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**Draft Determination to resolve disputes between BT and various communications providers about changes to AIT terms**

Response to Consultation dated 23|04|2009

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## 1 Summary

FleXtel has considered Ofcom's draft determination and whilst we are deeply disappointed in the outcome for the reasons set out below, we welcome the measures and emphasis as noted in Ofcom's concluding section 6.

In particular we look forward to the report by BT (within 18 months) on the performance of the new AIT process. We would expect this to be made available for comment to the contracted parties.

We note and accept that Ofcom's legal time constraints probably did not permit it to broaden the scope of the dispute as we requested earlier. We take comfort that Ofcom has noted in section 6.6 the concerns that others and we have raised about the AIT process to date.

### 1.1 Ofcom and Balance

However, we also note that Ofcom has made zero changes to the BT Wholesale (BTW) contractual AIT Annexes i.e. Ofcom has not accommodated any of the views made by the disputing parties. This is troubling and appears that Ofcom is afraid of "rocking the boat".

This is a pragmatic result for Ofcom, but it **does not address the core issue of the underreporting of crime.**

### 1.2 Incentives for Crime Reporting

Addressing these concerns Ofcom concluded in section 5.29 and 5.30 that:

*"We do not consider that there should be additional requirements placed, beyond those in the revised Annex E, on ONOs following a retention unless it would serve to make unjustified retentions less likely and improve the prospects for early resolution of disputed retentions, without unduly discouraging justified retentions, **by imposing a disproportionate administrative burden on ONOs or other bodies such as the Police**".*

#### **So does Ofcom consider reporting crime to be unimportant for the well being of society?**

Ofcom continues in section 5.33 with respect to Crime Reference Numbers (CRNs):

*"In relation to crime reference numbers, we consider that in many cases it may be appropriate for either an ONO or TNO to report suspicions of AIT to the Police, particularly if the "reasonable suspicion" that gave rise to the initial retention is elevated to a "strong and convincing suspicion" for the purposes of permanent retention on further investigation. **However, we do not consider that it would be reasonable or proportionate to require a report to be made before issuing a retention notice in all cases, merely as a mechanism to impose an administrative burden and discourage the issue of notices**".*

We accept Ofcom's point, so surely a reasonable compromise would be for Ofcom to require a CRN to be delivered by an ONO in the second phase of the process, (i.e. after any challenge by the 26<sup>th</sup> AIT Day).

By permitting the OCPs the temptation to dump losses down the supply chain, without mandating for the reporting of such crimes, Ofcom has removed a strong incentive for at least the logging of such crimes. This means the industry is sweeping such crimes "under the carpet" to the detriment of society. This act also nurtures the criminal underworld, which is free to enjoy the benefits of such crime, with only a low risk of apprehension.

**In conclusion, by endorsing BT's contract and allowing such underreporting to continue, Ofcom appears to be complicit in the nurturing of High Tech crime.**

## 2 Background & Discussion

### 2.1 Crime Reporting and Reduction

#### 2.1.1 AIT Nurtures eCrime

FleXtel recognises, and has provided Ofcom with evidence to demonstrate, that the current AIT process is actually nurturing fraud and eCrime, since it reduces the incentive for crime reporting and therefore crime recording by ONOs who are closest to the criminal events, such as call-theft (PABX hacking).

The working assumption in the AIT process, is that the TNO is always probably complicit. This is not the case and innocent Number Translation service providers are therefore left with the financial risk of eCrime.

A key factor in our evidence is that, at no time over the last five years of our operation of AIT, has FleXtel been able to obtain a Crime Reference Number (CRN)<sup>1</sup>. This suggests that the criminal fraud associated with a number of AIT notices, some worth over £50,000, seems to go unreported to the police and/or SOCA<sup>2</sup>, an organisation whose remit includes High-tech crime<sup>3</sup>.

This has occurred because BTW has designed the AIT process to transfer fraud risk from ONOs to TNOs, like FleXtel and thereby reduced the incentive for the ONO and its customers to report such crimes.

At one time this process might have been appropriate within the old, individually licensed, framework of the tradition UK based, 09 premium rate service. However, FleXtel is not a 09 premium rate provider and the AIT process is being increasingly misused beyond the scope of the industry's original intention.

Even within the 09 context, the current and the revised AIT process is no longer consistent with evolving national eCrime strategy<sup>4</sup>, since at no point do BTW's AIT processes mandate for CRN delivery. Since the underlying fraud is not required to be reported, the AIT process fails to contribute to the collection and analysis of National Crime statistics.

#### 2.1.2 Insurance Claims – An analogy

AIT claims contrast sharply with insurance claims for theft, where the claimant is required to obtain a CRN for the claim to be accepted. This long established methodology, supports crime reporting and reduces the risk of dishonest claims i.e. it helps neutralise the moral hazard.

Without such safety measures, the AIT process brushes criminal fraud under the carpet. This “silence” nurtures organised crime, since punishment becomes highly unlikely. This process is therefore detrimental to the wellbeing and security of the Consumer/Citizen, including the Vulnerable.

#### 2.1.3 Call and Equipment Theft

The security of call origination equipment, such as mobile handsets, mobile SIMs, PBXs, PC with Modems and simple phone lines, remains the clear responsibility of the equipment owner and authorised users. It is not the responsibility of ONOs, TOs or TNOs. In simple terms owners and users should lock-up their call generation equipment or risk have calls stolen.

<sup>1</sup> Crime Reference Number: [http://www.cjsonline.gov.uk/victim/what\\_next/police\\_procedures/](http://www.cjsonline.gov.uk/victim/what_next/police_procedures/)

<sup>2</sup> SOCA - Much fraud goes unreported: <http://www.soca.gov.uk/orgCrime/sectorFraud.html>

<sup>3</sup> SOCA – High-tech crime: <http://www.soca.gov.uk/orgCrime/index.html>

<sup>4</sup> Criminal Justice Strategy 2008-2011: [http://www.cjsonline.gov.uk/the\\_cjs/aims\\_and\\_objectives/](http://www.cjsonline.gov.uk/the_cjs/aims_and_objectives/)

Full report (3.4MB pdf) (see page 30): [http://www.cjsonline.gov.uk/downloads/application/pdf/1\\_Strategic\\_Plan\\_ALL.pdf](http://www.cjsonline.gov.uk/downloads/application/pdf/1_Strategic_Plan_ALL.pdf)

Home Office: <http://www.crimereduction.homeoffice.gov.uk/internet02.htm>

The Met - PCeU - Police Central e-crime Unit: <http://www.met.police.uk/pceu/index.htm>

Call theft insurance is widely available to protect consumers of mobile phone services and exists for consumers of fixed telephony equipment and services.

Since FlexTel received its first AIT claim in 2004, it has always experienced extreme difficulty in getting ONOs to supply information regarding the nature of the purported AIT. In number of cases, the underlying cause has eventually turned out to be due to the theft of calls due to stolen mobiles handsets or PBX break-in.

FlexTel suspects that such “stolen calls”, in some cases, are being resold, to allow cheap international calls to be made. They may also be used for revenue shared fraud, by diverting FlexTel’s bona fide NTS services to premium rate services, operated abroad and embedded within BT’s international calling service.

At no time has FlexTel been knowingly involved in such fraud. Blocking fraudulent activity, in a timely manner is challenging at best. It is not helped by the tardy supply of data by ONOs. This disinterest in the AIT claim investigation by the ONO and BTW (as a TO), significantly increases many TNOs, exposure to such eCrime.

Of great concern, is that at no time has BTW, the ONO or any retail customer, supplied FlexTel with a crime reference number (CRN). FlexTel must assume therefore, that this increasing serious and organised criminal activity is rarely reported to the police, since the financial incentive for the ONO to do so has been removed by the AIT process.

It is abundantly clear that the AIT process is not intended to be used to pass the risk of such call theft down the supply chain. Yet, the AIT process does not identify this as an exclusion and its intention in the contract is unclear. The moral hazard generated by AIT is not only clear, but it has lead to significant abuse by OCPs, both large and small.

From time to time, since 2004, FlexTel has suffered from such AIT misuse, but at an immaterial level. However over the last 12 months, FlexTel has experienced significant AIT claims (over £50,000) imposed upon it by the ONOs via BTW, acting as a Transit Operator (TO). Substantial claims have been due to call theft outside of FlexTel’s control and due to poor equipment security by ONOs or consumers. (e.g. PBX hacks<sup>5</sup> or stolen mobiles). This abuse of the AIT process seems to be a direct outcome of the moral hazard introduced by the AIT process.

Consequently, FlexTel is increasingly exposed to the severe risks of eCrime, due to call theft outside of its control.

Such risks have associated with it potentially very large costs, involving the outbound payment to BTW and others for the extension of calls to the final destination in both the UK and abroad.

**The net result of the AIT process is that it continues to place FlexTel at risk of being a victim of eCrime.**

## 2.2 The Contract for Wholesale Service

FlexTel does not consider it fair, reasonable or ethical for an upstream supplier to withhold monies from its downstream wholesale supplier on the basis of mere suspicion. Such a process introduces a moral hazard, distorts competition and encourages poor risk management and also nurtures eCrime.

The SIA contract is service supply contract. This contract provides for upstream suppliers (including both TOs and ONOs) with the ability to make use of the TNO systems and services, to establish calls, on a 30-day post paid interest free credit basis.

<sup>5</sup> BT PBX Hacking:

[http://www.btintheloop.com/december\\_2008/fraudsters\\_return\\_to\\_dial\\_through\\_fraud\\_pbx\\_hacking\\_15\\_top\\_tips\\_to\\_help\\_beat\\_off\\_attacks](http://www.btintheloop.com/december_2008/fraudsters_return_to_dial_through_fraud_pbx_hacking_15_top_tips_to_help_beat_off_attacks)

Using the telephone signalling system, the SIA contract permits the connected ONO/TO to place a call to its downstream supplier. This means that by placing a call (requesting call set-up) the ONO/TO is effectively ordering service supply, in good faith.

**It follows that before placing an order for downstream service, it is reasonable to expect that the ONO should ensure that such orders (calls) are bona fide.**

### 2.3 Credit & Fraud Risk

An ONO is able to use various credit checking and call vetting processes of its choice. For new Customers, the ONO has the option of making extensive credit and fraud checking, including requesting an insurance bond or a deposit. The ONO may also choose to restrict access to premium rate services for a probationary period. It may even set a maximum monthly/weekly/daily credit limit for new customers. The ONO can also decide to extend such credit limits to existing customers, possibly depending on each customer's credit rating/history. The ONO is also able to set its retail tariff, to cover such collection and fraud risks.

In case of a customer default or fraud, the ONO has the option of recovering the financial loss through the civil courts and/or reporting any suspected criminal activity to the police, without necessarily involving a third party. This greatly simplifies matters and it is easier for the courts and the police to understand the situation, which follows known commercial retail practice. Furthermore, in any investigation it is also technically safer to follow the call downstream (using the dialled number, which cannot be spoofed). Asking an ONO and the police to follow a fraud upstream (based on calling line identity, CLI) is fraught with difficulty, as CLI is easy to fraud with today's technology.

The decision as to what level of credit and fraud risk management, that an ONO needs to deploy, is rightly a matter for that ONO only. Such a judgement is typically a balance between risk and cost of operation, and competitive market forces. Such forces, that the ONO is probably in the best position to judge.

Consider then, that an ONO may decide, that it will minimise the cost of operation and/or the barrier to customer acquisition, by not performing risk management at all i.e. no credit or fraud checks. Without the existing AIT process, the ONO would be fully exposed to the increase level of risk of default or fraud from its customer base. This provides a healthy incentive for the ONO to deploy the correct level of risk management befitting its own unique business model. This seems to FlexTel to be a reasonable and just state of affairs.

However, as we shall demonstrate later, the AIT process gives ONOs a viable opportunity to dump such risk down the supply chain. The AIT process thereby introduces a moral hazard, where the ONO can opt to adopt cheaper levels of credit control, that reduce the barrier for customer acquisition, then use the AIT process to let the downstream supplier take that risk.

Since the new AIT process now removes such risk from TOs, then it is the TNO that is the final recipient of this risk. However, the TNO has no power to control or mitigate such risk.

Traditionally BT Retail has supplied residential lines, which are by default billed on a quarterly basis and open to premium rate access on activation. In today's fluid market, this seems, to FlexTel, to be imprudent. The BT proposed, AIT process offers protection for both BT Retail (as an ONO) and BT Wholesale (as a TO) from such risk and the TNO can do little to counter such risks.

**Thus, the AIT process increasingly puts the viability of the established micropayments supply chain at risk.**

#### 2.3.1 Risk Distortion in Other Markets

A recent and analogous example of the impact of inappropriate risk management has been seen in the banking system with disastrous consequences. This occurred when inadequate credit vetting was driven by the market's need for very high rates of customer acquisition. The credit

risk was then packaged as a wholesale product (Structured Investment Vehicles) which effectively dumped the risk onto the downstream wholesale suppliers.

**The moral hazard introduced by this cavalier approach is self-evident and the Regulators should have intervened. The banking crisis, following such inappropriate retail risk management is, as they say, history.**

### **2.3.2 Arbitrage, Bundled Tariffs and Fair Use policies**

#### **2.3.2.1 Originating Network Operator (ONO)**

The ONO rightly sets its retail tariff, as it sees fit. In the case where an ONO sets its retail call tariff below that of its downstream wholesale cost e.g. in a bundled tariff, where for example calls are free for the first hour, an arbitrage opportunity exists. Typically, ONOs mitigate this risk by a “fair use” policy. Policing of this policy is the responsibility of the ONO.

However, in the event that the “fair use” policy processes fail, significant arbitrage traffic could ensue. In this case, the offered AIT process presents the ONO with an opportunity to dump the cost of such arbitrage onto the TNO. This reduces the incentive for the ONO to deal with the underlying problem of its tariff or its policy policing mechanisms. Without the AIT process, this healthy incentive is restored.

#### **2.3.2.2 Transit Operator (TO)**

The TO sets its wholesale tariff as it see fit. In the event that a TO sets (by design or in error) its upstream wholesale tariff lower than its downstream wholesale cost, an arbitrage opportunity exists. Significant arbitrage traffic could ensue. In this case the offered AIT process presents the TO with an opportunity to dump the cost of such arbitrage downstream onto the TNO.

It seems reasonable that such risks should be borne by the TO, which is wholly responsible for its wholesale tariff. The removal of the AIT process, in arbitrage cases, restores a healthy incentive for timely correction of such tariff anomalies, by the TO.

**Thus, the AIT process again increasingly puts the viability of the established micropayments supply chain at risk.**

## 2.4 The Changed Regulatory Regime

Since 2002, much has changed in the Telecom regulatory environment with the introduction of the Communications Act 2003 and the recanting of many of the Oftel determinations by Ofcom<sup>6</sup> (including those pertaining to Annex E and AIT<sup>7</sup>). The many changes to the legal framework within the UK, include the coming into force on 15th January 2007 of the Fraud Act 2006, especially section 2 et al<sup>8</sup>. These changes increasingly make the AIT process redundant.

### 2 Fraud by false representation

- (1) A person is in breach of this section if he—
- (a) dishonestly makes a false representation, and
  - (b) intends, by making the representation—
    - (i) to make a gain for himself or another, or
    - (ii) to cause loss to another or to expose another to a risk of loss.
- (2) A representation is false if—
- (a) it is untrue or misleading, and
  - (b) the person making it knows that it is, or might be, untrue or misleading.
- (3) “Representation” means any representation as to fact or law, including a representation as to the state of mind of—
- (a) the person making the representation, or
  - (b) any other person.
- (4) A representation may be express or implied.
- (5) For the purposes of this section a representation may be regarded as made if it (or anything implying it) is submitted in any form to any system or device designed to receive, convey or respond to communications (with or without human intervention).*

Finally, FleXtel agrees with BTW, that the AIT fraud control process is ageing. Even the very basis of AIT is falling into disrepute, since BTW has steadfastly refused to acknowledge that Premium Rate services, supplied over its network to international destinations, are within the scope of the AIT process.

**This position is incompatible with BT’s purported *raison d’être* of the AIT process.**

## 3 In Conclusion

Today, with improved law and enhance computer processing power, there are demonstrably better methods for solving this issue - methods that do not distort markets by unconscionably transferring commercial risk.

**FleXtel does not consider the AIT process or its contractual conditions to be sound, instead it believes it should be deleted, in its entirety.**

<sup>6</sup> Ofcom interconnection directions cessation: <http://www.ofcom.org.uk/consult/condocs/Prop1984tele/197129/>

<sup>7</sup> Oftel SIA (inc. Annex E determination): <http://www.ofcom.org.uk/static/archive/Oftel/publications/pricing/supp1001.htm>

<sup>8</sup> Fraud Act 2006, Section 2: [http://www.opsi.gov.uk/acts/acts2006/ukpga\\_20060035\\_en\\_1#pb1-11g2](http://www.opsi.gov.uk/acts/acts2006/ukpga_20060035_en_1#pb1-11g2)