



2008/9 Annual Plan and Budget: A PhonepayPlus Consultation

A PUBLIC CONSULTATION

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Chairman's Foreword

This consultation document invites stakeholder views on our proposed plan and Budget for 2008/9. This is the first year of our Three-Year Strategic Plan, published on 15 October 2007.

The ability to use forms of phone credit or pre-payment to buy services and goods has great attractions. Services can be bought instantly and easily on mobile handsets, landline phones, websites and digital interactive television. Premium payment is also now possible on Skype and other forms of IP telephony. Nearly every single person in the UK has ready access to a way of paying that requires nothing more than a phone, mouse or red button on a remote control.

The public spends around £1 billion per year on these services and goods. Most of the sales are for information or entertainment services including mobile content, participation television, charity giving, and contact and dating services. All of these services are distance-sold and most are for instant consumption.

As with any payment mechanism, it is important that there is an appropriate regulatory framework that allows the public to use these services with confidence, and allows those developing services to innovate and invest with similar confidence that there will be a trusted market place. We want phone payment to be as trusted as any other payment mechanism.

Trust in the UK market for phone-paid services was seriously damaged in 2007 with a series of high profile allegations of abuse in participation television. While these reports did not translate into a high volume of new calls and complaints to the PhonepayPlus contact centre, they did result in the withdrawal of programming and a clear decline in public use of phone-paid services. We believe that the clear demonstration of firm, clear and effective regulation is going to be critical to developing trust and confidence in services during 2008/9 and thereafter.

We are committed to a regulatory approach based on pre-empting, preventing and protecting. We will identify and address market trends and possible consumer risks before they become problematic. We will stop problems arising by giving support, advice and assistance to businesses and others using phone payment. We want to give the public even greater support, and will help to provide advice and information about services and how they operate.

At the same time, we will be ready and able to act swiftly to deal with those who do not run services in an appropriate and responsible way. We have extensive enforcement powers and will not hesitate to use these to protect legitimate businesses from public mistrust.

Because consumer trust and confidence is critical in any market, we believe that effective consumer protection regulation is wholly consistent with a climate of investment, innovation and growth. We believe that the costs of regulation should be outweighed by its benefits. We will seek to quantify these benefits so they can be properly appreciated. Excluding the budget for 0871 services, for which we will assume responsibility for the first time in 2008, we have budgeted to provide our services at a lower cost in real terms than in 2007/8.

In this consultation document you will see a clear focus on measures to pre-empt and prevent problems and to protect consumers where necessary. You will read how we are focusing investment on these tasks. We look forward to your feedback. Phone-paid services will continue to evolve; it is essential that regulation evolves with it.



Sir Alistair Graham

Section 1

The 2007/8 market, regulatory performance and the context to our plans

Our 2008/9 Plan has regard to a number of fundamental issues:

Scope of regulation

Ofcom is carrying out a review of the scope of PhonepayPlus' regulatory regime. We expect consultations on this in the New Year. Thereafter, any changes in the scope and nature of our regulation would need to be implemented through a new Code of Practice and an Ofcom Direction redefining the scope of 'Controlled Premium Rate Services'.

At this point, we do not think it is possible to anticipate the outcome of this process. Any Code of Practice would be the subject of extensive consultation and notification to the European Commission under established procedures. It seems unlikely that these changes would take effect during the 2008/9 financial year. We have, however, been asked to assume responsibility for revenue-sharing services on the 0871 range on or after Spring 2008. Accordingly, we make provision for 0871 services but have otherwise assumed no change in the scope of the regulatory regime in the coming year.

Legislative and other developments

In our plan we highlight where it is likely that we will be involved with other regulators and identify possible legislative developments. As well as working closely with Ofcom, we have close working relationships with the Information Commissioner, Advertising Standards Authority, Gambling Commission and Financial Services Authority. In an increasingly converged world it will be important that all regulatory bodies are clear on their purpose, and that any clarification of remit is managed effectively from a consumer and business point of view.

We need to contribute to planning for implementation of EU Directives on Payments and Audio-Visual content, and to contribute to work related to the Services and Telecommunications Framework Directives.

Market developments

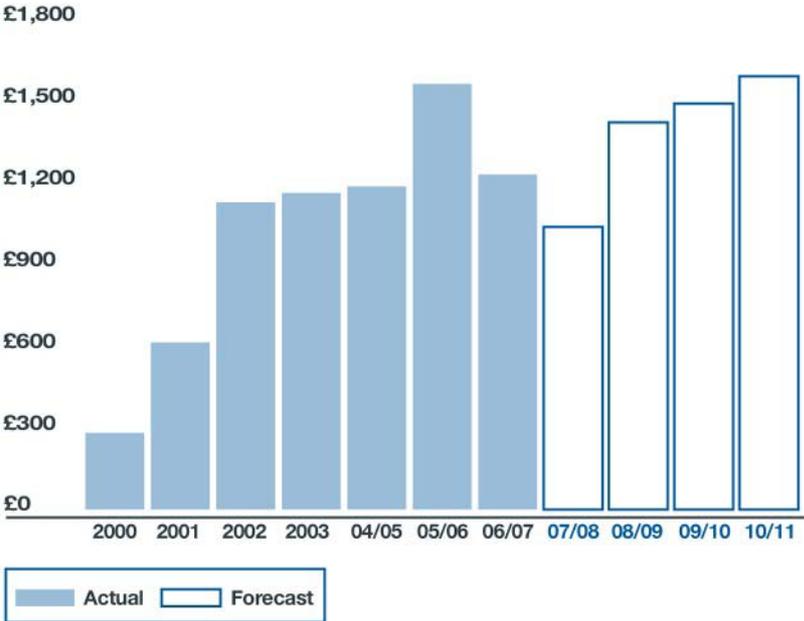
2007/8 has seen further innovation and market developments. We have seen the rapid growth and increasing commercialisation of social networking sites. We have seen further take-up of 3G telephony and the development of mobile broadband products. And we have seen phone payment used across every leading broadcasting network and an increasing number of niche satellite channels.

Overall, 2007/8 seems certain to show a fall in the size of the phone-paid services market.

Chart 1 (see next page) shows our data, our latest forecast for 2007/8 and the projections for the years thereafter set out in our Three-Year Strategic Plan (assuming a 17% decrease in 2007/8, with 10% recovery each year thereafter, taking in 0871 traffic from 2008/9).

Chart 1

ANNUAL SIZE OF UK INDUSTRY (£m)



The fall in the 2007/8 market is almost wholly attributable to public concern over problems with competition and voting services on mainstream television channels. Calls to landline numbers fell by 17.5% in the first quarter of 2007/8 (the three-month period that followed on from the media outcry of March 2007). Since then, we have seen a recovery of around 6% in the landline market and equivalent growth in the mobile sector. We believe this recovery will be sustained.

The figures behind developments in the first half of 2007/8 present some apparent contradictions. We have seen an exceptional fall in the use of certain services but this has not been matched by a high volume of complaints to PhonepayPlus. There is no question over the extent to which individuals have been harmed by some of the developments reported and now adjudicated upon. On this occasion, it did not result in a high volume of calls to our contact centre. This may be due to action taken by certain broadcasters and others to offer refunds, compensatory participation in games and other measures to address viewer frustration.

The fact that our complaint levels for the first half of the year fell by around 6,000 does nothing to reduce the seriousness of some of the issues we have had to address. By the end of October 2007, we had imposed £1.2 million in fines, as well as a number of bars and refund orders.

Key performance indicators

Under our Memorandum of Understanding with Ofcom, PhonepayPlus is committed to measuring performance against a number of indicators. These relate to the efficiency of our contact centre, the speed with which we process complaints, the way in which we deal with 'out of remit' contact from the public, our speed in processing cases to maximise the recovery of fines imposed and the general level of public satisfaction with our service.

Information on performance against these key performance indicators is set out in **Appendix 1**. We believe we are now seeing the benefits of past policy changes including the 30-day payment rule and the duties on networks to carry out due diligence. We are also seeing the benefits of operational disciplines we have installed. We have consistently met or exceeded the two key

operational key performance indicators (KPIs) relating to complaint case handling and call management at the contact centre. As a result, we believe that, in 2008/9, we will be able to make staff savings in both these areas in relation to our existing regulatory responsibility for Controlled Premium Rate Services.

This should allow us to deal with our new responsibilities for 0871 services at far lower cost than would otherwise have been possible. Our fine recovery rate for fines imposed in 2007/8 stood at 91% as at the end of October 2007 (up from 76% in 2006/7 and 34% in 2005/6).

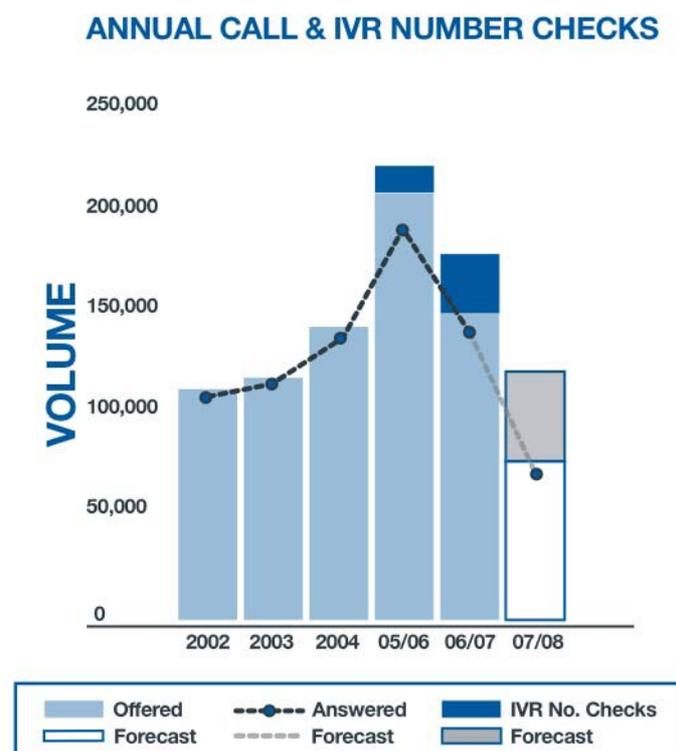
All fines recovered will be available in 2008/9 to reduce the cost of regulation in levy terms to the majority of legitimate traders.

2007/8 saw changes in the scope of our prior permission arrangements. The ability to put new or possibly problematic services through a prior permission procedure is a valuable tool and a practical way of pre-empting and preventing problems in a new area. We do not, however, want to retain this form of 'licensing' where it is no longer necessary or proportionate to a product or sector.

Our decision to reduce the scope of prior permission arrangements this year has led to a 96% fall in the number of cases processed, compared with the same period last year. This has allowed us to transfer staff from reactive, 'transactional' work to preventative work assisting companies with compliance. Here too, we hope to assume new responsibilities for 0871 services and a new community of networks and service providers without any addition to our staffing levels.

2007/8 has seen a 12% increase in the volume of numbers checked through our website, IVR and contact centre staff. We continue to seek the right balance between automating services and information wherever this is practical and useful to the public, while remaining available to those who wish to make a complaint or explore matters person-to-person. The latest information on our contact centre activity is in **Chart 2**.

Chart 2

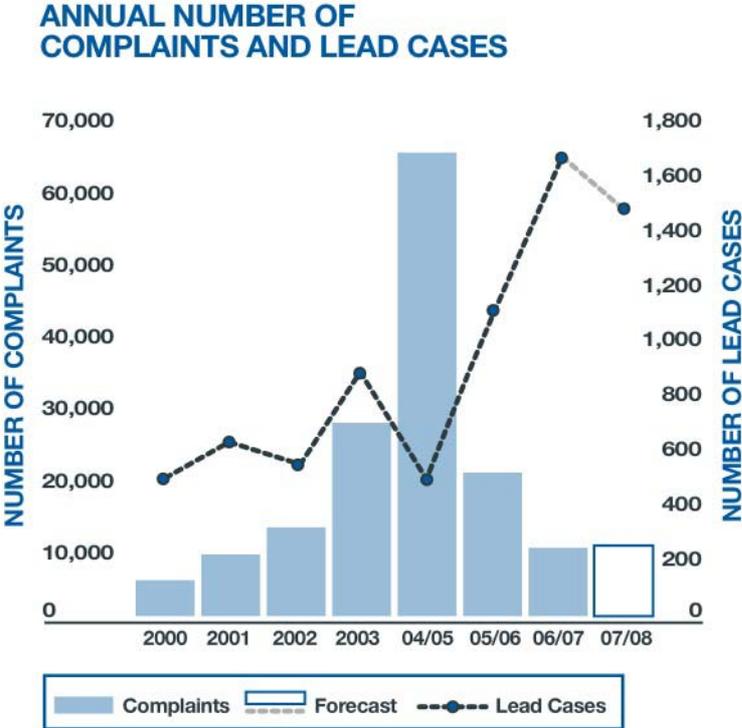


As a result of this and of the promotional activity related to the launch of PhonepayPlus, we have seen a steady increase in the number of businesses coming to us for compliance advice with possible new services, with an increase of 54% over the same period last year. This is a trend we want to continue. We will continue to assist individual service providers but also develop relationships with networks, aggregators and trade bodies and others.

In addition to our main website, we have seen strong interest in www.phonebrain.org.uk. This site is targeted at children and seeks to explain premium codes and numbers, and non-premium numbering in ways that should remove uncertainty or fear. By June 2007, our Phonebrain material had been included in a *Know IT All For Parents* CD-Rom information pack sent to over 400,000 parents and schools.

Monitoring has also become a critical part of our preventative agenda. Our latest figures on monitoring activity are shown in **Chart 3**.

Chart 3



Our aim, in the first instance, has been to use the findings of our monitoring work for the basis for informal discussions with relevant industry organisations. We are duty bound to pursue any serious breaches of our Code through established procedures but we have strived in the first part of 2007/8 to bring standards up to the expected level through dialogue and persuasion. We remain committed to making use of our ‘informal procedure’ wherever this is appropriate and, from 15 October 2007, we have started to publish informal proceedings on our website.

Section 2

Our approach in 2008/9

We have already identified a number of uncertainties. These include how the 0871 market will develop when new numbering arrangements are introduced by Ofcom. There are important decisions to be taken over the future regulation of participation television and phone-paid services in particular. These are issues that Ofcom and PhonepayPlus are discussing but ones that will also have to have regard to the provisions of the Gambling Act 2005.

In addition, as in every year, there are certain to be further major developments in terms of new products, new ways of delivering phone-paid services across new and existing platforms, and the possibility that alternative payment mechanisms will emerge or that existing alternative payment mechanisms may expand or fall away.

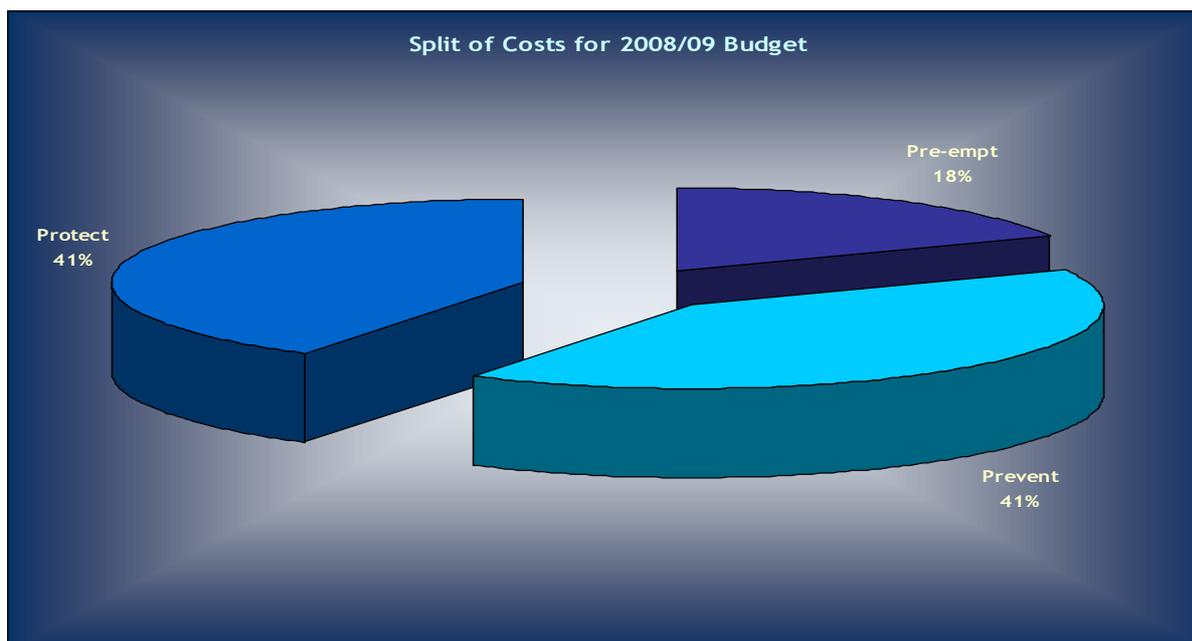
These are issues we have to address in terms of our approach and philosophy to regulation in 2008/9. We have identified a number of principles which we think are important:

- Our plan has to have regard to the strained circumstances in parts of the area we regulate. Regulatory cost is not some form of 'commission' based on the size of the market. There is an argument that investment in regulatory safeguards is critical to the development of the phone-paid services market. We appreciate, however, that a major shift in our funding levy would be an unwelcome burden for some at this time.
- Accordingly, we must demonstrate efficiency and effectiveness in our work. We have already referred to staff savings. Overall, we expect to enter 2008/9 with a 7% reduction in our headcount. This consultation document contains a number of proposals for measuring the market, public confidence and our effectiveness.
- We think it is essential that the plan is true to our pre-empt, prevent and protect agenda, and our Three-Year Strategic Plan. The plan must continue the shift in focus from reactive to proactive and preventative regulation. Readers will see a series of specific proposals designed to reach this goal.
- We need to show that we are assuming 0871 responsibilities in a proper way, that regulation is proportionate to the potential for consumer harm, and answers public concern over price transparency and call waiting times. We propose to deal with 0871 services through our existing Code and funding model. We will be looking, in the first instance, to see that the costs of our new regulatory work are broadly consistent with the levy income that will come with this responsibility.

Our plans

This section sets out our planned activities under the pre-empt, prevent and protect headings. PhonepayPlus is a relatively small organisation and some of our work could be categorised under more than one of these headings. We have, however, sought to allocate direct costs and overheads to these agendas in order to give a visual presentation of how we are addressing these aspects of our work. This is set out in **Chart 4** (see next page).

Chart 4



A. Pre-empting problems

There are three core activities planned as part of our efforts to pre-empt problems arising, and to create a sound framework for investment and innovation.

Research

A good evidence base is critical to planning and policy-making. We have made provision for research spend of £165,000 for 2008/9 which is an increase over the previous year. The emergence of new markets through an increasingly diverse range of phone-paid services poses more challenges to the regulatory model. These market developments include platforms and micro-payment mechanisms such as VoIP telephony, revenue-share through social-networking and user-generated content services, mobile internet content plus data charges, and services including gambling and charitable donations. Additional research will be needed to understand the effectiveness with which a broader remit is carried out, for example with regulating 0871 services in 2008/9.

Regulating an increasingly diverse market puts a greater emphasis on the need to research consumer understanding and trust in phone-pay services. In addition, there is a need to investigate how best we can address issues arising from this. In all cases we would enhance the industry's capacity to follow best practice by sharing findings with them and other stakeholders.

Policy-making

We expect to start work on our 12th Code of Practice, addressing, in particular, issues coming out of the Ofcom Scope Review. We also expect to explore the possibility of using statements of application, statements of expectation and our prior permission regime to deal with new consumer challenges and any issues from Ofcom's Review that can and must be addressed in advance of the 12th Code of Practice. More generally, we will review the framework of regulation to see whether an overarching code, permissions regime and the use of levels of expectation and precedent cases are still the best way of delivering fast, effective solutions to new challenges.

Monitoring

This activity is critical to our ability to step in and deal with a compliance issue before it becomes a problem for consumers. We appreciate that monitoring, like any other activity, has to be

proportionate and targeted if it is to be effective and cost-efficient. We will publish a list of monitoring priorities and issues to be examined. We expect to report to the Industry Liaison Panel and to stakeholders at large on a regular basis on the outcome of our monitoring work. We also expect to continue to make use of the informal procedure wherever this is proportionate to our findings and results in improvements in Code compliance.

B. Preventing problems

We will continue in 2008/9 to promote and extend the work of our compliance support service. In addition to providing assistance to individual businesses, we will arrange workshops with industry and other stakeholders to discuss market developments and address issue-specific matters of compliance. These may include charity services using phone payment, content aggregators, competition and lottery services, contact and dating services, and social networking services.

The industry support team will attend and exhibit at key industry events during the year, providing advice to those considering phone-paid services activity in the UK market. We expect to arrange workshops and other activities to support those who are new to the regulation being applied to services using 0871 numbers. We are conscious that many of these businesses, networks, intermediaries, and providers of call centre and other services need to understand a new regulatory framework.

There are a number of industries or sectors with commercial interests in phone-paid services activity and/or with some substantial ability to influence the standards in the sector we regulate. We want to engage more with these organisations: with broadcasters, publishers, online media organisations, the radio community and others who run, host or carry marketing material for these services. Through partnership we want to reduce the risk of non-compliance and help with the development of 'best practice operation' of phone-paid services.

We want to provide practical support to billing networks in relation to our regulation, and about how our contact centre and web services can assist with their customer service activity. We will upgrade the short code and number-checking service which can be accessed online through our website and via our IVR freephone number. Customer service call-handling is expensive. By dealing with enquiries in a single place online, via IVR and through our contact centre, we hope to reduce costs and give customers answers that will prevent uncertainty and frustration turning into distrust and criticism.

To achieve this we will further develop our website. Our website is well-regarded and is generally structured in a user-friendly way for business and regulatory users. It is not, however, a site that is structured or written in ways that make it helpful to the public at large or those with particular problems. We intend, therefore, to create a separate and distinct consumer advice section within our online portfolio.

In total, we have made a £50,000 provision for web developments. We have already started a review of our consumer literature to coincide with the launch of PhonepayPlus. This work will continue into 2008/9 when we review our publications to ensure that our help is focused on those with most need for advice and guidance. Children and their parents have always been an important audience. We will continue to address these groups but we should also be looking at other social trends, including migration to new services, such as TV channels dedicated to ethnic community groups. We have a £35,000 provision for consumer literature.

It is also important to continue to engage strategically at an international level. 2007 has seen the marketing of premium VoIP services and cross-border IP-telephony access to premium services in numerous world markets. This trend, alongside a global capacity for mass-marketing and reductions in trading barriers, make it more important that we have the necessary connections at European Commission and Member State level. We need to understand and

influence legislative proposals as appropriate, and have the right enforcement network to deal with problems in the UK caused by those overseas and to support overseas regulators if UK businesses are the source of problems in their markets. We will continue to support and possibly expand the membership and substance of the IARN Group (the International Audiotex Regulators Network).

C. Protecting consumers and the industry when problems arise

Not all problems can be pre-empted or prevented. We need to be able to deal clearly and effectively with wilful or reckless behaviour that threatens consumers and the market at large.

For this reason, we have said that we expect to introduce a Code Compliance Panel of dedicated adjudicators. This was the subject of consultation in 2007 and we expect the Panel to begin to sit in 2008. The Panel has pay and associated costs of approximately £47,000. We believe these are counter-balanced by planned savings in the cost of the PhonepayPlus Board, and by continuing the reduction in the need for reviews and oral hearings in light of the detailed, considered adjudications we now publish.

We will continue to seek to recover administrative costs associated with handling cases where serious breaches of our Code are found to have taken place. Revised charging rates and our policy for recovering administrative costs will be published in due course and will apply in the coming year. Our aim is to recover the costs associated with casework where breaches are found. The anticipated increase in income will, like fines, be used to reduce the cost of regulation of the industry at large.

It is important that we deal promptly with any circumstance where wrongdoing may risk becoming systemic. If situations arise where a new product or practice is deemed unacceptable, there is a clear duty on PhonepayPlus to communicate this to all interested parties, giving them the opportunity to change their products or practices. We would then stand ready to take more serious action against any business that continued to be involved in practice that had been declared unacceptable.

The transparency of our adjudicatory decisions is important. We have taken major steps to increase the information provided in terms of the parties involved in the value chain, and also in terms of the findings and the thoughts of the Panel in reaching its decisions. This is a process that we expect to continue with the arrival of the Code Compliance Panel.

We have talked elsewhere about the importance of ensuring that policy is coherent and consistent in an increasingly converged market. The same applies to enforcement practice. PhonepayPlus is in regular contact with fellow regulators including Ofcom, the Advertising Standards Authority, the Information Commissioner's Office, the Gambling Commission, the Office of Fair Trading and the Financial Services Authority. We already have Memoranda of Understanding with Ofcom and the Office of Fair Trading. We are discussing a similar arrangement with the Gambling Commission and may also formalise some of our other relationships.

Boundaries between regulatory bodies are not always absolute as many businesses now offer a variety of services across a variety of markets and the unavoidable parallel interest of those looking at payments and those looking at promotions and privacy. We want to give our stakeholders as much certainty as possible. We will be looking at whether it would be possible to publish a statement during 2008 explaining more fully the nature and structure of the arrangements we have with other regulatory bodies.

Our prior permission arrangements are a form of prevention and protection. We have announced our plans to review the Live Services Compensation arrangements. This work has started. We are planning on the assumption that we will be implementing some form of change during 2007/8.

Our operational assumptions

It is difficult to anticipate market conduct over a 12- month period – and six months in advance of that period. **Charts 2 and 3** set out the position with regard to contact centre traffic and complaints and individual investigations.

Each year we open a considerable number of basic investigations that prove not to relate to any serious breach of our Code. We hope in 2008/9 that better understanding of how services work, better data sharing and the impact of new mechanisms, such as the Payforit tool, will result in a reduction in the number of investigations we feel we have to open. We will always seek to deal with issues informally where it is adequate and proportionate to do so. Recently, however, fine levels have risen, as has call traffic to the contact centre and web service. We do not, however, think it right in light of recent data to assume any reduction in complainant levels, call levels or in the number of serious cases for investigation and adjudication in 2008/9.

We have announced our plans to exempt a wide range of live services on the 087 number range from the prior permission regime. There is, however, the distinct possibility that we will need to add one or two categories of service to the prior permission regime in 2008/9. These arrangements may need in future to be specific to individual information providers and their service provider and aggregator partners. Some growth in this activity is assumed; but on the basis it can be met from existing resources.

Section 3

Transparency and performance management

In our Three-Year Strategic Plan and our Statement of Practice on Stakeholder Engagement we committed ourselves to increased transparency, sharing data and information, and to new performance measures additional to those in the existing Memorandum of Understanding with Ofcom.

We plan, through the Industry Liaison Panel, to publish quarterly reports on the size of the UK market, and on key operational information covering calls and complaints received, our monitoring work and informal enforcement action.

We will publish half-yearly reports, recording our progress, performance against KPIs, forecast year-end financial position and proposed activities for the remainder of the year.

We expect to share in full or in summary form the findings of our research into market structure, market trends, public use and trust in phone-paid services, and other issues.

Information about regulation and our industry support activity will be published in a quarterly report to the industry. We will be looking at the mechanisms for an equivalent report to fellow regulators, consumers, child protection organisations and other bodies with an interest in the work we do.

We plan to continue to host Forum meetings, open to all our stakeholders, on at least three occasions each year and to hold an annual public meeting, most probably in June 2008, when we present our Annual Report.

In our Three-Year Strategic Plan we proposed a number of additional productivity measures to support our existing key performance indicators:

- At the end of 2007/8 we will benchmark the 'cost per case' by the Investigations & Monitoring Team and the 'cost per call handled' by the contact centre. We will publish these figures and will seek to achieve a reduction in both by the end of 2008/9 and year-on-year thereafter.
- We plan to benchmark the cost of regulation relative to the size of the sector we regulate. Again, we will use the end of 2007/8 as a benchmark and our goal will be to see a year-on-year increase in this ratio.
- We are keen to explore methodologies for calculating the cost:benefit ratio of regulation. This is not straightforward but the volume of charge-backs, the percentage figures for public trust/distrust and trends in complaint levels might contribute to this model.

Section 4

Our spending plans

We are proposing a total budget of £4.4m. This includes a provision of £254,000 for work in relation to our new responsibilities for services on the 0871 number range. Excluding this provision, our budget on a like-for-like basis with 2007/8 represents a 2.2% increase in spending terms but a decrease in real terms for the third consecutive year.

0871 services

The financial provision covers the cost of existing management and executive staff time that has been committed to this project. It includes a provision of up to £60,000 for temporary staff in the contact centre on the assumption that the regulatory change will attract attention and that there will be public groups keen to exercise the assistance now available. We have also made provision for at least one stakeholder event specific to this market, and one piece of research later in the year on the structure of the market following the changes in non-geographic numbering and on the balance and effectiveness of regulation. We want to explore doing this work in partnership and expect to make findings available to everyone.

The other key elements of our 2008/9 budget are shown in **Appendix 2** with supporting explanatory footnotes. In this document, we have identified some specific investments relating to our website, research and the Code Compliance Panel. We have identified an overall reduction of nearly 7% in our staffing headcount. We have also explained the balance of spend (and overhead attribution) against our pre-empt, prevent and protect agenda and responsibilities. In addition, we would like to highlight the following moves in investment and expenditure:

Staff

Staff costs on a like-for-like basis have increased 2% over the 2007/8 budget, which is well below RPI at 3.9% for the year ended 30 September 2007. However, with PhonepayPlus taking responsibility for 0871 services in 2008, the total budgeted staff costs will increase by a further 7.9%. This further increase in staff costs is expected to be covered by the additional forecast levy income generated by 0871 outpayments.

Events

This heading covers all costs for industry forums and open annual meetings, the Annual Report launch, policy and Code workshops, the Industry Support Team's attendance and possible exhibition at trade events, conference fees, and venue-hire and related costs. The provision is in line with past expenditure but there is going to be more focus on industry support and product and platform-related events.

External professional services

We have provision for professional support with IT, communications, legal, research, audit, and web and software development. In some areas like IT, we recognise the cost effectiveness of using more external support. In the case of legal services, we have appointed an internal Head of Legal and we expect to recover at least the full employment cost of this role by focusing and limiting our need for external advice.

2007 has seen serious and complex oral hearings, and further cases for the Independent Appeals Body, as well as disputes over the coverage of our Code and at least one legal injunction in relation to the use of the emergency procedure. In a year when there are likely to be serious scope and policy-related issues to explore, and with the possibility of precedent cases going to the Independent Appeals Body, we have had to have a provision specifically for counsel's opinion and representation.

We plan to retain the possibility of using media support services on a project-specific contract basis but expect to deal with core media and public education and information work in-house using a team that is two staff smaller than it was three years ago.

Overheads

These costs will be lower in 2008/9. We have made the planned investment in software and support for a PhonepayPlus text service to be introduced this year.

Printing

Printing costs are budgeted to be lower as we move to publishing online.

Telecoms

There is an anticipated increase in costs in response to SMS messaging telephone contact.

Website

We have budgeted for an increase in Phonebrain and PhonepayPlus website hosting costs as we increase our emphasis on pre-empting and preventing problems through the education of younger users.

Capital expenditure

This is presented as “Depreciation” in our documentation. Our investment in 2008/9 will be in a replacement telephony system (£145,000), development of our existing complaints database system (£50,000), server upgrades (£18,000), software licences and desktop replacements.

Section 5

Revenue sources under the 2008/9 levy

PhonepayPlus is basically funded by a levy on service providers. Funds are withheld at network level. Each year, we ask networks to forecast their outpayments to service providers and agree payment schedules based on these assumptions. At the end of each year, these are reviewed against actual market activity levels and there is reconciliation, with any additional monies owed to PhonepayPlus paid over and/or any excess payments made by the networks on account refunded.

The levy rate is affected by a number of issues:

- The cost of regulation – the amount the levy and other sources of funds have to cover.
- The expected size of the market – the amount of expected outpayments on which the levy would be payable.
- Fines and administrative charges – these monies go towards the cost of regulation and therefore reduce the amount we need to collect through the levy.
- Market developments in the proceeding year – if the phone-paid services market exceeds expectations in 2007/8, the additional levy collected would go towards covering the costs of 2008/9. On the other hand, a fall in the market in 2007/8 would involve the repayment of excess levy collected from networks and this deficit would need to be made good in the following year.
- Any need to make changes to the PhonepayPlus contingency reserves – these exist to deal with the possibility of winding-up of the organisation at some future point, without defaulting on obligations, and the need to deal with any new, exceptional ‘spike’ problems that require extra staff and legal or other resources.

Our position on each of the issues is set out in brief below:

- The 2007/8 market: as explained, this is down against forecasts. Based on half-year figures, we believe that the market will be around 13% below expectation and that PhonepayPlus will need to refund around £350,000 at the end of the financial year.
- Administrative charges: we have said that we intend to increase our recovery of these charges. This will start in the near future with simplified charges based on hourly charge-out rates for the costs attributable to individual cases. We plan, in future, to budget on the basis that we will recover and use in the same year a high percentage of the administrative charges levied.
- Fines: fines are up in 2007/8, in part as a result of significant penalties imposed on participation television and some mobile services. We are assuming that approximately £1.4 million of fine income will be available for use in 2008/9. Our policy will continue to be that we should not budget on the basis that fines will be levied and used in any given financial year, but that any fines imposed should be retained and be available to meet the funding requirement in subsequent years.
- Contingency reserves: during 2007/8 we have used funds from the contingency reserves to meet the cost of the re-branding exercise and preparatory work for the regulation of 0871 services. Our auditors were asked to consider the method we used in calculating the level

of the contingency reserves at £1.8 million and their advice was that it “is appropriate and reasonable”. This means that there will be no need in 2008/9 to replenish these funds through a higher increase in the levy than would otherwise be necessary.

- 2007/8 budget: we expect our 2007/8 year-end expenditure to be on target and it is therefore unlikely that there will be any underspend available for use in 2008/9.

Section 6

The 2008/9 market

After the events of 2007/8, the market for the coming year is clearly the most important consideration. We will be talking with every network about their assumptions and forecasts for the coming year before a levy is set. We are also interested to hear the views of other stakeholders as part of their response to this consultation.

In our Three-Year Strategic Plan we included assumptions of a 17% decline in market size in 2006/7 and 10% market growth in 2008/9. The latest information suggests that our forecasts for 2007/8 may have been slightly pessimistic. Half-year data suggests the market is down around 13% for the year-to-date. We have no wish to over-anticipate growth in the coming year and to base the levy on such an assumption. Accordingly, we have reduced our assumption for growth in 2008/9 to 5% across the existing phone-paid services sector and the 0871 market as we assume it to be. We would particularly welcome views on this.

Section 7

The levy

We cannot set a levy figure at this point. The final levy will be informed by decisions on this budget, trends in the market in the coming months, and our financial position this year in terms of spend, charges, fines and other income and expenditure.

At the same time, we recognise that stakeholders find it useful to have our best assessment of what we think the outcome will be. Our assessment is that the net effect of the reduction in the market in 2007/8 and the limited recovery in 2008/9 will mean a limited levy increase will be necessary next year to cover the cost of regulation, even though that cost will have decreased for a third year in real terms. We believe, however, that the levy will remain below 0.4%.

Section 8

Responses and next steps

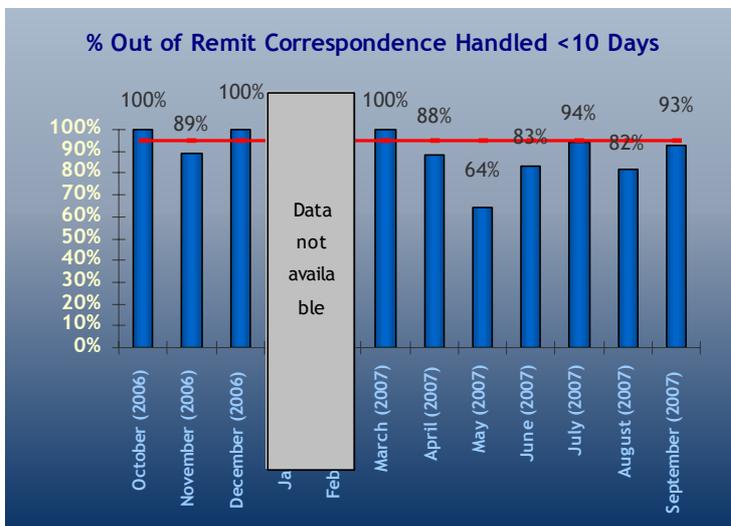
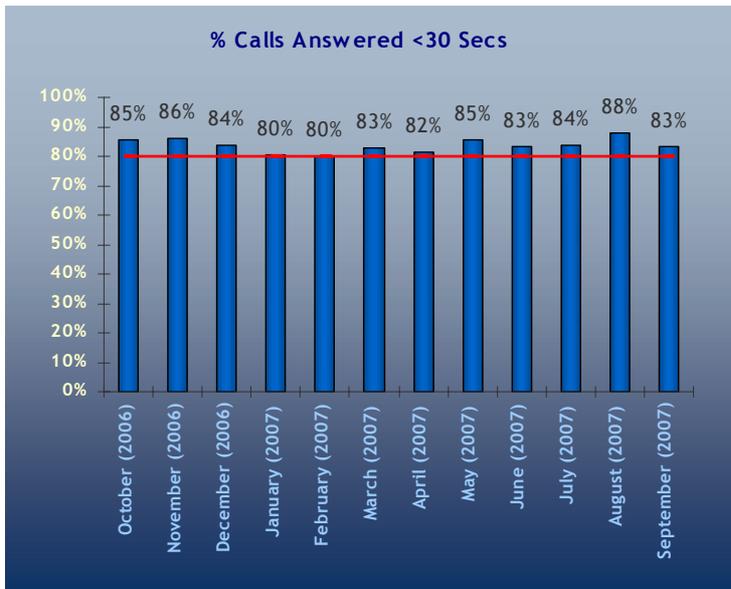
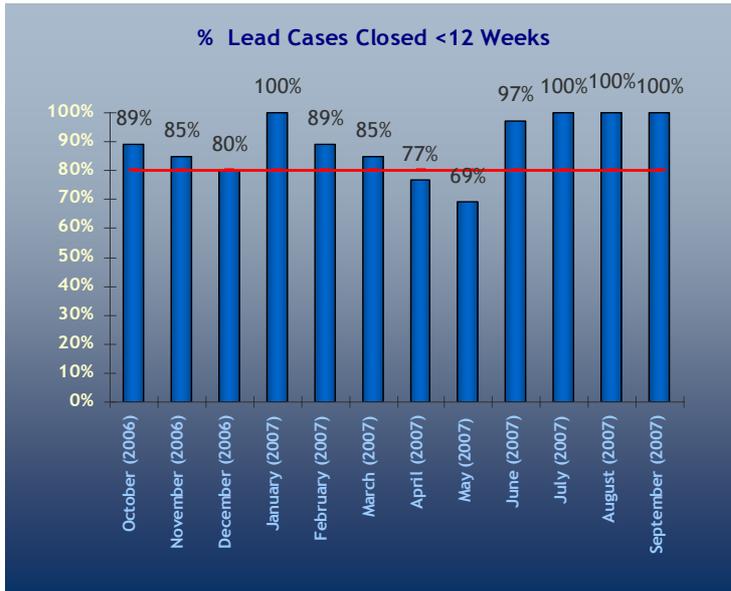
We welcome responses by close of business on **5 December 2007**. This deadline is necessary as PhonepayPlus has to present its final proposals to Ofcom early in the New Year.

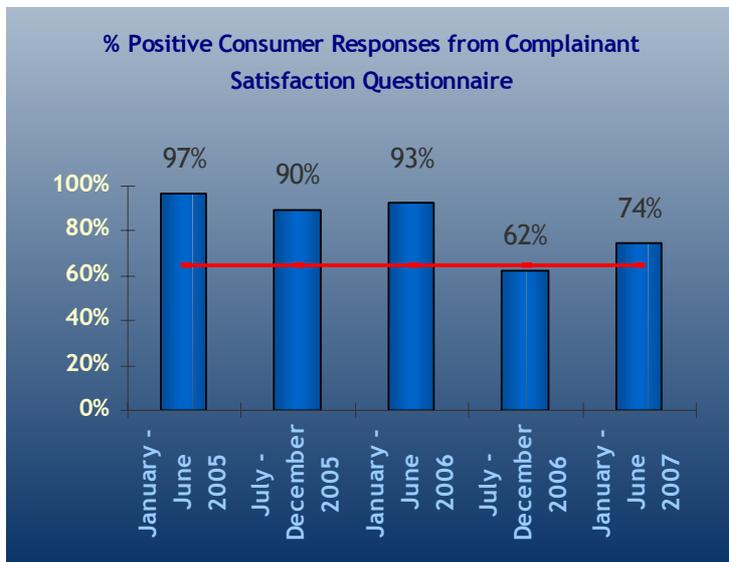
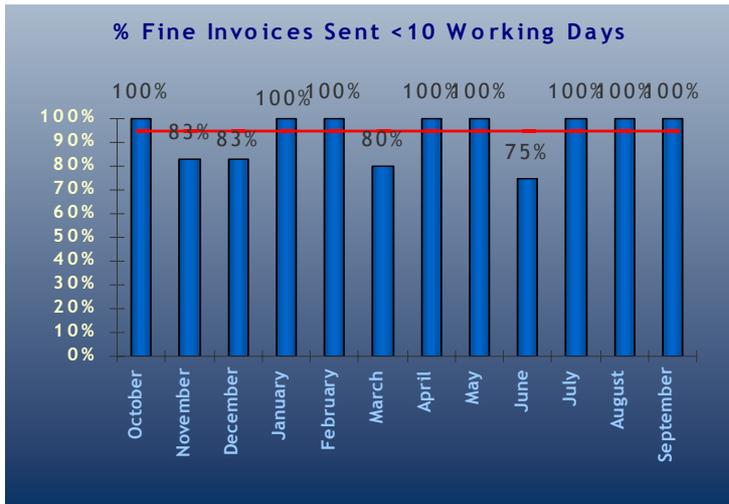
We welcome comments on any and all points in this document. We are, however, particularly interested in your views on:

- The size and the challenges that the 2008/9 market may pose.
- The expenditure plan, our focus on a pre-empt, prevent and protect agenda, and the allocation of costs within this.
- Our continuing shift towards the 'polluter pays' principle through maximisation of administrative charge income and use of fines.
- Any external commercial, technological, legislative or other development that you feel we have not addressed.
- Our plans for research and for the sharing of our findings.
- Our proposals for additional productivity measures.
- Ways of assessing the benefits as well as the costs of regulation.

Replies should be sent to Dawn Carré at dcarre@phonepayplus.org.uk. Replies will be shared with Ofcom and may be made public on our website. Please indicate if you wish your reply to be treated in confidence.

Appendix 1





Appendix 2

PhonepayPlus Expense Budget 2008/09

As noted in Section 4 of this document, we will be taking on new responsibility for services on the 0871 number range in 2008/9. Therefore, for ease of understanding, our Expense Budget (excluding 0871) is presented on a like-for-like basis, with the 0871 Budget shown separately.

	EXPENSE BUDGET (EXCLUDES 0871)			0871 BUDGET	TOTAL BUDGET	TOTAL BUDGET	TOTAL BUDGET
	2008/9	2007/8	Variance Inc/(Dec)	2008/9	2008/9	2007/8	Variance Inc/(Dec)
Staff	2,499,558	2,450,700	48,858	192,961	2,692,519	2,450,700	241,819
Events	104,500	99,000	5,500	6,000	110,500	99,000	11,500
External professional services	399,970	366,220	33,750	30,000	429,970	366,220	63,750
Overheads	259,262	317,730	(58,468)	680	259,942	317,730	(57,788)
Premises	337,900	338,800	(900)	0	337,900	338,800	(900)
Printing	50,960	66,000	(15,040)	2,000	52,960	66,000	(13,040)
Telecoms	65,575	80,350	(14,775)	22,100	87,675	80,350	7,325
Website	104,920	82,600	22,320	0	104,920	82,600	22,320
Depreciation	280,645	215,000	65,645	0	280,645	215,000	65,645
TOTAL	4,103,290	4,016,400	86,890	253,741	4,357,031	4,016,400	340,631
			2.2% (1)	(2)			8.5%

(1) Expenditure (excluding 0871) increased by 2.2%, while RPI rose by 3.9% for year-to-date September 2007.

(2) 0871 Budget Staff (£192,961) includes £132,160 of staff salaries and on-costs which will have to be absorbed back into the Expense Budget if the project does not proceed. 0871 estimated income is expected to cover its budgeted costs.

The budget has been calculated on a 'business as usual' basis and does not attempt to pre-empt any changes which may emerge from the Ofcom Review.

Staff levels have decreased from 56.8 FTE to 52.8 FTE (7%) with decreases in Investigations & Monitoring, Customer Services and Communications. We have budgeted for an increase of two in Legal. However, costs associated with this increase have been offset with identified savings in external legal costs.