a request to switch received via the gaining provider.¹² This existing condition would therefore seem to act as an appropriate instrument for a prohibition on reactive save under a GPL-based switching process, subject to the relevant condition being amongst Ofcom’s administrative priorities for enforcement.

A Reactive Save ban delivers very high net benefits.

- 1.49. Because the proposed Reactive Save ban relates to a cessation of activity, the costs of implementation are expected to be minimal.
- 1.50. We understand that operators will already have IVR capability. As such the costs of implementing a separate, automated line for PAC/N-PAC request is likely to be low. The main costs of implementation will therefore arise from the internal costs of compliance, such as the appropriate re-training of staff and internal audit activity.

¹¹ Consumer Switching - A statement and consultation on the processes for switching fixed voice and broadband providers on the Openreach copper network, Ofcom, August 2013.

¹² Review of the General Conditions of Entitlement - Consultation on the general conditions relating to consumer protection, Ofcom December 2016.

- 1.51. The benefits of a ban on Reactive Save are likely to be very large in comparison. While it is inevitably very difficult to provide a precise quantification of the benefits of greater competition, Three has used a conservative approach to illustrate the expected order of magnitude (see Box 1 below).
- 1.52. Assuming that a ban on Reactive Save results in operators reducing their advertised prices by just 5% of the value of Three's entry-level Reactive Save discount, generates an annual benefit of £100m and a ten year NPV benefit of over £800m.
- 1.53. While there is no evidence to directly support the size of the reduction in advertised prices, Three considers that its estimate of harm is likely to be conservative and is supported by Ofcom's own analysis of the impact of increased competition on prices.
- 1.54. Ofcom's research shows that "even a moderate reduction in competition could have a substantial detrimental impact". In particular, Ofcom has calculated that a 1% reduction in consumer surplus would be equivalent to a £0.2 billion loss of consumer welfare in a single year.¹³
- 1.55. We have used information from Ofcom on retail revenues, subscribers and elasticity of demand to produce an estimate of consumer surplus (see Box 2). This shows that an increase in the monthly average price of 26p is sufficient to deliver a 1% reduction in consumer surplus. The reduction in prices that we have modelled (i.e. 10p) is therefore less than twice the price impact of the "moderate reduction in competition" that Ofcom have assumed. Three's approach to quantifying the benefits of a ban on Reactive Save is therefore conservative relative to Ofcom's own previous analysis.

Box 1: Calculation of benefit quantum of Reactive Save ban

	Calculation Step	Unit	Source
		Customers (millions)	
(1)	Total number of mobile subscriptions	83.51	<i>Telecommunications Market Data Tables, Ofcom, Q4 2016</i>
(2)	Annual number of switchers	5.12	<i>Figure A10.1, Consumer switching - Consumer switching - proposals to reform switching of mobile communications services, Ofcom, May 2017</i>
(3)	Value of Three's entry level Reactive Save discount (MTM -£2)	2.00	<i>Three UK internal retention process</i>
		Percent	
(4)	Proportion of discount transferred into reduction in advertised prices following Reactive Save ban	5%	<i>Assumption</i>
		£/pm	
(5)	Reduction in advertised market price following Reactive Save ban	0.10	<i>[3] * [5]</i>
		£	
(6)	Annual reduction in advertised price following Reactive Save ban	1.20	<i>[5] * 12</i>
		£m	
(7)	Aggregate annual consumer benefit from Reactive Save ban	100.212	<i>[6] * [1]</i>
(8)	Aggregate consumer benefit (ten year NPV)	862.593	<i>NPV of 10 year annual recurrence of [7]</i>

¹³ Annex 6 Revised competition assessment, Second consultation on assessment of future mobile competition and proposals for the award of 800 MHz and 2.6 GHz spectrum and related issues, Ofcom, January 2012.

Box 2: Implied price rise from a 1% reduction in consumer surplus

Calculation Step	Units	Source
(1) Retail mobile price elasticity of demand	-0.30	<i>Second consultation on assessment of future mobile competition and proposals for the award of 800 MHz and 2.6 GHz spectrum and related issues, Ofcom, January 2012</i>
	Millions	
(2) Total mobile subscribers in 2016	83.51	<i>Telecommunications Market Data Tables, Ofcom, Q4 2016</i>
	£m	
(3) Aggregate annual retail revenue in 2016	15,335	<i>Telecommunications Market Data Tables, Ofcom, Q4 2016</i>
(4) Aggregate annual consumer surplus	25,558	$[3] / (-2 * [1])$
	£/month	
(5) Monthly average consumer surplus per subscriber	25.50	$[4] / [2] / 12$
(6) Implied monthly price increase from a 1% reduction in consumer surplus	0.26	$[5] * 0.01$

2. Ofcom has understated the net benefits of GPL.

2. Ofcom's impact assessment is artificially skewed towards Auto-switch

- 2.1. Ofcom has provisionally concluded that while the GPL and Auto-switch options offer a similar scale of benefit, the Auto-switch proposal would cost less to implement and is therefore a more proportionate remedy.
- 2.2. In reaching this conclusion Ofcom has systematically understated the net benefits of GPL by:
 - failing to explore the most cost efficient implementation of GPL; and
 - adopting a valuation methodology which underestimates the gross benefits of GPL.
- 2.3. Ofcom's impact and proportionality assessments are therefore artificially skewed in favour of the Auto-switch process. This ultimately drives Ofcom's provisional decision to favour the losing-provider led Auto-switch process. In the following section we explain the errors in Ofcom's approach and as a result why it needs to re-visit its proportionality assessment.

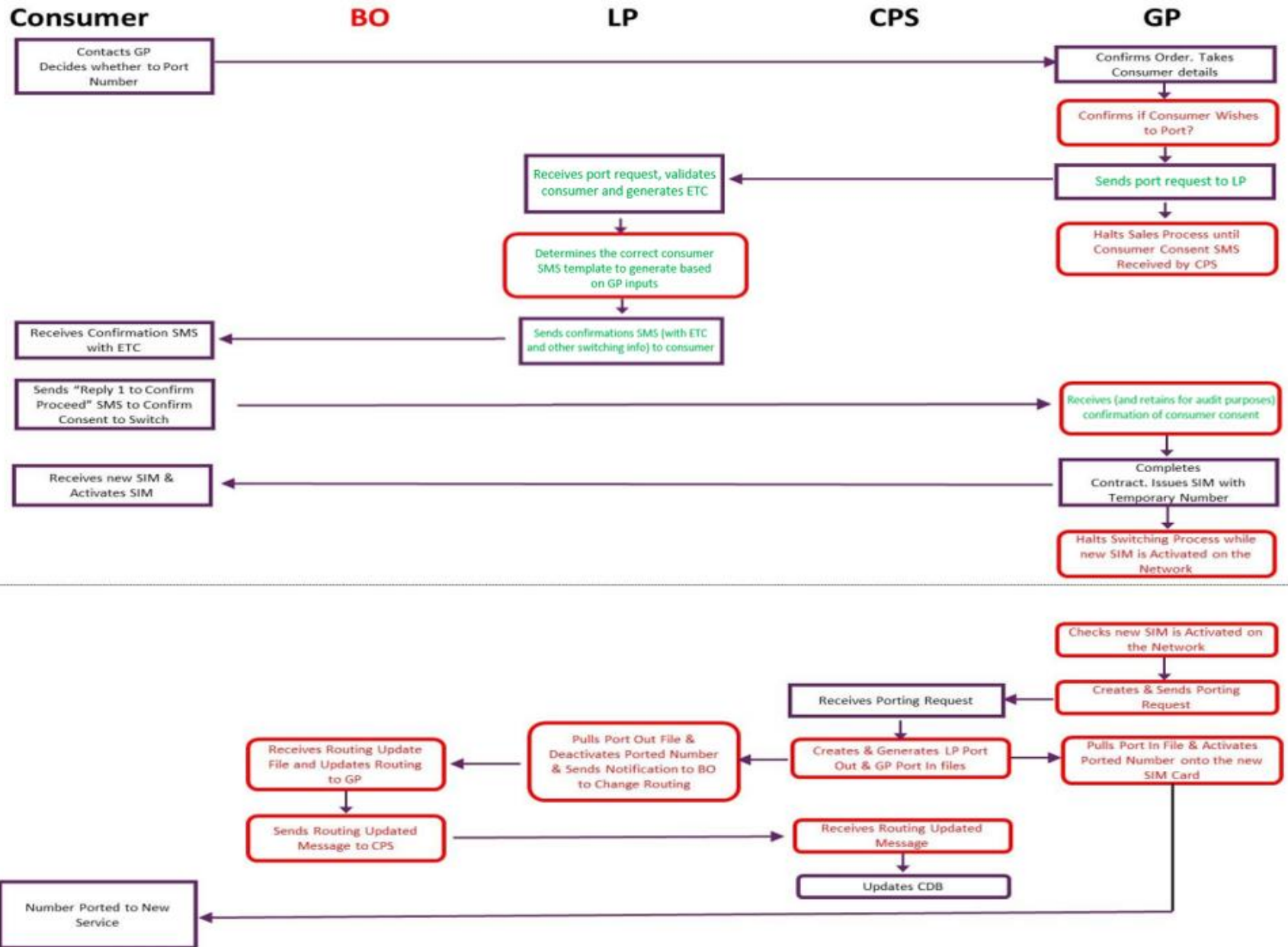
Ofcom has failed to explore the most cost-effective implementation of GPL

- 2.4. In its March 2016 and July 2016 analysis, Ofcom concluded that the cost of implementing each of its prospective reform options was broadly of the same scale. In its latest analysis, however, Ofcom identified that the costs of the Auto-switch option can be reduced by removing the requirement for the enhanced role of existing CPS (Central Porting Service).
- 2.5. More specifically, Ofcom had previously designed both the GPL and Auto-switch processes such that the gaining provider/customer would send a switching request to the CPS, which would then forward the request to the losing provider. This would require the CPS (and routing MNOs/MVNOs¹⁴) to establish and maintain an accurate centrally held ported number database.
- 2.6. Ofcom has now designed an Auto-switch process whereby customers directly contact their existing provider with a port/C&R request (rather than the CPS). This obviates the need to establish and maintain the central ported number database, and removes approximately £20m in associated costs (over ten years).¹⁵
- 2.7. While Three supports Ofcom's attempts to design as cost effective an Auto-switch process as possible, we are disappointed that Ofcom has not scoped out nor costed a similar option for the GPL process.
- 2.8. Figures 2 and 3 below provide an illustrative example of a GPL process (for porting and C&R switches, respectively) which would similarly obviate the need (and associated cost) of establishing and maintaining a central ported number database with the CPS. Changes to Ofcom's proposed processes are denoted in green.

¹⁴ Routing would be required to support the initial setup and configuration of the CPS central ported number database and thereafter ensure that the database is kept up to date at all times.

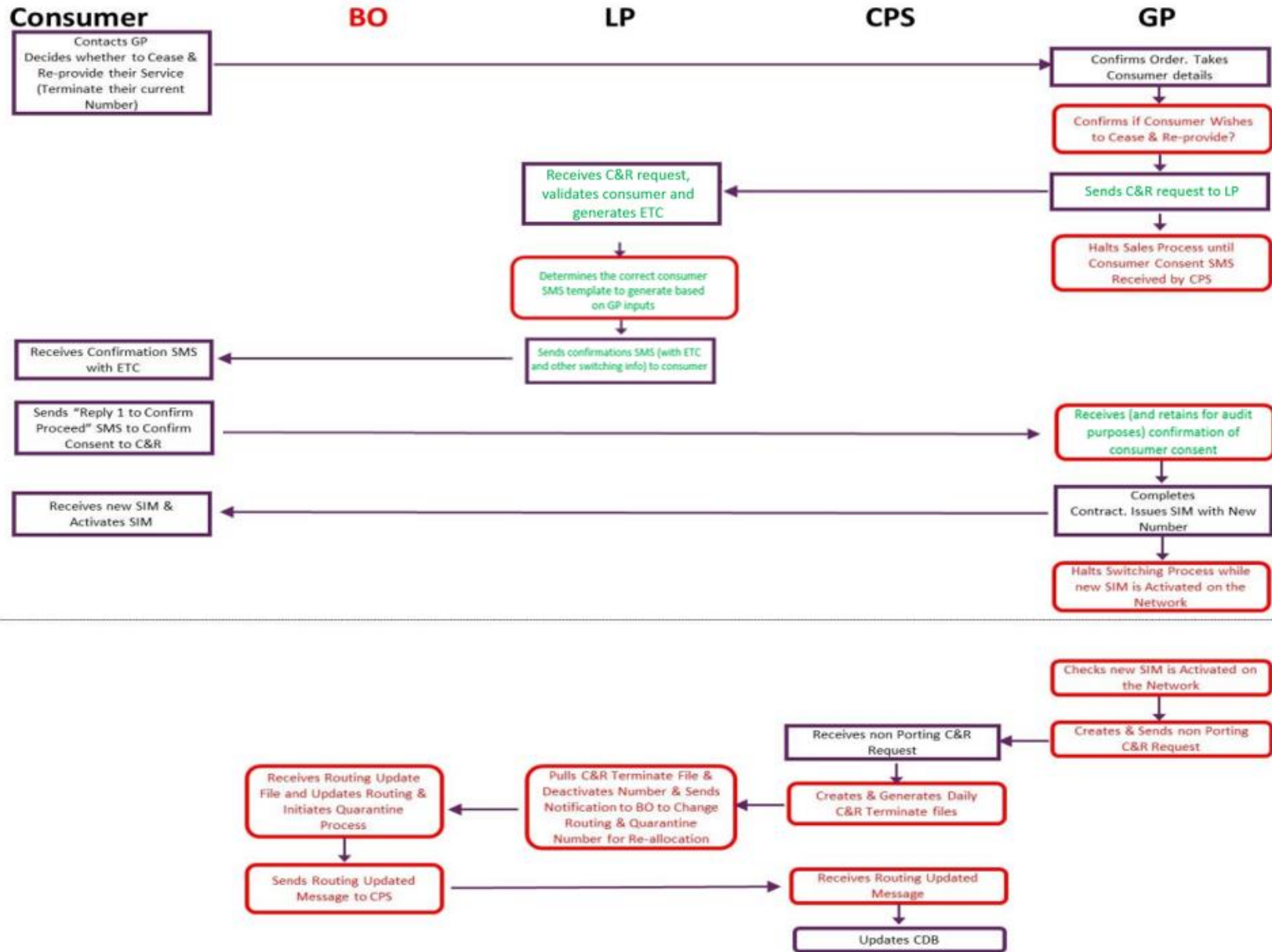
¹⁵ Paragraph 5.70, Consumer switching - proposals to reform switching of mobile communications services, Ofcom, May 2017.

Figure 2 Example of revised GPL process (porting number)



Note: changes to Ofcom's proposed processes are denoted in green

Figure 3 Example of revised GPL (non-porting)



- 2.9. Under this illustrative process the gaining provider, using the customer's knowledge of the identity of their existing provider¹⁶, directly contacts the losing provider (rather than the CPS) to prompt the losing provider to generate ETC information. The LP then directly sends this information and the confirmation text to the customer (rather than via the CPS).¹⁷
- 2.10. Three urges Ofcom to scope out the viability and cost impact of implementing such a GPL design that does not require the establishment and maintenance of a central ported number database.
- 2.11. In the absence of such an analysis, Ofcom's proportionality assessments are artificially skewed in favour of the Auto-switch process, which ultimately drives Ofcom's provisional decision to favour the losing-provider led Auto-switch process.

Ofcom's approach systematically underestimates the benefits of GPL

- 2.12. Ofcom's quantification of the direct impacts of its reform options is based on the WTP (willingness to pay) valuations of a survey of customers that have recently switched. Ofcom finds that the average WTP valuations are similar for the Auto-switch and GPL options.¹⁸ This drives Ofcom's conclusions that Auto-switch and GPL would produce a similar scale of benefits for switchers¹⁹, and that either option would effectively achieve its objectives.
- 2.13. However, the similarity in the level of benefits is a direct consequence of Ofcom's methodology. Ofcom assigns a WTP of zero to all survey respondents which did not state they would either "definitely" or "probably" use each of the respective reform options (if available for free). Ofcom has then further reduced the average WTP valuations (using arbitrary percentages)²⁰ to reflect its view that fewer existing switchers will use the reformed processes than stated in the survey.
- 2.14. Ofcom is therefore effectively weighting the scale of benefits by the proportion of survey respondents which stated they would use the process. In doing so Ofcom's benefit estimates implicitly reflect the survey respondents' understanding of each of the process reforms.
- 2.15. This is expected to lead to systematic bias towards the Auto-switch option because of its similarity to the existing LPL switching process that all of the survey respondents will have recently used.
- 2.16. Respondents are therefore likely to be more confident about the benefits they would derive from the Auto-Switch process. In contrast, recent switchers will be less familiar with a GPL switching process and how it will operate in practice. This will be reflected in their stated likelihood of using the service.
- 2.17. This concern is supported by Ofcom's own analysis of respondents' reported reasons for not using the GPL process. Such responses indicate that some respondents hadn't properly understand how the GPL process would work. For example, they stated that the GPL process was confusing, or cited irrelevant reasons for not wanting to use GPL.²¹
- 2.18. Despite identifying this problem with the evidential basis of its benefits quantification, Ofcom has not sought to remedy or investigate the impact, for example, by using qualitative research to explore switchers' understanding of the

¹⁶ In the unlikely event that a customer is unsure who their existing provider is, the GP can lead them through the process of checking the network settings on their handset (or asking the customer to check their voicemail) to determine the identity of their existing provider.

¹⁷ To ensure customers are protected against unwanted switches/number theft, the GP would be required to retain a record of the customer's confirmation of the switch (in the absence of such a record being centrally held by the CPS).

¹⁸ For example, the base case average WTP values range from between 40p-84p for Auto-switch and 41p-79p for GPL.

¹⁹ Paragraph 5.45, Consumer switching- Proposals to reform switching of mobile communications services, Ofcom, May 2017.

²⁰ Ofcom has not set out any empirical or theoretical basis for the size of this downward adjustment,

²¹ See paragraph A11.8, Consumer switching – Proposals to reform switching of mobile communications services, Ofcom, May 2017

reform options and the benefits they might derive once they are properly explained.

- 2.19. By analysing the average WTP valuations amongst only those respondents which stated they would use either core process reform options, it is possible to strip out the effect of this uncertainty. Three notes that such WTP valuations are materially higher for GPL than auto-switch. For example, recent PAC switchers on average stated that they would definitely pay £1.04 to use GPL compared to 77p to use Auto-switch.
- 2.20. This suggests that those respondents which were confident about how the GPL process would operate derived much higher benefits from GPL compared to Auto-switch.
- 2.21. The actual experience of customers using the LPL and GPL switching processes, for fixed line switching on Openreach copper network also supports the proposition that GPL is expected to offer the greatest customer benefits. For example, survey evidence collected on behalf of Ofcom while both GPL and LPL process were in operation found that 60% of customers who switched using the GPL process found the switch to be “very easy”. This compares with only 42% of customers switching using the losing provider led process.²²

Ofcom’s approach is at odds with the experience of other regulated sectors

- 2.22. Ofcom’s approach of weighting the aggregate benefits estimates by the ex-ante stated take-up of recent switchers, effectively assumes that awareness and understanding of the switching process will not change following implementation, i.e. that Ofcom will do nothing to publicise the new switching process. This is despite recent experience in other regulated sectors which has demonstrated the importance of raising awareness and understanding as critical success factor in the implementation of switching remedies.
- 2.23. For example, the FCA concluded that retail banking customers continue to perceive that switching accounts is burdensome, despite the introduction of a switching process which effectively addresses customers’ main concerns.²³ Furthermore the CMA, as part of its recently concluded Retail Banking Markets Investigation, included specific measures in its package of remedies to increase awareness of and confidence in the switching process.²⁴
- 2.24. Similarly the UK Regulators Network in its review of regulatory interventions on customer engagement and switching, identified that regulators can promote better outcomes by setting industry performance targets around consumers’ awareness of switching processes.²⁵
- 2.25. This is fundamentally at odds with Ofcom’s quantification methodology which is driven by the assumption that expected use, derived from a telephone survey of recent switchers, will accurately reflect the uptake of the remedy once it is launched. Instead Ofcom should base its quantification on the valuations of customers which understand the switching process, with a view to ensuring that either reform process is well-publicised and understood once it is implemented.
- 2.26. Ofcom must therefore re-visit its approach to benefits quantification to ensure that the relative net benefits of the GPL option are accurately captured. A failure to

²² Consumer Switching - A statement and consultation on the processes for switching fixed voice and broadband providers on the Openreach copper network, Ofcom, August 2013.

²³ Making current account switching easier - The effectiveness of the Current Account Switch Service (CASS) and evidence on account number portability, FCA, March 2015

²⁴ Retail Banking Market Investigation – Final Report, CMA, August, 2016

²⁵ Consumer Engagement and Switching Statement, UKRN, December 2014

do so will result in Ofcom selecting the Auto-switch option on an erroneous evidential basis.

3. Answers to Ofcom's specific consultation questions.

Below we provide answers to Ofcom's specific consultation questions

- Q1 **Do you agree with our updated conclusions that current mobile switching processes create consumer harm in terms of:**
- unnecessary time and difficulties progressing a switch, including contact the losing provider to request a PAC or cancel a service;
 - requirements to pay notice after the switch has taken place; and
 - loss of service that can occur when switching?

Three agrees that Ofcom is correct to identify these factors as a source of harm. However, Ofcom has failed to meaningfully consider the much greater harm arising from the dampening effect on competition of the existing switching process.

A direct consequence of Ofcom's narrow definition of harm is a remedy design and impact assessment which considers only the benefits accruing to the minority of customers which actually switch. In doing so Ofcom fails to design a switching process which translates customer engagement and switching activity into better price and quality outcomes for all customers.

- Q2 **Do you agree that our proposed package of reforms is likely to be effective in addressing the consumer harms we have identified?**

As described in Section 1 of the main body of this response, neither of Ofcom's reform options effectively address the material harm to customers from the Reactive Save activity of losing providers. Ofcom should impose a ban on reactive sales, as described in paragraphs 1.44 and 1.45.

Such a ban could deliver competition benefits to customers in the quantum of £800m over ten years. This would arise from improved incentives for providers to compete on advertised prices and a reduction in barriers to expansion faced by smaller providers.

- Q3 **Do you have any comments on the specific process design for the different elements of the proposed reform package?**

As described in paragraphs 2.4 to 2.11 of the main body of this response, Ofcom has not designed the most cost effective implementation of GPL.

Ofcom has re-designed its Auto-switch process to bypass the intermediary role of the CPS in forwarding switching requests and ETC information between the LP and customer. In doing so Ofcom was able to reduce the estimated cost of this option by approximately £20m (over ten years).

Ofcom has not sought to scope out a re-design of the GPL option on a similar basis. In Figure 2 and Figure 3 of this response we scope out an illustrative example of a GPL process which obviates the need for the enhanced role of the CPS (and in

Answers to Ofcom's specific consultation questions. continued

particular the requirement for the establishment and maintenance of a centrally held ported number database).

Ofcom's failure to consider the most effective form of the GPL process has a direct impact on its proportionality assessment and is a key driver of its decision to favour the Auto-switch reform option.

Q4 Do you agree with our assessment of the likely impacts that we have presented of each of the options for reform:

- **Prohibiting charging for notice after the switching date;**
- **Auto-Switch;**
- **GPL;**
- **End-to-end management; and**
- **Transparency requirements?**

As detailed in Section 2 of this response, Ofcom has systematically understated the net benefits of GPL relative to Auto-switch by failing to explore the most cost efficient implementation of GP and adopting valuation methodology which underestimates the gross benefits of GPL.

As a consequence, Ofcom's impact and proportionality assessments are systematically biased in favour of the Auto-switch process. This drives Ofcom to erroneously favour the losing-provider led Auto-switch process.

Q5 Do you agree with our preferred option for reform i.e. a requirement to offer an Auto-Switch process, a requirement to prohibit charging for notice beyond the switching date, and a requirement to provide transparency of switching processes?

As set out in section 2 of this response, Three disagrees with Ofcom's assessment of the relative net benefits of the core process reform options. This results in Ofcom preferring the Auto-Switch process, despite the potential to design a GPL at broadly similar cost which would delivery significantly greater benefits to customers.

Secondly the design of Ofcom's Auto-switch reform does not address the consumer harm arising from the Reactive Save activity of losing providers. To remedy this Ofcom must implement a ban on Reactive Save. Such a prohibition is required regardless of which core process reform option Ofcom implements. Three conservatively estimates that a failure to do so will result in customers' forgoing benefit in the of region of £800m over ten years.

Q6 Do you agree with our proposal for an 18-month long implementation period for our preferred reform option?

Three considers that an 18-month implementation period from Q1 2018 would provide sufficient time for operators (and the CPS) to design, implement and test the required process reforms. However, Three urges Ofcom to consider whether a 12-month implementation period would be feasible, and any case ensure that there are no unreasonable delays in the "go-live" date. This is to ensure that customers realise the benefits of the reforms as soon as possible.