WHOLESALE CHARGES FOR NUMBER TRANSLATION SERVICES & PREMIUM RATE SERVICES

24TH MARCH 2011

Cable&Wireless Worldwide

INTRODUCTION

Cable&Wireless Worldwide is one of the world's leading international communications companies. On the 26th of March 2010, C&W Worldwide demerged from C&W plc, beginning an exciting new chapter in the company's history.

C&W Worldwide provides enterprise and carrier solutions to the largest users of telecom services across the UK and the globe. With experience of delivering connectivity to 153 countries – and an intention to be the first customer-defined communications service business – the focus is on delivering customers a service experience that is second to none. More information on Cable&Wireless Worldwide can be found at: www.cw.com

Today, Cable&Wireless Worldwide has the necessary scale to meet the needs of UK enterprise customers and we are a strategic provider of services to both the UK public and private sectors, offering a range of innovative and market leading voice & data products. Our customers include many of the UK's top companies and public sector organisations, each of whom has placed its trust in Cable&Wireless Worldwide to deliver an array of business critical services.

We are a key player in the market for Number Translation Services, principally as a terminator of traffic, offering market leading solutions that are enjoyed by many businesses and organisations that depend on them to communicate with their own customers. We also originate and transit a significant volume of minutes to Number Translation Services.

Cable&Wireless Worldwide welcomes this opportunity to respond to Ofcom's revised proposals on wholesale charges for NTS and PRS. We fully support Ofcom's decision to maintain a charge control on the NTS Retail Uplift until September 2013 and believe this is a necessary step to guard against over-recovery given BT's position of SMP in the origination of calls to Number Translation Services. We do however have concerns that the proposed charge control may be too lenient on BT in its assumptions, and would urge Ofcom to look again at the detail. We also welcome the imposition of a control on the PRS Bad Debt surcharge. If left uncontrolled this surcharge has the potential to undermine the economics of the premium rate market. Ofcom has dismissed the prospect of introducing an efficiency reduction in the surcharge, without properly considering the evidence. It is important that Ofcom doesn't miss this opportunity to incentivise BT to take greater steps towards minimising bad debt and improve operational efficiency. We would urge Ofcom to introduce a realistic downwards glide path control that emphasises the importance of behaving efficiently and safeguarding revenue. Based on our reading of the evidence, there remains considerable room for improvement in BT's approach to bad debt prevention and revenue collection practices.

OUTLINE OF THIS RESPONSE

We have structured our response around the two specific issues in the consultation, namely the proposed Retail Uplift Charge Control and the PRS Bad Debt surcharge. Where relevant, we have also provided further insight into other issues that we believe are relevant for consideration. We conclude by answering the questions posed.

1. RETAIL UPLIFT CHARGE CONTROL

SECURING NTS UNTIL SEPTEMBER 2013

We fully support Ofcom's proposals to impose an RPI-X charge control on BT's NTS Retail uplift in the period until September 2013. Without an explicit control in place BT would have every incentive to raise charges and act inefficiently, leading to a series of protracted and resource intensive disputes which would result in a prolonged period of uncertainty for all stakeholders.

We see a charge controlled NTS Retail uplift as an essential part of the ex-ante regulatory landscape until such time as Ofcom can marshal through fundamental reforms to the NTS regime, where such reform removes the need for NTS terminating providers to meet BT's retail costs when originating traffic to chargeable NTS numbers.

STRUCTURE OF THE RETAIL UPLIFT CHARGE CONTROL

We are broadly supportive of Ofcom's proposals on both the duration and structure of the control. While there would seem some strong arguments in favour of maintaining a two basket approach to accommodate both chargeable and non-chargeable calls respectively, we recognise the arguments around proportionality and concede that a sub-cap preventing the freephone retail uplift charge from rising above that of chargeable calls should be sufficient to address any concerns we may have.

A glide path approach to price rises is always preferable as it lends itself to a far more stable investment environment, minimising the chances of price shocks and allows all market participants to respond appropriately to changing prices that are well sign posted in advance. We therefore support Ofcom's proposed conclusion that a glide path approach should be maintained in the forthcoming charge control.

LEVEL OF THE RETAIL UPLIFT CHARGE CONTROL

We would urge Ofcom to retain the 20% sales and marketing adjustment in the retail uplift model calculation. We do not believe enough evidence has been presented by Ofcom to justify a change in approach. We would like to obtain a far better understanding of what evidence BT has produced (ref. para 5.57) to justify Ofcom removing the adjustment and adding in these costs. We believe there are sound reasons for their exclusion and would urge Ofcom to reconsider; as a number of BT's recent marketing campaigns have appeared to focus on driving call volumes.

BT's arguments for the removal of the adjustment appear to be somewhat misleading and must be considered in their proper context. It is true that BT has deliberately focused a significant amount of marketing effort in recent years on contrasting 0845 and 0870 retail pricing against its major competitors in an effort to win back a substantial number of customers. But it is important to recognise that it has only been able to do this as a result of the way in which the regulated NTS formula works, of which the NTS Retail Uplift is part. BT is uniquely able to include 0845 (and until recently 0870) calls within its inclusive bundles because 100% of the cost of doing so is ultimately borne by terminating providers. As the lower retail revenues flow through into a higher average discount reduction in the NTS formula, it allows BT a facility to off-set this price reduction which can't be replicated by its competitors. While at one level BT Retail may appear to make a loss on these calls (as the POLO payment to terminating CPs will be higher than retail receipts), BT Group as a whole will be profiting as the net reduction in POLO payments made by BTWholesale to terminating CPs will more than balance out the 'losses' that BT Retail has incurred. Such manipulation of NTS revenues and payments is only made possible through BT's ability to alter wholesale charges for 0845 based on the retail price they set, allowing each 0845 price cut given away by BT Retail to be borne by terminating providers.

As we understand the evidence set out by Ofcom, BT's ability to control pricing and use this control to heavily discount certain NTS ranges is now leading Ofcom to take a soft line on BT's sales and marketing costs. As such, BT's competitors will not only have to contend with BT Retail possessing a unique ability to offset its 0845 price cuts, but will also have to pay BT more in the future when it originates NTS calls. Such an outcome would be grossly unfair and we would urge Ofcom to reconsider and revert to including its original 20% sales and marketing adjustment.

ATTRIBUTION METHOD AND VOLUMES

We welcome the pragmatic approach Ofcom has proposed regarding the attribution of common costs into the Retail Uplift Costs. Attribution methods are nearly always arbitrary decisions involving judgement and need to fit the circumstances. It would be unacceptable for Ofcom to deliver an outcome that pushed up the burden on NTS minutes beyond an acceptable level, based on the application of a methodology that no longer fitted the circumstances. In truth the costs incurred by BT in retailing NTS should have gone down in the years since the last charge control, as efficiency savings are realised.

The apparent 30% reduction in volumes, if applied to an unadjusted model would suggest that the share allocated to NTS would become unacceptably high. While we have our own view on the relevance of an apparent reduction of BT's Retail NTS volumes, which may in part be explained by the success of BT's Wholesale Calls product. BT Wholesale Calls is now subject of a Statement of

Objections under the Competition Act and may in the future result in an infringement decision. BT Wholesale Calls also uses many existing BT Retail platforms in its delivery, although we have no visibility over the extent of common costs allocated to this unregulated product. In addition, we could make a counter argument that sticking with the status quo and allocating costs based on net-revenues (retail – wholesale costs, when BT have reported that net revenues are negative) should result in no common costs being allocated towards the retail uplift. However, we acknowledge that taken in isolation, any of these factors bluntly applied to a static model wouldn't deliver a fair and reasonable outcome. On balance we think that Ofcom has exercised its judgement appropriately to reach a result that is both fair and reasonable.

EFFICIENCY AND THE VALUES OF X

The forecast decline in BT's retail activity may be viewed with hindsight as being overly pessimistic. With the mobile market now saturated and competition in the fixed line market now maturing, we believe BT may be more successful than Ofcom predicts at defending or even growing market share. Likewise the scope for BT efficiency savings appears considerable, with many regarding BT as having extensive scope to improve how it delivers its services. We will not repeat in detail our previous comments on BT's relative efficiency; however we would refer Ofcom to our previous submissions, and in particular the scope to improve labour practices within the company.

To this end, and having reviewed the model, we don't believe the proposed central guidance figure for the value of X is aggressive enough and appears to give BT the benefit of the doubt on a considerable number of issues, the cumulative result being a soft charge control. Ofcom must use this charge control to push BT to improve its efficiency and work toward reducing its costs in order to retain the benefits. A soft value of X will simply discourage BT from progressing with efficiency savings, safe in the knowledge that it is comfortably covering its costs. Despite what is said in the consultation document, we believe the bulk of efficiency savings remain for the taking and we would urge Ofcom to give a strong incentive to BT to realise these saving for the benefit of consumers and indeed its shareholders by setting a value of X at the lower end of the proposed range. Also with the Bank of England predicting an elevated RPI figure for some time to come, a control of RPI+0.0%

would still reward BT with year on year increases in the uplift, with BT's cost base insulated from many of the factors that have resulted in RPI staying at such a high level for a protracted period (such as food price inflation).

2. PRS BAD DEBT SURCHARGE

We very much welcome the work undertaken by Ofcom and BDO into the level of the PRS bad debt surcharge. We feel vindicated that our scepticism over the validity of BT's initial proposed figure of 9.7% was well founded and we were right to question the integrity of BT's figures and BT's initial claims over their accuracy and robustness.

It appears from the consultation document that much of the delay in reaching a conclusion around the reliability of the revised figure of 5.24% can be put down to BT's failure to present a complete data set to justify the number. We note that Ofcom is also consulting at this time as part of the Regulatory Accounting consultation on the need for BT to present additional financial information to validate these numbers alongside its existing regulatory accounting obligations. We would support the production of this additional financial information (AFI) in order to avoid a recurrence of this type of situation.

While we take BDO at their word about the robustness of the 5.2% figure and understand that BT doesn't discriminate between different services in their efforts to collect bad debt, we do question the broad conclusion that BT is doing enough to control the occurrence of bad debt. It would seem from BDO's findings that there is considerable scope for BT to improve both its processes and automated systems to discourage a small minority of customers running up debts which are ultimately met by legitimate and law abiding consumers and companies in the form of an explicit (or indeed implicit) bad debt surcharge. Improvements need not be costly and of course must justify any investment, but having reviewed BDO findings we believe that a more consistent use of existing systems and a more targeted profiled based approach, focusing on quarterly paying customers who dial a higher number of 09 numbers than average (typically with lower consumption of inland geographic calls and a greater proportion of calls to mobile and/or international minutes) and who have been customers for less than 24 months (under their current contract).

While Ofcom found no evidence that BT was any less successful than its rivals at collecting revenue owed (due mostly to the lack of available data from other CPs to sanity check the BT figures against), it does leave us wondering if the system of the terminating provider meeting 100% of the cost of bad debt on PRS calls does lead to an efficient outcome across the industry. The more inefficient BT are at collecting revenue, the higher the surcharge and the more their competitors in the retail origination market retain by way of compensation for bad debt. This outcome reduces the incentives across the industry to collect all monies owed. In another retail context, such as a supermarket, if £1 in every £20 wasn't collected at the checkout then a large amount of effort would be mustered to eliminate the flow of lost revenue, as the retailer has to bear the full cost of any bad debt and they are unable to pass this cost on to their suppliers.

While Ofcom's proposed charge cap at least prevents the surcharge from rising above 5.20% until the end of the control, based on past experience we are doubtful that it will act as enough of an incentive on BT to finally get to grips with the issue and normalise the amount of bad debt in the PRS market, to ensure that it is more closely aligned with the level of bad debt on other call types. A system that allows BT to simply recover its losses at the start of each control period may lead to a fluctuating focus on the issue, ultimately failing to address the fundamental factors that underpin the problem. This potentially results in far less incentive to resolve the issue towards the end of any control period.

BDO's report does highlight that BT's processes are slack enough to give some customers the opportunity to rack up large amounts of PRS debt on their exchange lines in a very short period, without agreed call limits kicking in and preventing further usage on the line until the bill is settled in full (or in part in cases where a large sum is outstanding). The situation for new customers appears even more surprising, with BT, which has little or no prior knowledge of the customer's typical call profile or their creditworthiness, willing to extend a considerable amount of credit to the customer in the form of an unrestricted phone line, even when BT's systems for debt recovery don't kick in until after the debt has been incurred.

Time and time again a minority of people appear able to run up large amounts of debt, which must be met by the law abiding majority through higher prices. We believe Ofcom should urge BT (and indeed other retail originating providers) to work to improve their automated revenue management systems. Firstly to discourage bad debt from being incurred, by taking steps to cut down the opportunity for it to occur, though more active use of agreed call limits and security deposits. Secondly, to make it harder for persistent offenders to repeatedly engage in this type of activity at a succession of different addresses.

✄

We are disappointed that Ofcom have concluded that an efficiency adjustment is not appropriate and we have a markedly different perspective on the evidence presented. We would question Ofcom's reasoning for not introducing an efficiency adjustment, and in doing so, highlight the following points.

- BDO's findings show that BT is not discriminating against PRS in its debt recovery practices when compared to other number ranges or services, however there is clear evidence that a number of standard debt management measures have either been overlooked or there is widespread under-use.
- The benchmarking evidence from other CPs that Ofcom have obtained is minimal and firm conclusions can't be drawn. While all OCPs report evidence of a higher incidence of bad debt on PRS, there is insufficient evidence to say if it is comparable with BT over a consistent period.
- It is our view that Ofcom have placed too much emphasis on the comparisons between monthly and quarterly bill payment in the consultation, and we recognise that some customers may wish to continue to settle their account quarterly in arrears and see no need to end this practice, provided other safeguards are in place.
- In our view the absence of a targeted profile base approach, focussed on particular customer characteristics is far more relevant than the issue of bill frequency. BT's failure to implement sensible precautions such as universal agreed call limits, enforced in real time

(barring outbound calls until payment has been received when the call limit has been reached and allowing customers to gradually increase their call limits over time when they have built up a regular history of payment) seems to go some way to explain why BT has suffered prolonged bad debt exposure. The introduction of such an approach need not be costly and would be relatively straightforward to implement, making it an entirely realistic way of reducing the incidence of bad debt.

- We also don't see the Universal Service Obligation as a significant handicap on BT's ability to get to grips with debt management. We note that Ofcom makes a number of references to the USO as an obstacle in BT's debt management approach, but never articulates why it should be an issue. It is of course in BT's interest to overstate the importance of the USO in this case, however it is our view that even with the USO in place, BT isn't expected nor obliged to offer repeat bad debt offenders a telephony service and is perfectly within its rights to turn down requests for service based on that criteria. The USO does not and should not impinge on BT's ability to effectively manage bad debt. If BT is in anyway unsure of what it can and can't do with respect to denying service to customers who have no legitimate reason not to settle past BT invoices then it should seek immediate clarification from Ofcom. We trust that Ofcom will give BT the comfort it needs to take appropriate precautions against bad debt exposure, as it would be against the public interest to expose BT to such unnecessary credit risks, when the costs of doing so are borne by others in the form of higher prices (either at a wholesale or retail level). If a customer is a recognised credit risk, BT must be able to take reasonable and proportionate precautions (like request modest advance payment and agree call limits), or in the case of past defaulters, service must be denied until the past debt is repaid in full.

For these reasons we would urge Ofcom to reconsider its proposal not to introduce an efficiency adjustment. We don't believe the evidence supports such a conclusion, indeed from a policy perspective it is in the public interest to create an efficiency incentive and tighten up debt management. We struggle with any conclusion that would suggest that BT's current incidence of bad debt is normal and there is little room for improvement. Historic rates have been much lower and while the emphasis of the BDO report may stress that BT is performing in line with what could realistically be expected of it, the report also highlights a number of areas which could be greatly improved. In a situation where the terminating provider is effectively compensating BT for 100% of its PRS bad debt, it is entirely reasonable to expect a policy outcome that pushes towards delivering a more effective outcome for all concerned. BT will, after all, reap the benefits of improvement debt management systems on other call types (like international and calls to mobile).

Ofcom should take action now to signal its expectation of improvement in this area. A glide path reduction in the bad debt surcharge over the term of the control would seem an appropriate way to achieve this. We would urge Ofcom to mandate a 1% reduction in the surcharge on each anniversary of its imposition, to ensure the control bottoms out at 3.2%, which is closer to its historic rate. With BT having extensive ‘real time’ tools available to it to help manage total debt, a target figure of just over 3% is not unrealistic if sufficient safeguards are in place.

We note that Ofcom’s unbundled tariff proposals may result in the burden of bad debt shifting to the originating provider, boosting the incentives in this area. But until such time as this change takes place, a greater incentive to reduce the incidence of bad debt in our industry is required and the current arrangement to place the bulk of the burden on the terminating provider, who has no direct control over the situation isn’t the best outcome. A charge control founded on strong efficiency incentives would result in a fairer and more economically beneficial outcome for consumers and other stakeholders.

3. Q&A

Q1 *Do you agree with the proposed approach to the form and structure of the NTS Retail Uplift Charge Control, including the use of an RPI-X price cap for the period to September 2013, a single basket, a sub-cap on charges for freephone calls and a glidepath approach to price adjustments?*

Yes, we believe Ofcom's proposals over the structure and duration of the control are sensible.

***Q2** Do you agree that there is no longer any basis for excluding 20% of BT's sales and marketing costs?*

No. We believe Ofcom should retain the adjustment to deduct 20% of sales and marketing costs from the total uplift cost stack. Ofcom have failed to present sufficient evidence to justify this move. If BT's 0845 (and 0870) marketing campaign is the reason behind this change in policy, then we feel it is inappropriate and Ofcom must understand that this campaign damages other originators (who can't compete with BT's price cuts) and terminating CPs, who effectively fund 100% of the retail price cuts through lower termination rates imposed upon them. Please refer to the main body of our response for further details.

***Q3** Do you agree with the proposal to reattribute generic sales and marketing costs using net revenues and to treat support costs as an uplift on causally attributed costs?*

We believe Ofcom has taken a sensible and pragmatic approach to this issue. Please refer to the main body of our response.

***Q4** Do you agree with our approach to determining base year costs and volumes?*

There are particular reasons for the change in volumes; however we believe Ofcom has taken a sensible and pragmatic approach to this issue. Please refer to the main body of our response.

***Q5** Do you agree that we should use a forecast of change in BT's overall retail service activity to project BT's costs?*

In the absence of other information it would seem appropriate to consider this information, however we refer you to the main body of our response for further views on BT's forecasting information.

***Q6** Do you agree with our approach to forecasting the change in BT's overall retail activity and the proposed range of forecast decline of 3.5% to 7.5% per year? If possible, please provide evidence to support your view.*

We are sceptical of BT's projections and believe the rate of decline is likely to be less significant than BT have forecast, with many other markets (such as calls from mobile) now maturing. BT's most recent wholesale price changes indicated that call durations appear to be getting longer and with many CPs now trying to avoid BT's transit service it may be the case that there is wider market evidence to support the view that NTS and PRS volumes are in fact stabilising.

Q7 *Do you agree with our preferred efficiency improvement assumption of 2.5%?*

We believe this figure does not reflect the efficiency opportunities available to BT. We would urge Ofcom to increase the percentage and include a frontier shift adjustment. We disagree with Ofcom's view of BT's relative efficiency as they don't reconcile with anecdotal evidence or the message BT Group has delivered to the City, when announcing £1BN efficiency improvements in year on year performance.

Q8 *Do you agree that our proposal for the value X with no one off adjustment to prices at the outset of the control has no impact on any previous aspect of our proposals?*

We would not support a one off adjustment, however we would urge Ofcom to reconsider the value of X, as the proposed charge control is likely to be too soft on BT, leaving it considerable opportunity to make excessive returns when originating NTS calls to other CPs.

Q9 Do you agree with our assessment of the potential options regarding the structure of the recovery for bad debt on PRS calls?

A control bad debt surcharge is essential if we are to create a stable environment year on year, avoiding the uncertainty that would occur should no control be in place.

Q10 *Do you agree that BT's attribution methodology for bad debt is an appropriate starting point to use in assessing the incidence of bad debt on PRS calls?*

It would seem sensible to look at this methodology as a starting point, however Ofcom must take a sensible and pragmatic view of what is fair and reasonable, rather than rigidly follow BT's methodology.

Q11 *Do you agree with our view that no adjustment should be made to the PRS Bad Debt Surcharge for inefficiency? If not, please provide analysis and evidence to support your arguments*

No. We strongly disagree with Ofcom's proposal not to include an efficiency adjustment. Please refer to the main body of our response for further details.

Q12 *Do you agree that in the current circumstances it is appropriate for the PRS Bad Debt Surcharge charge control to have effect on the first of the month* following our final statement? If not, please supply reasons why this would be the case.

Yes. This would seem a sensible outcome.

Q13 Do you agree with our proposals for monitoring BT's compliance with the NTS Retail Uplift charge controls?

Yes.

END