Response to PhonepayPlus ‘Business Plan & Budget 2013/14’ Consultation

on behalf of The Number UK Ltd (118 118)

17 January 2012

Introduction and Background

kgb ('knowledge generation bureau') is a privately held, New York-based company and the world's largest independent provider of directory assistance and enhanced information services. kgb has built some of the most successful brands in the telecommunications, customer care and enhanced information services sectors.

In 2002, kgb (then known as InfoNXX) established 118 118 (The Number UK - TNUK) which soon became the largest and most well known provider of directory services in the UK. Last year, it handled over 30 million calls, providing both core directory services and a range of enhanced offer, advertising and other information services.

kgb has also pioneered the provision of a broad range of wholesale and retail information services beyond traditional directory assistance services and in 2010 launched kgbdeals.com.

As the market leader in the UK DQ industry, TNUK has a significant interest in PPP's Business Plan and Budget. Whilst we are broadly satisfied we the proposed activity, we note that very little of what is planned relates to the DQ industry, which exhibits very low levels of harm, thereby requiring limited amounts of PPP time and resources.

At the same time, we note that the DQ industry (and TNUK in particular) contribute very significantly to funding PPP's budget, owing to the flat rate levy funding model employed. Whilst we are broadly satisfied with the total amount spent by PPP (which we largely accept on trust), it is clear that our significant funding contribution produces only very limited benefits to DQ consumers, let alone DQ providers. We therefore believe that there is an urgent need for the funding model to be reviewed, along the lines which we outline below.

Response to Questions

Q1: During 2013/14 we will commence the preparation of the next Three-Year Plan covering the period 2015-18. Do you have any feedback on the continuing appropriateness of both our current Vision and supporting Values?

TNUK generally agrees that PPP's Vision and Values are sensible and uncontroversial. However, we also believe that PPP should be mindful of the continuing steady decline across the PRS sector and what it can do to help reverse that trend and maintain the overall welfare of the industry for the longer term benefit of consumers. The industry has a rather different outlook to that which existed at the time when the current Three-Year Plan was first being developed and PPP should be cognisant and responsive to that fact.

Whilst it is of course not the job of the regulator to promote particular services, it can have a role in developing and promoting the health and benefit to consumers of the sector more generally. In that regard, TNUK believes that PPP's Vision is perhaps drafted too narrowly. Using PRS with confidence is

an admirable and worthwhile aspiration, but it should equally sit alongside a determination to help create a healthy, vibrant, successful, competitive etc PRS sector.

Likewise, TNUK believes that PPP's Values could include similar mentions. In particular, the 'Effective' and 'Collaborative' values could both make reference to the fact that PPP's role is to help facilitate the creation and continuation of a vibrant PRS sector offering a wide range of appealing services to consumers, in an environment which fosters creativity, innovation and competition.

TNUK does not contend that such changes to PPP's Vision and Values will have any direct impact on the commercial viability of the PRS sector. However, they may nevertheless be helpful in reminding PPP staff of the challenges faced by those operating in the sector which it is their job to regulate. Regulation is not as an end in itself, but rather a means of allowing consumers to benefit from the services on offer.

Q2: Do you agree with our assessment of the PRS market and do you have any other information or data that you could share?

TNUK largely agrees with PPP's assessment of the PRS market as it relates to DQ, although there are some additional comments which we would like to make.

Whilst there is undoubtedly a continuing significant decline in DQ call volumes, TNUK does not believe that the reasons are exactly as PPP has described. Although it is intuitive to assume that the decline is solely due to the fact that *"…consumers may use Google to look for email addresses and phone numbers instead of using a paid-for Directory enquiry search*", TNUK's own evidence suggests that the reality may not be quite so straightforward.

We have conducted consumer research which (amongst other questions) asked DQ users how else they could have obtained the information they requested <u>at the time</u> that they made the call to a DQ service. Perhaps surprisingly, the responses revealed that 85% of those DQ callers had alternative sources of information available to them at the time, but yet chose to make the call in any case. Predictably, those alternative sources of information were primarily internet access from either a computer/laptop or smartphone. The reason why consumers chose to call a DQ service rather than use the alternatives was primarily due to the greater speed, convenience and reliability of the DQ call.

Furthermore, separate research indicated that DQ users were actually <u>more likely</u> to own smartphones than the average population. Specifically, 83% of DQ users own smartphones and 17% own basic phones. This compares with 65% of the national population owning smartphones and 33% owning basic phones.

Both these pieces of evidence clearly demonstrate that the ready availability of online alternatives to traditional DQ services do not necessarily mean that consumers would automatically prefer or opt for those alternatives given the choice. To some extent, this therefore undermines the generally held view that the decline in DQ volumes is purely due to the availability of these alternatives and that consumers would always prefer to go to Google, rather than call a DQ service, if they had the option to do so.

Naturally, TNUK accepts that the availability of online alternatives is at least part of the reason for the decline in call volumes. But we strongly believe that another reason is the high cost of DQ calls set by non-BT (primarily mobile) operators as well as our inability to publicise and clarify the exact level of those charges as they differ for every operator.

PPP will be well aware that the current system of pricing for DQ calls allows providers only to set their call charges from a BT landline, whilst permitting other operators to set any charge they wish above that level. As a result, mobile operators typically add a significant mark-up on top of the intended call charge, meaning that consumers end up paying far more than should be the case.

The problem of these high call charges is exacerbated by the fact that the charges are all different and so it becomes impossible for DQ providers accurately to communicate them to consumers. The standard line that "*other networks may vary*" is clearly inadequate and largely meaningless, but regrettably is the only option available under the current system of pricing.

However, PPP will also be of aware of Ofcom's current Review of Non-Geographic Call Services which aims to address both of those problems. But TNUK has significant concerns about some of Ofcom's proposals, specifically regarding the lack of any cap on operators' access charges and the process by which service charge price points will be set.

Whilst we recognise that these matters are outside PPP's remit, we simply want to highlight our concerns that Ofcom's proposals will not be entirely effective at addressing the deficiencies which currently exist within the DQ market. As a result, we think that there is a reasonable prospect that some problems will endure and that these will continue to have a detrimental impact on DQ call volumes into the future. PPP should therefore bear in mind that although the decline in DQ call volumes seems set to continue, the reasons may not be as simple or straightforward, as they immediately appear.

TNUK would also highlight to PPP that the decline in call volumes to traditional 'basic' DQ services is prompting a new wave of innovation and creativity, as TNUK works to develop new revenue streams to replace those that are being lost. These take a number of different forms (many of which are not directly relevant to PPP) as we investigate new business opportunities in relation to our online and mobile apps, as well as voice calls to 118 118.

Many of our proposed business models are based around generating revenue from our partners, merchants and advertisers, rather than directly from consumers. Therefore, whilst there will be no cost to consumers in terms of charges for using our services, we expect that the new products will offer enhanced value and benefit to them. We believe that this virtuous circle of additional benefits to consumers driven by greater revenue from merchants, is the best model in order to sustain viable DQ services into the future.

Finally, TNUK would highlight briefly in answer to this question that DQ services appear to be generating a very low level of complaints to PPP, compared with some newer and less well understood services. DQ is therefore responsible for a limited amount of PPP's total workload and we address the point in greater detail in response to Q6 in relation to PPP's funding. But when considering the functioning of the PRS market more generally, it is important to note that the DQ market specifically

appears to be working well for consumers, generating few complaints and no particular problems which need addressing.

Q3: What comments do you have regarding our themes for 2013/14?

TNUK agrees that PPP's proposed themes appear to be sensible and well-targeted and in particular, we agree with the intended focus on "*making polluters pay*". As PPP is a regulator whose resources are directed at achieving its central objective of preventing consumer harm, it is only right and proper that those who are responsible for causing that harm should pay for the resources which their actions require to be spent. However, we recognise that 'making polluters pay' has long been a cherished ambition of both PPP as well as most industry stakeholders, that has often proved easier to say than to achieve in practice.

That aside, TNUK agrees with the broader theme of 'strengthening compliance', as well as 'improving consumers' experiences' and 'protecting vulnerable consumers'. These would seem to be areas in which PPP can be most effective in addressing the causes of consumer harm. However, we would note again that there is little (if anything) in any of those themes which would relate to DQ. To be clear, TNUK has no objection to that, but it further highlights that PPP is proposing to undertake very limited work in relation to the DQ sector. Again, this calls into question the funding which PPP receives from DQ SPs and whether we are therefore subsidising other sectors within the PRS industry which are generating a greater quantity of work for PPP, that is not fully recovered by their levy contributions. Again, we will address these issues further in response to Q6.

Q4: Do you agree with our proposed work plans for 2013/14? If not why not?

Several of the points which we have made above in response to Q3 are again relevant in response to this question. In particular, we strongly support the work programme designed to "make polluters pay" which TNUK believes should always be at the heart of everything that PPP aims to do.

However, we would note once again that of the 11 work programmes listed by PPP, only one has any direct relevance to the DQ sector, which is "*work with Ofcom to ensure Higher Rate PRS and 070 enforcement are effective*". Even this proposed work programme is framed in terms of enforcement, which TNUK does not expect to apply to us or the vast majority of DQ providers. Whilst we note that PPP also refers to some additional work with Ofcom "*to consider the effect of potential raised spending caps* …." etc, we are aware that Ofcom is due to publish its final statement on the issue in mid-January. It would therefore appear to TNUK that this work is likely to be largely (if not entirely) completed by the start of PPP's year in April.

In any case, the fact that only one work programme relates directly to DQ would again suggest that the vast majority of PPP's work is neither generated by the DQ sector nor of benefit to the DQ sector. This again calls into question the fairness of PPP's current funding mechanism. Whilst we note that several of the work programmes are necessarily general in nature, they nevertheless all have a common underlying theme which is in some way targeted towards areas of non-compliance. To put it another way, it does not appear that any of the more general work programmes have been prompted by concerns or complaints in relation to the DQ sector.

Finally, we would caution PPP to ensure that all of its proposed work programmes provide genuine benefits in line with identified problems, whilst at the same time offering real value for money. In that regard, TNUK does have some concerns about PPP's PhoneBrain project. Whilst it began simply as a means of educating young consumers about the use of PRS (particularly as a result of harm caused by subscription services) it appears to have grown to something considerably bigger and therefore more expensive and rather less relevant in the form of the PhoneBrain awards.

TNUK does not know the cost of the PhoneBrain awards and importantly, we do not know to what extent those costs are met by sponsors or by the PPP levy. If the costs are borne largely (or entirely) by sponsors, we have fewer concerns. However, we would still question whether this is the type of activity with which a regulator should be engaged, as it seems to have become increasingly far removed from what PPP's role should be. The website describes the competition:-

> "*Phone-paid services, including many mobile apps are big money makers - not just for businesses but for charities too. It's big business. We are looking for ideas for a phone-paid service (which could be an app) that can send a charge to your bill or pre-pay account*."

And

> "*Ideas must include a way to generate revenue by charging the cost to your phone bill or credit. But ideas can be:*
>
> - *Purely commercial, to make a profit.*
> - *To generate revenue for a community or social benefit*"

PPP has previously tried to justify the relevance and value of this competition by saying that it is intended to encourage participants to consider code compliance issues when designing their service or app. However, there is no reference to this anywhere in the information concerning this competition. Furthermore, none of the winning entrants of the 2011 awards appear to have considered code compliance issues in any way as part of their apps or services.

It appears to TNUK that PPP has become somewhat carried away with the success of this initiative and in so doing, it has completely lost focus on whether it is providing any value to PPP's core objective of preventing harm in the PRS market. It may well be supported by mobile operators and others who have a commercial interest in promoting use of these paid-for service amongst children, but that does not mean that it is the role of regulator to promote. Unquestionably, the competition has no value, relevance or benefit whatsoever to the DQ sector and we would be extremely concerned if our levy contribution went in any way towards funding it.

Q5: Do you agree with our planned resource allocation and activities for 2013/14? If not, why not?

The Business Plan and Budget contains only limited detail of how PPP intends to allocate its resources for 2013/14 and specifically what work is encompassed in each of the specified activities. Moreover, only PPP itself can really know the level of resource required to undertake the necessary work in each area. Therefore, it is difficult to provide a substantive response to this question.

However, TNUK largely agrees with the proposed allocation between each of the activities, as far as we understand them. In particular, we agree that enforcement should be PPP's principal activity and requiring the largest part of the resources. Similarly, consumer support is obviously a critical activity which must be sufficiently well-resourced to enable it to be performed effectively, although we have already highlighted concerns about any resources which PPP may be spending on the PhoneBrain initiative.

TNUK notes the proposed budget decrease for industry support, although we would query whether compliance advice can continue to be provided free of charge indefinitely. Whilst we understand that PPP would not want to discourage providers from seeking advice, PPP should bear in mind that the advice is being given to support providers' commercial business models. It is questionable therefore, whether all providers should be required to fund advice which is only required by a few for their own commercial benefit.

Finally, the descriptions of regulatory development and corporate governance are somewhat opaque, so it is unclear exactly what they encompass. Whilst acknowledging that they constitute relatively small parts of PPP's total budget, TNUK also notes that their resource allocation is not being reduced. We would query whether that it is appropriate bearing in mind the resource pressures which PPP is under and the greater priorities for funding which it faces.

Q6: Would you support extra cost for a Funding Review in 2013/14?

PPP has clearly framed this question in such a way as to try to prompt a negative response. By focussing the question on the extra cost of a Funding Review, instead of the fairness and benefits (and indeed lower costs for compliant providers) which such a review might generate, PPP is hoping that respondees will accept the status quo, rather than press for a more equitable form of funding. Indeed, the fact that PPP has chosen to include this issue within the section of the document relating to resource allocation also seems designed to engender opposition to the proposal.

Moreover, PPP disingenuously implies that the previous KPMG Funding Model Review concluded that the current model was the best available and did not recommend any changes to it. As we discuss below, this was demonstrably not KPMG's conclusion and in fact, they recommended several changes to improve the fairness of the model, which PPP chose not to implement.

PPP's proposed £100,000 additional budget to commission external consultants to conduct a further review is therefore also disingenuous, as this work has already been undertaken and recommendations provided. PPP need simply act upon those recommendations without incurring any further cost. Regrettably, reference to the £100,000 budget increase also seems intended to deter stakeholders from supporting this course of action

TNUK takes exception to how PPP has chosen to present this issue within the Business Plan & Budget and strongly supports a Funding Review.

We have highlighted throughout this response PPP's very limited amount of past and planned future activity related to the DQ sector. TNUK has no objection to this approach which reflects the reality of

where consumer harm is likely to arise and where PPP's intervention is therefore most required. Indeed, TNUK is not aware of any adjudications in relation to voice DQ services.

Similarly, TNUK understands anecdotally from PPP that the number of consumer complaints received in respect of DQ is very low. Figures published by Ofcom[1] suggest that PPP receives only about 35 DQ complaints during the whole of 2011. This compares with the 8,499 complaints that PPP's Annual Report 2011/12 states that it received in the year, which means that DQ constituted only 0.4% of PPP's total annual complaints. It also does not seem likely that PPP receives many requests for compliance advice from DQ service providers. Moreover, it is a relatively straightforward sector which PPP well understands and so there is no need for significant work in response to new and emerging threats.

Taken together, it seems clear therefore that the DQ sector works well in the interests of consumers and is characterised by a lack of consumer harm, complaints and emerging threats. It means that PPP is not required to undertake any significant level of work or expend much of its resource on regulating the sector. In this context TNUK believes that the current flat rate levy funding model (based purely on revenues generated) is demonstrably inequitable and directly contrary to the 'polluter pays' principle.

TNUK is aware of the ongoing concerns of some fixed providers about the effective subsidy to the mobile industry as a result of the fact that a greater number of complaints are mobile related. Whilst we agree with the general concerns about the inequitable nature of the flat-rate levy funding system, we do not agree that a simple fixed versus mobile approach is the appropriate.

Most obviously, this is because many voice services (not least DQ) can be accessed equally by fixed or mobile consumers. Therefore, if problems arise in relation to the service, there is no logic in requiring the activity to be funded by either a fixed or mobile levy, because it is the same service at fault in either case.

TNUK believes that it would be far preferable to adopt a service-oriented funding model. This would most closely align with the 'polluter pays' principle and therefore PPP's desire to target the information providers and make them more directly responsible for any harm which their services may produce. For voice services, this would be based simply on the number range in question. Non-voice services could similarly be divided by category e.g. reverse billed SMS, Payforit, red button, mobile apps etc. To the extent to which any services did not fit into any defined non-voice category, it may be necessary to spread the cost equally over all such categories.

A service-based model would be simple enough to administer and provide equivalent clarity to the current model, but with the huge advantage that it far more effectively targeted those parts of the premium rate industry which were responsible for generating harm and required them to fund the necessary PPP work. Crucially, it would be far more equitable than a blunt fixed versus mobile model, which as PPP highlights would create just as many problems as it solved.

We note that this proposal is closely aligned with one of the four principal recommendations of the KPMG Review, in the form of Option 4b which was defined as:-

[1] Fig 4.1 of Ofcom consultation 'Service Charge Caps for 09 and 118 Services' dated 25 July 2012

> "*levy rates differ by a small number of service segments, and are calculated based on the cost to regulate those segments*"

And at para 2.18 the key elements were outlined as:-

"*Revising levy calculations to more closely reflect the costs and benefits of Strategy and Policy work and the differences in the risk profile of certain services based on their track record or potential to generate consumer harm*."

KPMG's assessment of this option at para 2.11 of its review is that:-

> "*KPMG considers that a levy system based on TCP gross revenues, and which varies by service risk, (Option 4b) would more fairly reflect the benefits earned by stakeholders from PRS as well as the cause of regulatory costs and consumer harm*." [Emphasis added]

KPMG calculates that even after allowing for implementation costs, this change is likely to produce an overall net financial benefit to PPP. However, even if it were financially neutral, TNUK strongly supports this option as a means of ensuring a more equitable basis of funding according to where consumer harm arises.

It is interesting to note that that PPP describes at para 6.33 one of its objections to any move away from a flat-rate funding model as follows:-

> "*Whilst regulators like Ofcom or the FSA have separate charging regimes for some of the different sub-sectors they regulate, the rationale for this lies in their wider regulatory span and the diversity between the sub-sectors they regulate. This is not true for PhonepayPlus, as PRS is already a small and relatively coherent sub-sector of the telecommunications market. It is therefore questionable whether sub-dividing PRS further, in terms of different charging regimes, would be appropriate*."

TNUK regards this as a somewhat odd and highly disingenuous justification in view of the many other comments made throughout the consultation about the diverse and varied nature of the PRS industry which PPP regulates. The description of PRS as a "*small and relatively coherent sub-sector*" is hardly consistent with the statement in para 3.1 that "*The diversity of PRS in the market is limitless*" and clearly contradicts the comment in para 6.4 that:-

> "*…the industry that we regulate is extremely broad and complex so our teams have to be highly knowledgeable about a vast range of services and issues, from adult chat lines to Payforit and mobile malware*."

TNUK therefore believes that reliance upon the apparent small and coherent nature of the PRS market as justification for the current funding model is simply not credible. Moreover, the fact that PPP has attempted to use it significantly undermines the strength of its other arguments and raises serious questions about the objectivity with which it is viewing this issue.

If PPP does not accept the service-based model, TNUK believes that at the very least it should consider a different approach based on its enforcement activity. Currently, a proportion of the substantial 39% of Ofcom's budget spent on enforcement is covered by administration charges. TNUK believes that the entire enforcement budget should be recoverable from those against whom Ofcom takes action and who therefore require the budget to be spent. This would be a very simple and logical application of the 'polluter pays' principle.

There does not seem to be any reason why the remainder of the PRS industry should be required to fund PPP activity which is only necessary due to the fault and harmful activity of others. For these purposes it should not matter whether the costs are incurred in relation to complaint resolution or investigations because in either case the costs relate specifically to actions of an individual service or information provider. It should therefore be they, rather than the wider industry who are responsible for meeting those costs.

Again, this proposal is closely aligned with another one of KPMG's recommendations in the form of option 8, 'fuller recovery of admin charges' which is described as:-

"*recovery of admin charges increased to more fully reflect resources spent on adjudications*"

TNUK is aware that PPP has generally increased the admin charges for its enforcement work since 2009, although some of the charges have on occasion also been reduced. We assume that this is as a result of the formula by which the charges are set and its inter-relationship with PPP's budget and level of fine income etc. As a matter of principle, TNUK does not believe that the charges should ever be reduced if they are at a level which is not recovering the full cost of the enforcement activity.

Critically, it is not clear to TNUK whether the current level of admin charges does or does not cover the full cost of enforcement activity and therefore whether KMPG's recommendation has been implemented. We recognise that this is somewhat of a subjective question, where the costs incurred are largely a matter of staff time. But TNUK believes strongly that there can be no credible argument for enforcement costs not beign fully recovered by the admin charges, which should therefore be set at that level as an absolute minimum. This is surely what KPMG proposed.

Indeed, TNUK believes there is an argument for going even further. That is, that those who are subject to any form of PPP's enforcement activity should be required to pay an additional surcharge levy in order to contribute to PPP's other costs, above and beyond the costs of the enforcement activity itself. That would act both as a disincentive to further harmful activity, as well as an additional application of the 'polluter pays' principle.

Whilst the affected providers may seek to argue that they are not directly responsible for these additional costs, in reality it is the actions and existence of the providers who are the subject of enforcement activity who necessitate the need for much of PPP's broader activity. To put it another way, if there was never a need for any enforcement activity, it is unlikely that PPP would have to undertake much of the work that it does, or possibly have to exist at all.

TNUK notes that this is similar in part to another of KPMG's recommendations, 'notification fees' which was defined as:-

> "*in addition to the direct registration scheme costs, it may also facilitate funding broader regulatory activities in the future (eg the cost of compliance advice)*"

Whilst KPMG recommended that the additional sum be added to the registration fee, TNUK believes that it would be more equitable for it to be added to the administration costs. This is simply because the registration fee is paid by all providers, many of whom (like TNUK) will not be directly responsible for any increase in PPP workload and resources. By contrast, the 'enforcement surcharge' would only be payable by those who were so responsible.

Finally, we mentioned above the fact that it may also not be appropriate for PPP to continue to provide industry support and compliance advice free of charge indefinitely. A requirement on the providers who seek this advice also to have to pay for it would additionally fit with the broader principle that those who cause costs to be incurred should be required to meet those costs.

TNUK believes strongly that such a principle should be central to PPP's approach to meeting its funding requirements going forwards. As profits reduce and budgets are stretched, it is essential that a greater level of fairness is injected into the funding model. As just described, it also aligns with the rationale for KPMG's recommendation that compliance advice costs should be met by an increase in the registration fee, although we do not believe that has any obvious advantages over the current system.

Q7: Do you agree with our assessment that the charging model, and exemptions, should remain unchanged during 2013/14? If not, why not?

TNUK is content with the current proposed method of funding the registration scheme and has no further comments to make in that regard.

Whilst we do not particularly support KPMG's recommendation to increase the registration fee to pay for the costs of industry support and compliance advice, nor are we fundamentally opposed to it. The main benefit that TNUK can identify is that it may help deter some rogue providers from entering the market in the first place.

All queries in relation to this response should be to Simon Grossman, Director of Government & Business Affairs, The Number, Whitfield Court, 30-32 Whitfield Street, London W1T 2RG – simon.grossman@118118.com – 07971 050 001