



Effective competition review of number translation services

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Summary

S1. Oftel's effective competition reviews are intended to assess the state of competition in a particular sector. In the light of that assessment, Oftel determines the level of regulation appropriate to the level of competition. This consultation document presents the initial findings of Oftel's review of competition in the provision of voice number translation services.

S2. Number translation services (NTS) are used by their purchasers to provide callers with information or value-added services using non-geographic numbers such as 0800 and 0845, ie numbers which are used to identify a type of service rather than a geographical location. The translation services convert a telephone number from its non-geographic format into a geographic format which enables it to be routed to a specific location. The services provided through NTS range from freephone charitable helplines to premium rate information services. Callers pay a variable charge depending on the type of service being called.

S3. Oftel is conducting this review following a request from BT that Oftel lifts regulatory obligations on BT in respect of certain voice NTS services. Under Condition 43 of its licence, BT is required to supply some telecommunications services, including NTS, to any person who reasonably requests such services. Linked to this requirement is an obligation to notify prices and an obligation not to unduly prefer or discriminate between customers.

S4. There are a number of indicators which need to be taken into account in determining the level of competition in a particular market. Having considered these factors, Oftel's initial view is that the relevant market for voice NTS is effectively competitive. A market which is effectively competitive will deliver the benefits of competition, eg lower prices, higher quality and greater choice of services, without needing sector-specific regulation to promote competition.

S5. The specific considerations which have led Oftel to this initial view include:

- Prices for voice NTS services have fallen in recent years;
- The fact that barriers to entry into the relevant market are low, as evidenced by the extent of entry in recent years. There are now over a hundred potential suppliers of NTS, and the number of suppliers increased by over 50 per cent between March 1999 and December 2000;
- The costs to customers of switching from one NTS provider to another also seem to be low;
- Customers who obtain NTS from operators seem to be well informed about the range of alternatives available to them and are able to use this information to negotiate favourable prices, terms and conditions with suppliers;
- BT's market share seems to have declined over the past few years, whilst the market shares of its competitors has risen; and,
- The effect of other regulation, including that over NTS interconnection, prevents BT from leveraging its market power in other related markets into the relevant market for NTS.

S6. Oftel is seeking the views of interested parties on its initial views set out in this document and the underlying analysis. After considering these responses Oftel will publish a

statement on the state of competition in the relevant market for the provision of NTS. The statement will set out proposals for withdrawing, amending or continuing with current regulation in relation to BT's provision of NTS. If Oftel confirms its initial view that the relevant market for NTS is effectively competitive, the current intention is to issue a determination removing, in whole or in part, BT's obligation to supply NTS services under Condition 43 of its licence.

Chapter 1

Introduction

Details of BT's request

1.1 Oftel's strategy is to match the level of regulation to the level of competition in the market, lightening formal regulation as competition develops, while continuing to protect and inform consumers where the market cannot do so.

1.2 Oftel carries out market reviews to assess the level of competition in a particular sector and to ensure that regulation is appropriate. The methodology for these reviews is set out in *Implementing Oftel's strategy: Effective competition review guidelines*, August 2000.

1.3 The subject for this particular review is the relevant market for voice Number Translation Services, described in more detail in paragraph 1.11. The review began in December 2000 with the publication of a statement entitled *Review of certain voice number translation services*.

1.4 Oftel is conducting this market review of NTS following a request from BT that the Director General of Telecommunications (the 'Director') makes a determination under Condition 43 of its licence that BT is not obliged to provide certain voice NTS services on request. BT has requested that Condition 43 of its licence should not apply in relation to particular voice NTS products it supplies, namely Freefone, Lo-call, Nationalcall and Premium Rate Services. The results of this review will therefore be used to assess BT's request for deregulation in the area of these NTS services.

1.5 This consultation document:

- describes NTS in more detail and explains why this review is being carried out;
- considers the present state of competition in the relevant market for NTS;
- outlines the possible implications for continued regulation in this market at the conclusion of the review; and,
- describes Oftel's plans for further work during the rest of the review.

Definition of number translation services

1.6 Number translation services are used by their purchasers (NTS customers) to make use of non-geographic telephone numbers, ie numbers which are used to identify a type of service rather than a geographical location. The use of NTS means that the standard geographical tariff bands do not apply to calls.

1.7 NTS refers to the process associated with the routing of a non-geographic number to a network termination point, eg, the number is translated from its non-geographic format into a geographic number to enable it to be routed to a specific location.

1.8 In addition to providing the translation services, telecoms operators who supply NTS customers may also provide ancillary services such as statistical analysis of call patterns. An overview of BT's NTS products is given in Annex II.

1.9 The NTS customer, or 'called party', is typically a firm which uses the non-geographic number in the course of its business. The 'calling party' is the end-user of the service provided by the called party. The translation services are not therefore supplied directly to end-users, but are instead supplied to NTS customers who provide services to end-users using non-geographic numbers.

1.10 Services provided through the use of non-geographic numbers include sales, marketing, customer support, order handling, customer care, technical support and information services. For instance, banks and building societies may use freephone numbers for handling enquiries about financial services. Premium rate services (PRS) numbers, meanwhile, are typically used by service providers to offer content-based services to callers, eg information helplines, competitions, chatlines, etc. Companies may use a number of different types of NTS. For instance, they may use a freephone number in order to attract new customers, whilst using a local rate number to provide services to existing customers. Internet service providers (ISPs) may also use NTS services in order to provide dial-up internet access, although these are outside the scope of this review.

1.11 The services which use NTS and which are covered by the review include:

- Freephone: Services typically using the 080x/0500 number range. They enable the called party (the NTS customers) to be called free of charge from anywhere in the UK. The NTS customer pays the full cost of the call.
- Local rate: Services typically using the 0845 number range. NTS customers can be called from anywhere in the UK at a price up to the local call rate. The caller pays the local rate and the NTS customer pays the balance.
- National rate: Typically using the 0870 number range. Customers can be called from anywhere in the UK at up to the national rate. The caller pays a price up to the full national rate and the NTS customer pays nothing. In some cases, the NTS customer receives some revenue from the supplier of NTS.
- Premium rate service (PRS): Use the 09xx number range. Callers pay for the cost of the call together with a variable charge for the content of the call. NTS customers earn revenue from the calls.

1.12 The use of services which employ NTS has grown significantly in recent years. They are increasingly used for services such as sales and marketing, customer support, and order handling. Table One shows the enormous rise in the total number of NTS calls in the period between 1995/96 and 1999/00. For instance, the use of special national rate services (ie national rate calls involving NTS) has increased more than fourteen-fold in a matter of four years, whilst special local rate calls (ie local rate calls involving NTS) have increased by a factor of more than seventy. A significant proportion of the rise is due to increasing use of internet access. But the use of other services which employ NTS (eg services supplied through call centres) has also risen significantly.

**Table One: Calls involving NTS
(million minutes per year)**

	1995/96	1996/97	1997/98	1998/99	1999/00
Freephone calls	757	1325	2071	1936	3080
Special local rate	547	1218	6618	18,050	39,051
Special national rate	132	492	748	1296	1925
Calls to premium rate services	429	406	455	576	771

Source: Oftel Market Information

1.13 Rising demand for NTS seems to have stimulated a virtuous circle. As demand has grown new innovative services (eg sophisticated call management techniques) have been offered to NTS customers. For example, a pizza delivery company is making use of translation services which route telephone customers' calls to the restaurant nearest to the caller. These innovative services have, in turn, stimulated use of NTS further.

1.14 This review will examine the state of competition in the relevant market for NTS and consider whether there is now effective competition in that market. The rest of this chapter considers the current regulatory framework, and provides a definition of the relevant market (considered in greater detail in Annex I) for the purposes of this review. Chapter Two analyses the current state of competition in the market and Chapter Three presents possible outcomes resulting from the review.

The regulatory framework

1.15 Under Condition 43 of its licence, BT is required to supply telecommunications services (other than those supplied as part of the universal service obligations contained in Part A of its licence) including NTS services, to any person who reasonably requests such services. Linked to this obligation is a prohibition on undue preference and undue discrimination (Condition 57) together with the requirement to notify prices in Condition 58 (Publication of charges, terms and conditions).

1.16 In contrast, most other operators are only required to supply these services if the Director so determines. Accordingly, unless the Director has made such a determination, most other operators are not obliged to provide services (including NTS) under Condition 43 of their licences and they are not therefore, subject to undue preference/discrimination or price notification requirements in relation to the provision of NTS.

1.17 Over 70 per cent of calls involving NTS originate on the BT network. Therefore, BT's interconnection retention continues to be regulated. All other operators are free to set their origination and/or termination charges and, through these, the retail prices for calls to their services. The Oftel publication, *Relationship between Interconnection Charges and Retail Prices for Number Translation Services* (published in December 1999) gives more details of the current regulations in the area of NTS interconnection.

1.18 Condition 43 of its licence requires BT to provide services on reasonable request except to the extent that the Director determines otherwise. BT has made a request for such a determination in relation to certain voice NTS services. In considering whether to make a determination under Condition 43.1 to disapply the obligation to supply in relation to those

NTS services, the Director is required to have regard to all factors (including those listed in Condition 43.4) which appear to him to be relevant. He must also have regard to his duties under section 3 of the *Telecommunications Act 1984*. If the Director decides to issue such a determination at the conclusion of this review, it would also have the effect of removing the obligations on BT not to unduly prefer/discriminate and to notify prices in relation to those NTS services (Conditions 57 and 58 respectively).

1.19 Given BT's request, and Oftel's strategy to withdraw sector-specific regulation where it is no longer necessary to secure the best possible deal for the consumer, it was decided to undertake a review of effective competition in the relevant market for NTS, following the process set out in the Oftel statement, *Implementing Oftel's strategy: Effective competition review guidelines* August 2000. This is in accordance with Oftel's strategy statement.

Market definitions

1.20 Defining the relevant market is a first step in assessing whether or not market power exists in that market. In order to define markets, Oftel uses the standard competition authority approach to market definition (see the Competition Act guidelines, *Market Definition*), the so-called hypothetical monopolist test. This involves considering whether a hypothetical single supplier of a product could profitably enact a small, but significant, increase in price for a non-transitory period. If this is not possible, either because of substitution by consumers to a particular product (demand-side substitution), and/or because of a switch in production by suppliers of an alternative product (supply-side substitution), that product is added to the relevant market and the test performed again until a situation is reached where a hypothetical monopolist is able to enact a small, but significant, non-transitory price increase.

1.21 The detailed analysis of market definition is set out in Annex I. It considers two key issues: whether different types of voice NTS services (freephone, local, national rate etc) should be in the same market, and whether NTS voice and data services belong in the same market. Oftel's current view is that the different types of voice NTS services belong in the same economic market. For instance, a hypothetical monopolist of freephone NTS could not profitably enact a small, but significant, price rise for a non-transitory period without some demand-side substitution taking place, ie customers for freephone NTS would substitute local rate NTS for the freephone version. In addition, supply-side substitution would also take place, ie suppliers of local rate NTS could begin to supply freephone NTS. This view is based on the fact that the intelligent network features which implement number translation for different types of NTS are identical, and the fact that the marketing and distribution mechanisms involved are also similar.

1.22 Consideration of supply side substitution has also led Oftel to the initial view that NTS for premium rate services belong in the same market as other types of NTS – despite the fact that demand side substitution in the case of PRS is likely to be more limited.

1.23 Oftel has also considered whether the possibility of supply side substitution means that NTS for voice services belongs in the same economic market as NTS for data services (as used, for example, by some internet service providers to provide access to the internet at local call rates). Such supply-side substitution has, in the past at least, been possible. The growth of unmetered internet services, however, has meant that traffic is increasingly moving away from using traditional NTS services and towards using digital local exchange (DLE) connection instead. However, to the extent that data calls still use the traditional NTS route,

supply-side substitution between use of NTS for voice and for data could be relevant, although it only appears to be possible for large players as smaller NTS providers do not always possess the necessary call termination exchanges capable of terminating ISP calls.

1.24 Nonetheless, supply-side substitution by larger players alone could, in theory, be sufficient to maintain a common pricing constraint between voice and data NTS. At present, Oftel does not have conclusive evidence as to the extent to which such a constraint operates in practice. In the light of this, and given the limited scope for demand-side substitution between voice and data services, Oftel has adopted NTS services for voice traffic as the relevant market for the purposes of this review. This market includes all the services which are the subject of BT's request.

1.25 Changes in the relevant markets for internet access, and the extent to which these markets are effectively competitive, are being considered as part of Oftel's *Effective competition review of dial-up Internet access* (July 2001). Some NTS suppliers, including BT, offer other facilities, such as statistical analysis of call patterns, in addition to translation services themselves. But Oftel believes that these firms operate in the same economic market for NTS as those who offer a more basic NTS package since the prices of the translation services themselves are constrained by the availability of similar services from elsewhere.

1.26 Annex I considers all the relevant market definition issues in greater detail. Comments from respondents on the relevant market definition are welcome.

Chapter 2

Indicators of effective competition

2.1 Oftel's guidelines *Implementing Oftel's strategy: Effective competition review guidelines* set out four groups of indicators of effective competition: consumer outcomes; consumer behaviour; market structure; and supplier behaviour. This chapter looks at each group in turn.

Consumer outcomes

2.2 For the purposes of this review, the 'consumers' of NTS are the companies or individuals that use NTS in order to provide callers with services using non-geographic numbers. They are referred to as NTS customers. References to consumers, and consumer outcomes, should be considered references to NTS customers rather than end-users.

A wide range of services available to UK consumers

2.3 The growing use of NTS has meant that operators have become increasingly innovative in the range of services they offer to NTS customers. As well as the basic services themselves, operators also offer facilities which allow sophisticated management of calls, such as the ability to match callers with suitably qualified call handlers.

2.4 Most suppliers of NTS tend to offer only a limited selection of these more advanced features. Some of the larger operators, however, offer a full range. These operators include BT, Colt, CWC, Energis, Worldcom and NTL. Notably, these larger operators offer tailor-made packages to NTS customers which mean that the latter are not restricted to 'off the shelf' products.

Consumer behaviour

Consumers able to access and use information to help make effective choices

2.5 The fact that NTS customers are often large, well-informed organisations in their own right with a commercial imperative to obtain services at the lowest possible cost, makes it more likely that they will be able to take advantage of market opportunities.

2.6 BT has provided some evidence for this proposition to Oftel. For instance, some examples indicated that NTS customers obtained services from more than one supplier, ie they used one NTS supplier for local rate services, and a different one for national rate services. Such purchasing behaviour could allow customers to compare the price, discounts and quality offered by different NTS suppliers. The transparency of information which results from this strategic purchasing behaviour allows NTS customers to negotiate better deals from their various NTS suppliers. In turn, this makes it less likely that any supplier of NTS will be able to exercise market power.

2.7 Nor are the benefits of competition necessarily confined to larger operators. It is possible for small and medium sized enterprises to enter into joint purchasing agreements which allow them to gain better terms and conditions than otherwise possible - although the number of these is currently limited.

Absence of barriers to consumers switching suppliers

2.8 If there were significant costs associated with moving NTS customers from one operator to another, then this could inhibit competition and confer market power on one or more operators. For instance, large switching costs could arise from the fact that NTS customers may invest considerable amounts in promoting particular telephone numbers to callers. These NTS customers may then be deterred from switching between NTS operators if that involved changing telephone numbers.

2.9 However, the advent of number portability has reduced these switching costs significantly. It is now possible for NTS customers to switch between different suppliers whilst keeping the same telephone numbers as previously.

2.10 These low switching costs have meant NTS customers have been prepared to move from one operator to another in order to obtain better prices, terms and conditions. Oftel asked BT to provide information on the proportion of its numbers which had been ported to other NTS suppliers since 1997. This evidence suggested that the extent of porting had increased significantly in recent years with 3.33% of numbers being ported in 1997-98, rising to 17.67% in 2000-01.

2.11 There are still likely to be some costs associated with switching. For instance, the transaction costs in finding, and negotiating with, alternative suppliers. Alternatively, there may be barriers to switching if NTS customers are tied to lengthy contracts. The level of switching which has occurred in recent years suggests however that these barriers to switching are not extremely high.

2.12 The availability of portability, combined with the fact that NTS customers are able to make use of the opportunities available to them, therefore provides evidence for the proposition that the market for NTS is effectively competitive.

Market structure

Changes in market structure over time

2.13 There are a large number of suppliers of NTS. Over 150 companies have blocks of numbers which can be used to provide NTS. However, not all of these companies are active in the market. Nevertheless, there has been a significant degree of entry into the NTS market in recent years. Figures provided by BT indicate that the number of other licensed operators (OLOs) terminating NTS calls originated on the BT network rose by over 50 per cent (from 61 to 94) between March 1999 and December 2000. It is possible that this number underestimates the total number of NTS suppliers since it does not include information from other originating operators.

2.14 It is also notable that many firms offer all of the different types of NTS, ie NTS for freephone services as well as for local, national rate and premium rate services. Evidence on the barriers to entry into the market (see paragraphs 2.19-2.23) also indicates that firms are able to enter the NTS market relatively easily.

Market shares by network operator

2.15 As discussed in Annex I, Oftel believes the relevant market includes all the various types of voice NTS services.

2.16 Oftel has sought market information from different NTS suppliers. The fact that there are approximately a hundred different suppliers of NTS, however, has made it difficult to derive a complete set of market share figures. Nevertheless, BT's position in the origination of NTS calls means that it is possible to use figures for traffic carried over its network as an indicator of different market shares. This was also the approach used in Oftel's previous consideration of competition in the NTS market (see the 1998 statement, *Tariffing Issues: Bundling of Inbound and Outbound Services*). Oftel has however acknowledged that the data excludes calls originated on non-BT networks and does not incorporate the effects of number portability, which lead some non-geographic calls to be terminated by an operator other than the one to whom a particular number is allocated.

2.17 Evidence taken from the BT call sample database suggests that BT's market share in NTS calls fell significantly between 1997 and 2000. BT estimates that for September 1996, it accounted for around 81% of all 0800 call minutes and 62% of all 0845/0345 call minutes. But the most recent figures indicate that it provides NTS services for approximately a third of the total amount of NTS voice calls originated on its network, and a similar amount if voice and data calls are considered together. Combined with the entry of other firms into the NTS market, this suggests that the overall level of concentration in the industry has decreased markedly in recent years, although it is not possible to be conclusive on this point given the shortage of data.

2.18 BT's share in the market for voice NTS services (approximately one third) is not at a level which would normally be taken to indicate individual dominance, which would be indicated by the ability of a firm to behave to an appreciable extent independently of its competitors, customers and ultimately of its consumers. The Competition Act guidelines, *The application in the telecommunications sector*, March 2000, state that it is "unlikely that an undertaking will be dominant individually if its market share is below 40 per cent."

Limited entry barriers which would make the threat of entry a competitive discipline

2.19 The extent to which the behaviour of undertakings in a particular market is constrained by the threat of entry from other undertakings is an important factor in assessing the state of competition. If entry barriers are low, then the incumbent firms will be constrained by the prospect of entry from new firms and are thus unlikely to possess market power.

2.20 The market for NTS appears to be one with low entry barriers. There are two main ways of entering the market. One is through acquiring a licence to provide NTS and investing in the necessary infrastructure; the second is to become a reseller of NTS. The availability of this second method means that the sunk costs of entering the market are particularly low. Where the first method is pursued there would have to be some investment in hardware and software, but the costs involved are not such that they would be expected to constitute a significant barrier to entry. The technology used to offer NTS is relatively commonplace, for instance, and is often embedded into the switches used by network operators.

2.21 Not all of the firms with NTS number codes allocated to them are currently active in the market. But if they were to become aware of profitable opportunities available (ie if prices for

NTS were to be raised consistently above the competitive level by one or more operators) many of them could enter the market relatively easily. This fact is likely to restrain the pricing behaviour of the firms currently supplying NTS to customers

2.22 Other things being equal, entry will be more likely in a growing market than one which is static or declining. The fact that the NTS market has been growing rapidly is thus likely to facilitate entry.

2.23 The number of operators in the market for NTS seems to indicate that the barriers to entry into the market are low. As discussed in paragraph 2.13, the number of operators offering NTS services increased by over 50 per cent between March 1999 and December 2000.

Potential for the leverage of market power

2.24 Although BT has market power in a number of separate telephony markets, it is subject to regulatory obligations which prevent it from leveraging this market power into the market for NTS. For instance, the terms for interconnection offered by BT for NTS calls continue to be regulated. Regulatory obligations governing the provision by BT to NTS customers are not therefore appropriate purely as a result of BT's market power in other related markets.

Supplier behaviour

Active competition on price and quality

2.25 The extent of price competition is difficult to assess given that pricing for NTS tends to be bespoke according to the range and type of services supplied by the telecoms operator. BT's published prices indicate that the prices it charges have fallen significantly since 1995. The amount charged by BT for local rate NTS for instance fell by almost half between 1995 and the present.

2.26 It is also notable that NTS suppliers such as BT are beginning to give service provider payments for national rate calls whereas in the past these have been restricted to premium rate services. In recent years, the level of payments to service providers for national rate and premium rate calls has also increased, suggesting that price competition in those areas is also common.

2.27 The fall in prices may be partly attributable to changes in technology which make it cheaper to offer NTS (eg the integration of the necessary software within network switches), but competition is likely to have played the major part. In particular, it is notable that BT's published prices have tended to fall following the growth of entrants into the market from 1995 onwards and following the introduction of number portability. This suggests that low switching costs have enabled NTS customers to use their enhanced negotiating positions to obtain lower prices.

2.28 The price charged for NTS is only one of the factors in assessing the state of competition. As mentioned above there is a wide range of services offered by different suppliers, including tailor made packages with features such as call management, call routing

and call information. As lower switching costs have stimulated competition in prices, they are also likely to have increased competition in terms of quality.

Profitability, relative prices and efficiency

2.29 Profitability levels may demonstrate market power alongside other indicators of market power, notably market share and low entry barriers. In a competitive market, Oftel would expect prices, and consequently profits, to broadly reflect efficiently incurred costs plus an adequate return on capital. As part of the consultation process for the market review, Oftel will be seeking to obtain additional information from BT and other operators in order to see whether profitability data supports its current views, provided such information can be obtained at reasonable expense to the operator concerned.

Absence of anti-competitive behaviour

2.30 Oftel has not substantiated any complaints and representations relating to BT's behaviour in the provision of translation services to NTS customers.

Absence of collusion

2.31 Given that negotiations over prices tend to be undertaken on an individual basis, it is unlikely that signalling of prices, often associated with tacit price collusion, takes place in the provision of NTS. Furthermore, the fact that prices have declined in recent years, rather than remained stable for long periods, supports the conclusion that outright collusion does not appear to be a feature of this market.

2.32 It is possible however, that the current regulatory obligation on BT to publish prices may lead to more muted competition. Since it is obliged by regulation to publish its prices in advance, it is possible that other companies may use these as a marker to set their own prices. Oftel is currently examining whether price publication obligations are an appropriate regulatory measure, irrespective of the extent of competition in a given market. The consultation document, *BT's regulatory obligations to provide advance notification of price changes and to maintain a published price list*, (June 2001), discusses the issue of price publication obligations in more detail.

Effective competition review: provisional conclusions

2.33 On the basis of the evidence considered, Oftel's initial view is that the relevant market for NTS is effectively competitive. The specific considerations which have led Oftel to its initial view include:

- Prices for voice NTS services have fallen in recent years;
- The fact that barriers to entry into the relevant market are low, as evidenced by the extent of entry in recent years. There are now over a hundred potential suppliers of NTS, and the number of suppliers increased by over 50 per cent between March 1999 and December 2000;
- The costs to customers of switching from one NTS provider to another also seem to be low;

- Customers who obtain NTS from operators seem to be well informed about the range of alternatives available to them and are able to use this information to negotiate favourable prices, terms and conditions with suppliers;
- BT's market share seems to have declined over the past few years, whilst the market shares of its competitors has risen; and,
- The effect of other regulation, including that over NTS interconnection, prevents BT from leveraging its market power in other related markets into the relevant market for NTS.

2.34 These indicators point towards the fact that any market power possessed by BT in the past has been eroded. There is a reasonable expectation that the trend of increased competition will continue as NTS customers become better informed about the opportunities available to negotiate lower bespoke tariffs from the rising number of suppliers in the market. In Oftel's current view, these factors suggest that competition in the provision of voice NTS is effective.

2.35 This initial view will be reviewed in the light of the comments and information received from respondents during the consultation process. Oftel's final conclusions will be published in a statement as soon as possible after the close of consultation later in the year.

Chapter 3

Possible outcomes

Implications for regulation

3.1 Oftel will set out its proposals for withdrawing, amending or continuing with regulation in respect of NTS services in the final statement on effective competition in the relevant market for NTS following the completion of this consultation process.

3.2 If Oftel confirms its initial view that the relevant market for NTS is effectively competitive, the Director currently intends to issue a determination removing, in whole or in part, BT's obligation to supply NTS services under Condition 43 of its licence. BT has requested that Condition 43 of its licence should not apply in relation to particular NTS products that it supplies, namely Freefone, Lo-call, Nationalcall and Premium Rate Services.

3.3 In considering such a determination, the Director will have regard to the state of competition in the relevant market, the factors set out in Condition 43.4 of BT's licence and any other factors he considers relevant. He will also consider his duties as set out in section 3 of the Telecommunications Act 1984. Having considered those matters, if minded to make a determination, he would issue the determination for consultation in accordance with the procedure set out in BT's licence. If such a determination were made, BT would no longer be required to provide certain NTS services under Condition 43. As a result, BT would no longer be subject to price publication and non-discrimination requirements, as set out in Conditions 57 and 58 of its licence, in relation to those services.

3.4 If, however, the Director finds that the relevant market is not effectively competitive, the final statement will examine in greater detail whether the present regulatory framework secures the best deal for the consumer and promotes competition. The Director will still consider, amongst other things, whether it is appropriate to meet BT's request.

3.5 The Director could also consider whether it is appropriate to make a Market Influence determination under Condition 56 of the BT licence. Consideration would be given to such a Market Influence determination if regarded by the Director as necessary to secure effective competition in the relevant market. Furthermore, if the obligations under Condition 57 and 58 remain triggered (by the retention of the Condition 43 obligation or a determination of Market Influence), the Director may also consider whether he would give his consent to relax the price publication obligations under Condition 58 of BT's licence.

Consultation

3.5 Oftel welcomes the views of interested parties on the matters set out in this consultation document. In particular, views are welcome on the following issues:

Market definitions

Q1. The market definitions set out in Chapter 1 (and Annex I) state Oftel's initial view that the relevant economic market includes different types of voice NTS services..

Oftel seeks comments on its market definitions presented in Chapter 1 and discussed in more detail in Annex I.

Prices and consumer outcomes

Q2. Oftel considers that competition on price, and other features, is in evidence.

Comments on these initial conclusions are sought. Do respondents have additional evidence, eg, on profitability levels, relative pricing and efficiency, which provides further information on the extent to which the voice NTS market can be considered effectively competitive?

Q3. Oftel considers that the costs to consumers of switching between different NTS suppliers are low.

Do respondents agree with Oftel's initial views on switching costs? Do respondents have further evidence on the size of switching costs?

Market structure

Q4. Oftel believes that the barriers to entering the market for NTS are low.

Do respondents agree with Oftel's initial views on the size of entry barriers in this market?

Q5. Oftel put forward the view that BT's market share in the provision of NTS has fallen in recent years and that this is evidence that competition in the market has risen.

Do respondents agree that BT's falling market share in recent years provides sufficient evidence that competition in the relevant NTS market is increasing? Do respondents have further information they can provide on market shares?

Conclusions

Q6. Oftel has proposed that the presence of well informed consumers, the low costs of switching between suppliers, the low barriers to entering the market, the declining prices for NTS, together with the observed structure of the market are all consistent with a conclusion that the relevant NTS market is effectively competitive.

Do respondents agree or disagree that this is the case? Why?

Q7. If it is found that the relevant market is effectively competitive, Oftel will consider removal of the existing regulatory obligations on BT, in whole or in part. If the relevant market is not effectively competitive, Oftel will examine in greater detail whether continued regulation in the area is necessary to secure the best deal for the consumer.

Comments are sought from respondents on the effectiveness of the current regulation, and Oftel's proposal to consider removing this regulation if the market is found to be effectively competitive. Comments on the potential costs and benefits of the current regulation are particularly welcome.

Q8. The Director, after the necessary consultation, may issue a determination which lifts, in whole or in part, BT's obligations in relation to NTS.

Comments are sought from respondents on whether any such determination should be broad in scope (eg covering all present and future NTS services) or instead cover a smaller range of NTS services (eg the services for which BT have requested deregulation).

Address for responses

Oftel seeks the views of consumers and industry on the issues raised in this consultation document by 7 December 2001.

Comments should be made in writing and sent to:

Anil Patel

Oftel
50 Ludgate Hill
London, EC4M 7JJ

Tel: 020 7634 8928

Fax: 020 7634 8893

E-mail: anil.patel@oftel.gov.uk

Oftel will publish on its website copies of all non-confidential responses, and they will also be made publicly available in Oftel's Research and Intelligence Unit except where respondents indicate that their response, or parts of it, are confidential. There will be no formal period set for comments-on-comments but respondents are welcome to provide comments on the responses which are made public.

Respondents are therefore asked to **separate any confidential material into an annex which is clearly identified**. In the interests of transparency, respondents are requested to avoid confidentiality markings wherever possible. Appointments to view written comments in Oftel's Research and Intelligence Unit must be made in advance by ringing 020 7634 8617.

The consultation criteria

Oftel considers that this document meets the Cabinet Office code of practice on written consultation documents. The code is reproduced below for convenience. If you have any comments or complaints about this consultation process please contact the Oftel Co-ordinator for the code of practice:

Rob Jex
Oftel
50 Ludgate Hill
London
EC4M 7JJ
e-mail: rob.jex@oftel.gov.uk
tel: 020 7634 5340
fax: 020 7634 8943

- 1) Timing of consultation should be built into the planning process for a policy (including legislation) or service from the start, so that it has the best prospect of improving the proposals concerned, and so that sufficient time is left for it at each stage.
- 2) It should be clear who is being consulted, about what questions, in what timescale and for what purpose.
- 3) A consultation document should be as simple and concise as possible. It should include a summary, in two main pages at most, of the main questions it seeks views on. It should make it as easy as possible for readers to respond, make contact or complain.

- 4) Documents should be made widely available, with the fullest use of electronic means (though not to the exclusion of others), and effectively drawn to the attention of all interested groups and individuals.
- 5) Sufficient time should be allowed for considered responses from all groups with an interest. Twelve weeks should be the standard minimum period for consultation.
- 6) Responses should be carefully and open-mindedly analysed, and the results made widely available, with an account of the views expressed, and reasons for decisions finally taken.
- 7) Departments should monitor and evaluate consultations, designating a consultation co-ordinator who will ensure that all the lessons are disseminated.

Annex I: Market definition of number translation services

The services

A1. Number translation services (NTS) are used by their purchasers (NTS customers) to make use of non-geographic telephone numbers, ie numbers which are used to identify a type of service rather than a geographical location. The translation services convert a telephone number from its non-geographic format into a form which enables it to be routed to a specific location. In addition to providing the translation services, telecoms operators who supply NTS customers may also provide ancillary services such as statistical analysis of call patterns.

A2. The NTS customer, or 'called party', is typically a firm which uses the non-geographic number in the course of its business. The 'calling party' is the end-user of the service provided by the called party. The translation services are not therefore supplied directly to end-users, but are instead supplied to NTS customers who provide services to end-users using non-geographic numbers.

A3. Services provided through the use of non-geographic numbers include sales, marketing, customer support, order handling, customer care, technical support and information services. For instance, banks and building societies may use freephone numbers for handling enquiries about financial services. Premium rate services (PRS) numbers, meanwhile, are typically used by service providers to offer content-based services to callers, eg information helplines, competitions, chatlines, etc.

A4. The use of NTS means that the standard geographical tariff bands do not apply to calls. Instead, the cost to the calling party of ringing a non-geographic number depends on the type of service being accessed. This can range from zero in the case of freephone numbers, to over £3 per minute for some premium rate numbers.

A5. Freephone and local rate services are similar in that the called party pays part, or all, of the costs of the call. In the case of a call to a freephone number (ie calls using the 0500 or 080x number ranges), the called party pays the full cost of the call, whilst the calling party (within the UK) pays nothing. By contrast, the calling party pays up to the cost of a local call for local rate services (calls typically using the 0845 number ranges), regardless of their location in the UK, whilst the called party pays the balance.

A6. In the case of national rate and PRS calls, the called party makes no contribution to the cost of the call, and has the opportunity to collect revenue from the calls. With national rate calls (calls which typically use the 0870 number ranges), the calling party is charged up to the standard national rate no matter where in the UK the call originates. The called party does not face any call charges, and may earn some revenue from the call.

A7. Calls to premium rate numbers (in the range of 09xx) are billed at a higher rate than for a standard phone call; the charges are variable, costing an end-user anything above the national call rate. The calling party pays a charge for the content of the call as well as for the cost of conveyance. As a result, these call types generate revenue for the service provider, whilst the supplier of NTS shares the revenue from each call with the service providers, who operate and promote their services independently. Non-geographic numbers are also used by

internet service providers (ISPs) to provide access to the internet, with ISPs typically using local rate or freephone services for this purpose. Oftel is currently considering competition in relevant internet markets as part of its separate review of dial-up internet access.

Market definition

A8. Oftel's approach to market definition follows that used by the UK competition authorities (see the Competition Act guideline, *Market Definition*) and is in line with those used by EC and US competition authorities. Market boundaries are determined by identifying the constraints on the price-setting behaviour of firms. The two main competitive constraints are the extent to which it is possible for *consumers* to substitute other services for those in question (demand-side substitution) and the extent to which *suppliers* could switch, or increase, production capacity to supply the relevant products (supply-side substitution) following a price increase.

A9. The concept of the 'hypothetical monopolist' is a useful analytical tool for identifying close substitutes in order to set the boundaries of the relevant market. The response of consumers and suppliers to a small but significant, non-transitory price increase by a hypothetical monopolist is assessed. If sufficient consumers could easily switch to alternative (although not necessarily identical) products then the price increase would be unprofitable and the price of the alternative product would act as a constraint on the behaviour of the monopolist. In this case the definition of the economic market should be widened to include both products. This approach can be repeated until a set of products is found where the hypothetical monopolist could profitably maintain an increase in the price that it charged for these goods. In the same way, the reaction of firms supplying related products to a price increase can be considered in order to assess the possibilities for supply-side substitution.

A10. The geographical boundary of the relevant market is the area within which substitution can take place such that the conditions of competition within that area are broadly similar. A similar approach to that outlined above can be taken. If customers can easily purchase from operators located elsewhere or other suppliers can quickly and cheaply begin to offer services in that area, then the scope of the initial geographical market needs to include these areas.

Different types of number translation services

Demand-side substitutability

A11. Firms generally use different types of NTS for different purposes. Freephone numbers have tended to be associated with sales and marketing applications, whilst firms tend to use local and national rate numbers for longer term customer service functions.

A12. This may indicate that businesses regard different types of NTS as part of a portfolio of products, possibly implying that they are complementary rather than being directly substitutable for each other. On the other hand, BT has suggested that since businesses use the full range of NTS services, their prices will effectively constrain each other. For example, a business could readily shift to using NTS for national rate services in response to a small but significant, non-transitory price increase in NTS for local rate services. Oftel does not have any evidence about customer behaviour in relation to changes in relative prices so it has not been possible to assess the extent of this switching behaviour.

A13. It is likely, however that PRS calls face different demand-side influences to other types of calls using NTS. Given the different function and charging system involved with PRS, firms may be unlikely to regard NTS for premium rate numbers as close substitutes for other types of NTS. It seems likely that the possibility for demand-side substitution between NTS for PRS and NTS for national rate calls is fairly weak, since premium rate calls are generally used by service providers to generate revenue. Although national rate calls allow service providers to derive some revenue from payments, it does not allow the same scale of revenue that PRS allows. If the price of NTS for PRS were to rise by a small but significant amount, therefore, it seems unlikely that there would be a large scale shift by NTS customers to NTS for national rate calls, for example.

Supply-side substitutability

A14. In contrast to the possibility for demand-side substitution, there is considerably more scope for supply-side substitution in response to a small but significant, non-transitory increase in the price of one category of NTS. For example, if a hypothetical monopolist supplier of local rate NTS increased the price of its services it seems likely that operators providing freephone, national call rate or PRS would be able to quickly switch into supplying NTS for local rate calls without having to make substantial additional investments. Once an operator has established the intelligent network platform to terminate NTS calls, it can be used equally for all types of NTS voice calls. In addition, the marketing and distribution systems for the various types of NTS are likely to be very similar. In support of this view Oftel observes that it is fairly commonplace for terminating operators to offer the full range of NTS services. This provides some evidence of the ability of operators to practise supply-side substitution.

Geographical market

A15. It seems clear to Oftel that the relevant geographical market is national. As noted in the 1998 statement, *Tariffing Issues: Bundling of Inbound and Outbound Services*, an operator does not require a national network in order to provide the NTS call termination services to businesses across the UK; it is sufficient for operators to be able to interconnect with the networks of BT and other operators to provide a national service.

Voice and data markets

A16. BT has proposed to Oftel that the relevant market for NTS should cover voice services only. The suggestion was that there is a distinct market for NTS for data services (predominantly used to obtain access to the internet). Oftel has considered this issue with reference to the hypothetical monopolist test.

A17. If a sole supplier of NTS for data services increased the price by a small but significant amount (for a non-transitory period of time) it seems likely that NTS customers would not find NTS for voice services effective substitutes. This conclusion reflects the fact that callers are currently limited in their ability to substitute voice for data services.

A18. The possibility of supply-side substitution also needs to be considered, however. Internet traffic is increasingly moving away from using traditional NTS services through digital local exchange (DLE) connection. This is outside the scope of this review and it should also be noted that competition in internet markets is being considered as part of Oftel's

review of dial-up internet access. However, to the extent that data still uses the traditional NTS route, supply-side substitution between use of NTS for voice and for data could be relevant, although it only appears to be possible for large players as smaller NTS operators do not always possess the necessary call termination exchanges capable of terminating ISP calls. Nonetheless supply-side substitution by larger players alone could in theory be sufficient to maintain a common pricing constraint between voice and data NTS.

A19. At present, Oftel does not have conclusive evidence as to the extent to which such a constraint operates in practice. In the light of this, and given the very limited scope for demand-side substitution between voice and data traffic, Oftel has adopted as the relevant market for the purposes of this review the use of NTS for voice, which includes all the services which are the subject of BT's request.

Services additional to NTS

A20. Some of the larger NTS suppliers, including BT, offer other facilities, such as statistical analysis of call patterns, in addition to translation services themselves. But Oftel believes that these firms operate in the same economic market for NTS as those who offer a more basic NTS package since the prices of the translation services themselves are constrained by the availability of similar services from elsewhere.

Relevant product market – summary

A21. Although there is an argument to suggest that chains of substitution link different types of NTS products, it appears to Oftel that the link between national call rate and PRS is potentially weaker on the demand-side. However, it is not appropriate to use demand-side substitution only to define the relevant market; the competitive constraint offered by the prospect of supply-side substitution also has to be taken into account. The fact that suppliers of one type of NTS for voice traffic can readily supply other types of NTS leads Oftel to the initial view that different types of NTS for voice should be included within the same market.

A22. The scope for demand-side substitution between voice and data traffic is very limited. However, it is possible that there is some supply-side substitution. At present, Oftel does not have conclusive evidence as to the extent to which such supply-side substitution takes place, especially given the recent shift of data traffic away from traditional NTS services. Oftel has therefore adopted the use of NTS for voice traffic as the relevant market for the purposes of this review.

Annex II: Overview of BT's NTS products

A23. The following gives a brief overview of BT's NTS products. The translation services for which BT is seeking deregulation are:

Freefone: A toll-free service which enables customers (which means the organisation to which the calls are made) to be called free of charge from anywhere in the UK. The customer (the called party) pays the full cost of the call.

Lo-call: Customers can be called from anywhere in the UK at a local call rate. The caller pays the local rate and the customer pays the balance.

Nationalcall: Customers can be called from anywhere in the UK at the national rate. The caller pays the full national rate and the customer pays nothing. BT may make a call payment to the customer.

Premium Rate Service (PRS): Caller pays for the cost of the call together with a variable charge for the content of the call. Customers earn revenue from the calls.

A24. Freefone, Lo-call, Nationalcall and Premium Rate Services can be delivered by three methods:

- Basic translation to a specified number
- Using advanced features to route calls based on pre-determined criteria
- Using intelligent call routing which offers dynamic call routing functionality.

A25. BT may also provide a range of statistics packages allowing customers to analyse call patterns.

A26. BT's price list at <http://www.serviceview.bt.com/list/homepage.htm> provides more details of these services.

Annex III: Glossary

Barriers to entry – an additional cost which must be borne by entrants but not by firms already in the industry; or other factors, which enable an incumbent to maintain prices above the competitive level without inducing entry.

BT - British Telecommunications plc.

BT's licence - the licence granted to BT on 22 June 1984.

Digital Local Exchange (DLE) – the telephone exchange to which customers are directly connected.

Interconnection – the physical and logical linking of telecommunications networks used by the same or a different organisation in order to allow the users of one organisation to communicate with users of the same or another organisation, or to access services provided by another organisation. Services may be provided by the parties involved or other parties who have access to the network.

Internet service provider (ISP) – a service provider who provides access to internet services

Market power – the ability to profitably raise prices above the competitive level for a non-transitory period.

Non-geographic number - these are numbers which are used to identify a type of service rather than a geographical location. These services are sometimes referred to as Specially Tariffed Services and include freephone, local rate, national rate and premium rate numbers. Mobile and Personal numbers are also non-geographic numbers.

Number portability – number portability between operators enables a customer to transfer from one operator to a second operator and retain the same number provided the customer remains at the same address.

Number Translation Services (NTS) - the process associated with the routing of a non-geographic number to a network termination point, eg, the number is translated from its non-geographic format into a geographic number to enable it to be routed to a specific location.

Other Licensed Operators (OLO) - companies, other than BT, which operate telecommunications systems

Premium Rate Service (PRS) – services, including recorded information and live conversation, run by independent service providers. All calls to these companies are charged at a higher rate than ordinary calls to cover the companies' costs in providing the content of the call and the operator's cost for the special network facilities needed.