

NTS call termination market review

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Consultation

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Section 1

Summary

Introduction

- 1.1 A new regulatory framework for electronic communications networks and services entered into force in the UK on 25 July 2003. The basis for the new framework is five new EU Communications Directives that are designed to create harmonised regulation across Europe. Four of these Directives have been implemented in the UK via the new Communications Act 2003 (the “Act”). The fifth has been implemented by Regulations that came into force on 11 December 2003.
- 1.2 The Act provides for functions, powers and duties to be carried out by Ofcom (the Office of Communications), which include, inter alia, functions, powers and duties flowing from the four EC Communications Directives referred to above.
- 1.3 The new Directives require National Regulatory Authorities (“NRAs”), such as Ofcom, to carry out reviews of competition in communications markets to ensure that regulation remains proportionate in the light of changing market conditions.
- 1.4 In this document, Ofcom undertakes a review of the market for Number Translation Services (NTS) call termination in the UK.
- 1.5 Ofcom has been prompted to undertake this review of NTS call termination at this time for two reasons:
 - Firstly, Ofcom is currently re-examining the regulatory regime for NTS (a consultation will be published separately). As part of this re-examination, Ofcom considers several policy options that would involve to varying degrees the removal of regulatory support for revenue sharing on NTS number ranges. Given this change, the competitive and regulatory model for some or all NTS call types might, in future, arguably be expected to more closely follow the existing model for geographic calls. In this context, it is appropriate to consider whether any of the competition issues surrounding geographic call termination also apply in the case of some or all NTS numbers, both before and after the adoption of any new regulatory model.
 - Secondly, and more importantly, the need for this review derives from the fact that, since 1st May 2004, NTS markets have been characterised by a new feature, namely differential termination charges based on the identity of the Originating Communications Provider (OCP), i.e. BT charging other OCPs more than it charges itself. These charges were introduced by BT under Network Charge Change Notice 500 (NCCN 500). Previously, such differential charging was not observed, meaning that, in all cases where BT was involved as either an originating, transit, or terminating Communications Provider, the amount paid for NTS call termination by BT to the Terminating Communications Provider (TCP) had been effectively determined by the retail price for that class of call on the BT network and the interconnection arrangements put in place by Oftel as remedies to BT’s Significant Market Power (SMP) in wholesale NTS call origination. Under NCCN 500, this is still the case for calls that are originated on BT’s network, but not for calls that originate on a non-BT network and which terminate on the BT network.

Identification of markets

- 1.6 The products and services under consideration in this market review are the NTS call termination services provided between OCPs (or a transit communications provider) and TCPs. Ofcom proposes to identify the following economic wholesale market in accordance with competition law principles, for the purpose of ensuring that regulatory obligations are appropriate, proportionate and objectively justifiable: - **NTS call termination in the UK.**
- 1.7 The reasoning behind this market definition is explained in Section 3.

Assessment of market power

- 1.8 Having analysed the operation of these markets, and taken the utmost account of the Commission's Guidelines on market analysis and the assessment of significant market power (SMP) ("SMP Guidelines"), Ofcom proposes that BT has significant market power in the market identified above. The details of Ofcom's approach to the assessment of market power, together with its analysis in relation to the market for NTS call termination, are contained in Section 4.

Regulatory remedies

- 1.9 Based on the evidence presently available to it, Ofcom proposes to impose two SMP service conditions – an obligation to provide Network Access and an obligation not to discriminate. The detail of the proposed regulatory remedies, and the approach taken by Ofcom when setting those remedies, are contained in Section 5.

Final steps

- 1.10 Consultation on the proposals set out in this market review closes on 7 January 2005. Ofcom intends to publish a second consultation in the first quarter of 2005.

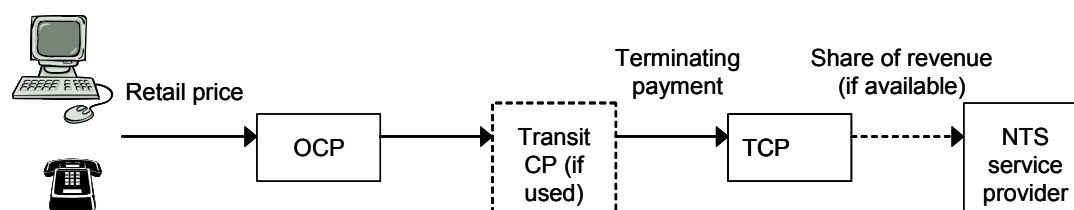
Section 2

Introduction

What is NTS?

- 2.1 NTS calls are calls to numbers identified in the National Telephone Numbering Plan¹ ('the Plan') as Special Service numbers (broadly, numbers that start with 08 or 09). In addition, NTS includes calls to the legacy 0500 Freephone numbers, which, whilst still in use, are not listed in the Plan as they are no longer available for new allocations. Calls to 0844 04 numbers for Surftime internet access services and calls to 0808 99 numbers for FRIACO are not included.
- 2.2 NTS numbers are examples of non-geographic numbers in that the number dialled does not relate to a specific geographic location, but instead relates to a particular service. At a technical level, the NTS number dialled by a caller is 'translated' by the network to a geographic number to deliver the call to its destination.
- 2.3 For a given NTS call, there can be several different Communications Providers (CPs) involved in conveying the call from the caller to the organisation or individual receiving the call. This includes an Originating Communications Provider (OCP), on whose network the call commences, and a Terminating Communications Provider (TCP), on whose network the NTS number resides. The OCP and the TCP may be the same for some calls. There may also be a CP carrying the call between the OCP and the TCP (this is known as a 'transit' service).
- 2.4 A key feature of NTS is that the regulatory framework makes revenue sharing possible between the TCP and the organisation or individual receiving the call. In this way, the regulatory regime supports the use of NTS as a micro-payment mechanism for the various services which can be accessed via 08 and 09 numbers. The caller pays the OCP for the call. The OCP passes on a terminating payment to the TCP, who is then able (subject to commercial viability) to share some of this revenue with the individual or organisation using the NTS number². These relationships are shown diagrammatically in Figure 1.

Figure 1: Parties involved in an NTS call



¹ The Plan is a document that Ofcom is required to publish under Section 56 of the Communications Act 2003 setting out the telephone numbers made available for allocation by Ofcom.

² For a fuller description of how Ofcom has used the phrase 'terminating payment' in the context of this document, see the discussion at paragraph 3.21.

- 2.5 The revenue share available to the SP depends on the retail price of the call, which in turn varies by number range. The NTS ranges are designated for use as follows:
- 080 (freephone): usually free to caller;
 - 0844: up to and including 5p per minute or per call for BT customers;
 - 0845: standard local call price for BT customers before discounts and call packages;
 - 0870: standard national call price for BT customers before discounts and call packages;
 - 0871: up to and including 10p per minute or per call for BT customers; and
 - 09: generally over 10p per minute or per call for BT customers (also commonly known as 'premium rate services').
- 2.6 NTS numbers are used by organisations and individuals to provide access to a very wide range of services from dial-up Pay As You Go (PAYG) internet access to financial services, road traffic advice and tele-voting on TV programmes. Ofcom does not have any reliable quantitative data on the types of services using different NTS number ranges, but believes that the general picture is as follows:
- Freephone numbers (0800 and 0808) are principally used to access private sector voice services such as sales lines and helplines; and telephony services provided by two stage indirect access service providers;
 - 0844 and 0845 numbers are used extensively to access PAYG internet services (predominantly using 0845 numbers), and also support a wide range of other services, including pre- and post-sales enquiry lines, public sector services, transaction services and information services;
 - 0870 and 0871 numbers are principally used to provide access to pre- and post-sales enquiry lines, some public sector services and services such as the international telephony services provided by resellers. Recent evidence also indicates that they are now being used to support some sexual entertainment services (SES); and
 - premium rate (09) numbers are used mainly to access SES services, chatlines, voting services and some post-sales services such as technical support. 09 call volumes have been growing rapidly - these grew by 31% between 2002 and 2003. The recent growth in call volumes has been driven principally by the increasing popularity of TV programmes in which viewers are invited to express a preference by calling a premium rate number.

The current regulatory regime

- 2.7 Current regulatory policy for NTS calls was established in 1996 with the aim of encouraging the growth in the provision of access to new and cheaper, value added services via the telephone. The policy is based on the principle that BT, because of its market power in wholesale call origination, should retain only cost-related charges for originating and retailing NTS calls, and must pass the remaining revenues over to the TCP on whose network the call ends. These termination revenues are often sufficient to support revenue sharing with organisations using NTS numbers for inbound calls.
- 2.8 The key elements of this policy were retained following the introduction of a new regulatory regime for electronic communications networks and services on 25 July, 2003, based on five new EU Communications Directives. Under the new regime, Ofcom

carried out a series of market reviews, one of which covered the wholesale market for call origination³. As a result of this review ('the Call Origination Market Review'), Ofcom concluded that BT has SMP in the wholesale call origination market and, as a remedy, imposed an NTS call origination condition on BT ('the BT NTS Call Origination Condition'). A copy of the BT NTS Call Origination Condition is included as Annex 5 of this document.

- 2.9 A key feature of the BT NTS Call Origination Condition is an obligation on BT both to originate and to retail calls to NTS numbers on behalf of TCPs. This creates a mechanism for TCPs to collect micro payments from consumers and to share these payments with service providers using NTS numbers to provide content or other services, without TCPs or NTS SPs having to bill consumers directly themselves. BT is only permitted to make cost-related charges for originating and retailing NTS calls and must pass the remaining revenues over to the TCP.
- 2.10 Retail prices for NTS calls are not currently subject to regulation. However, under the National Telephone Numbering Plan, the various NTS number ranges have different designations for use, some of which relate to retail pricing. For example, the 080 range is designated as a range where no charges are made to customers unless those charges are notified to the customer at the beginning of the call. In selecting a particular NTS number block, a TCP takes on an obligation to use the numbers in accordance with the designations given in the Plan. In this sense, the TCP is restricted in its use of NTS numbers.
- 2.11 Charges for the termination of NTS calls are not currently subject to regulation.

Ofcom's re-examination of the NTS regime

- 2.12 This review is part of a wider re-examination of the NTS framework that Ofcom is currently undertaking. The re-examination is the subject of another Ofcom consultation *Number translation services: options for the future* ('the NTS Policy Options Consultation') which will be published separately.
- 2.13 The NTS Policy Options Consultation includes a detailed description of the current NTS regime and the concerns that led Ofcom to undertake the reviewer-examination. The consultation defines a range of policy options designed to address these concerns. Ofcom has expressed an initial view that changes should be made to the pricing and interconnect arrangements for NTS and that these should be implemented in conjunction with a package of consumer protection measures. Under the changes to the pricing and interconnect arrangements that Ofcom proposes, BT's retail prices for 0845/0870 calls would no longer be related to BT's retail prices for geographic calls, and TCPs would be able to select retail prices for their services on the BT network.
- 2.14 The closing date for responses to the NTS Policy Options Consultation is 7 January 2005.
- 2.15 The linkage between this review, Ofcom's re-examination of the NTS framework and other Ofcom work on NTS are explored in more detail in the NTS Policy Options Consultation. This market review should be read in conjunction with the NTS Policy Options Consultation and the reasoning contained therein.

³ Ofcom published its Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets (Explanatory Statement and Notification) on 28 November 2003 ('the Call Origination Market Review'). The Call Origination Market Review is available on Ofcom's web site at:

http://www.ofcom.org.uk/legacy_regulators/ofcom/narrowband_mkt_rvw/fixednarrowbandstatement.pdf

Further background to this review

- 2.16 Ofcom has been prompted to undertake this review of NTS call termination at this time for two reasons.
- 2.17 Firstly, as outlined above, Ofcom is currently re-examining the framework for NTS and on 22 October 2004 issued the NTS Policy Options Consultation. This considers several policy options for changes to the current regulatory regime. These involve, to varying degrees, the removal of regulatory support for revenue sharing on NTS number ranges. Given this change, the competitive and regulatory model for some or all call types might, in future, arguably be expected to more closely follow the existing model for geographic calls. In this context, it is appropriate to consider whether any of the competition issues surrounding geographic call termination also apply in the case of some or all NTS numbers, both before and after the adoption of any new regulatory model.
- 2.18 Secondly, and more importantly, the need for this review derives from the fact that, since 1st May 2004, NTS markets have been characterised by a new feature, namely differential termination charges based on the identity of the OCP, i.e. BT charging other OCPs more than it charges itself. These charges were introduced by BT under Network Charge Change Notice 500 ("NCCN 500"). Previously, such differential charging was not observed, meaning that, in all cases where BT was involved as either an originating, transit, or terminating CP, the amount paid for NTS call termination by BT to the TCP had been effectively determined by the retail price for that class of call on the BT network and the interconnection arrangements put in place by the BT NTS Call Origination Condition. Under NCCN 500, this is still the case for calls that are originated on BT's network, but not for calls that originate on a non-BT network and which terminate on the BT network. The shares of the termination payment retained by the TCP and the NTS service provider respectively are determined in the market for termination services sold by TCPs to NTS SPs (the competitiveness of which is not examined in this consultation). NCCN 500 gave rise to concerns that BT might have SMP in the market for NTS call termination (which had not previously been reviewed by Ofcom) and that the current wholesale call origination and interconnect arrangements might be a contributory factor. There were two main concerns:
- the BT NTS Call Origination Condition and the current designations in the Plan for 0845 and 0870 numbers⁴ in effect prevent TCPs from raising their own termination charges to BT for 0845 and 0870 calls originating on the BT network; and
 - each of the alternatives available to OCPs in response to BT's NCCN 500 charges appeared unlikely to constrain BT as would be the case in an effectively competitive market:
 - if the OCP raised its retail prices for NTS calls terminating on the BT network, its retail service offering would become less competitive than BT's;
 - similarly, if the OCP refused to carry the traffic for NTS numbers on the BT network its retail service offering would become less competitive than BT's;
 - if the OCP absorbed the additional cost of BT's NCCN 500 charges its competitiveness in relation to BT would be reduced since BT does not incur similar costs (and BT would not be constrained because the demand for its termination services would not be affected by it having increased its charges) .

⁴ The Plan stipulates that 0845 and 0870 calls originating on the BT network must be charged at BT's standard local and national geographic call rates.

- 2.19 The effectiveness or otherwise of the options available to other CPs in constraining BT's behaviour are a key part of the SMP assessment and are explored in more detail in Section 4.
- 2.20 Prior to NCCN 500 it had therefore been Ofcom's view that any potential departures from effective competition in NTS call termination that arose from the calling party pays arrangement (see below) were in effect prevented by a combination of:
- the BT NTS Call Origination Condition;
 - the retail pricing arrangements for NTS calls; and
 - BT's voluntary practice of not setting differential termination charges on the basis of the identity of the OCP, i.e. behaving in a reciprocal fashion.
- 2.21 Given that BT has now chosen to abandon its reciprocal conduct, i.e. it now engages in differential charging, it is necessary to consider whether BT's increased terminating charges to OCPs might be constrained by the actions of OCPs (or any other players).

Scope of this review

- 2.22 This review considers the market for NTS call termination in the UK. It should be read with Ofcom's NTS Policy Options Consultation where appropriate.

Market reviews

- 2.23 The new Directives referred to in Section 1 require National Regulatory Authorities ("NRAs") such as Ofcom to carry out reviews of competition in communications markets to ensure that regulation remains appropriate in the light of changing market conditions.
- 2.24 Each market review has three parts, namely:
- definition of the relevant market or markets;
 - assessment of competition in each market, in particular whether any companies have SMP in a given market; and
 - assessment of the appropriate regulatory obligations that should be imposed where there has been a finding of SMP (NRAs are obliged to impose some form of regulation where there is SMP).
- 2.25 More detailed requirements and guidance concerning the conduct of market reviews are provided in the Directives, the Act, and in additional documents issued by the European Commission, Oftel/Ofcom, and the Office of Fair Trading (OFT). As required by the new regime, in conducting this review Ofcom has taken the utmost account of the two European Commission documents discussed below.

EC Commission "Recommendation on relevant product and service markets"

- 2.26 In its Recommendation on relevant product and service markets (the "Recommendation"), the Commission has identified a set of markets in which ex ante regulation may be warranted. The Recommendation seeks to promote harmonisation across the European Community by ensuring that the same product and service markets are subject to a market analysis in all Member States. However, NRAs are able to regulate markets that differ from those identified in the Recommendation where this is justified by national circumstances. Accordingly, NRAs are to define relevant

markets appropriate to national circumstances, provided that the utmost account is taken of the product markets listed in the Recommendation (section 79 of the Act).

EC Commission “Guidelines on market analysis and the assessment of SMP”

- 2.27 The European Commission has also issued Guidelines on market analysis and the assessment of SMP (“SMP Guidelines”). Oftel produced additional guidelines – see *Oftel's market review guidelines: criteria for the assessment of significant market power*, http://ofcom.org.uk/static/archive/oftel/publications/about_oftel/2002/smpg0802.htm. Ofcom is required to take these guidelines into account when identifying a services market and when considering whether to make a market power determination under section 79 of the Act. These guidelines supplement the SMP Guidelines and replace Oftel’s effective competition guidelines issued in August 2000.

Obligation to inform the Commission and other NRAs

- 2.28 Although this is Ofcom’s national consultation in accordance with Article 6 of the Framework Directive, Ofcom has sent this document to the European Commission for its information. Ofcom intends to publish a second consultation in the first quarter of 2005 which will set out Ofcom's draft measures in accordance with Article 7 of the Framework Directive.

Final steps

- 2.29 Consultation on the proposals in this document closes on 7 January 2005.

Markets considered in this review

- 2.30 This market review relates to the market for NTS call termination.
- 2.31 The market reviews are required to be forward looking in their analysis. It is envisaged that there will be another market review of the services covered by this review in the next one and a half to two years (although precise timing will be a matter for Ofcom) and therefore the analysis will look forward over that time period.

Existing regulation in this market

- 2.32 There is currently no regulation imposed within this market.

The impact of regulation in other markets

- 2.33 The purpose of Ofcom’s market definition is to inform the assessment of market power and identify appropriate remedies in the relevant market. The market definition exercise in any assessment of market power in downstream markets must be conducted in the presence of any proposed regulation in markets that are further upstream, since the presence of any such regulation may provide a constraint at the downstream level by removing barriers to entry. As is shown in Figure 2 NTS call termination is the furthest upstream of the relevant communications markets that are discussed in this analysis. This means that the market definition is carried out assuming that no regulation is in place in other markets. However, as outlined in Section 4, the workings of the NTS regime are such that downstream regulation (relating to BT’s position as an OCP) has an impact on the SMP assessment for NTS call termination. NTS call termination is one of a number of inputs that goes into the provision of retail calls to NTS numbers, meaning that formally setting out the retail market would not provide any further insights with regard to the analysis of NTS call termination.

Section 3

Market definition

Introduction

Identification of markets

- 3.1 Section 79(1) of the Act provides that before a market power determination may be considered, Ofcom must identify the markets in which, in its opinion, circumstances in the United Kingdom are such that it is appropriate to consider such a determination and to analyse those markets. Ofcom is required to take the utmost account of all applicable guidelines and recommendations issued by the European Commission. Ofcom is required to issue a notification of its proposals. It is entitled, by virtue of section 79(5) of the Act, to issue this notification with its proposal as to a market determination and with its proposals for setting SMP services conditions. As this is a national consultation, the proposed notification at Annex 4 is the draft notification containing all such proposals and at this stage has been provided to the Commission for information purposes only.
- 3.2 The purpose of this section is to define the relevant wholesale markets in which the assessments of market power are to be undertaken. The definition of the relevant market itself follows a discussion of Ofcom's general approach to market definition.

Commission's approach to market definition

- 3.3 Recital (7) of the Recommendation clearly states that the starting point for market definition is a characterisation of the retail market over a given time horizon, taking into account the possibilities for demand and supply-side substitution. The wholesale market is identified subsequently to this exercise being carried out in relation to the retail market. This approach is repeated in paragraph 3.1 of the main Recommendation and is exactly that set out above and followed by Ofcom. Ofcom's approach in this regard is outlined at paragraph 2.33 above.
- 3.4 Paragraph 3.1 of the Recommendation states that because market analysis is forward – looking, markets are defined prospectively taking account of expected or foreseeable technological or economic developments over a reasonable horizon linked to the timing of the next market review. Again, this is the approach followed by Ofcom.
- 3.5 Paragraph 3.1 of the Recommendation also states that market definition is not an end in itself, but a means to assessing effective competition for the purposes of ex-ante regulation. Ofcom has adopted an approach by which this consideration is at the centre of its analysis. The purpose of market definition is to illuminate the situation with regard to competitive pressures. For example, Ofcom's approach to supply-side substitution explicitly identifies as the key issue the question of whether additional competitive constraints on pricing are brought to bear by additional suppliers entering the market. Thus, the key issue is not the market definition for its own sake, but an identification of the extent and strength of competitive pressures.
- 3.6 Paragraph 4 of the Recommendation states that markets should be examined in a way that is independent of the infrastructure being used, as well as in accordance with the principles of competition law. Again this approach is key to Ofcom's analysis. Ofcom's approach is based on a competition law assessment of markets and an assessment of

the extent to which switching among services by consumers constrains prices, irrespective of the infrastructure used by the providers of those services.

Account taken of the EU Guidelines/Recommendations

- 3.7 Ofcom has given careful consideration to the markets listed in the Commission's Recommendation. In Ofcom's Explanatory Statement and Notification on the *Fixed geographic call termination markets*, published on, 26th August 2003 (http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/cal_term0803.pdf), Ofcom said at paragraph 2.12 that:

*"In the (Commission's) Recommendation, the Commission defined the market for call termination as **call termination on individual networks**. Ofcom narrowed the market definition to the extent that the Commission's Recommendation could be said to include call termination on **non-geographic** telephone numbers. However, Ofcom has previously found that the markets for call termination on fixed non-geographic numbers are effectively competitive and that the competitive conditions for termination on such numbers are not homogenous with call termination on non-geographic numbers. Barriers to entry into non-geographic call termination are lower and, as the markets for fixed non-geographic services are not strictly 'calling party pays', competitors compete for the terminating consumer."*

- 3.8 The markets referred to in the above reference were examined by Ofcom in 2002 - For details see Effective competition review: dial-up Internet access - 29 January 2002 (<http://www.ofcom.org.uk/static/archive/oftel/publications/internet/imr0102.htm>), and Effective competition review of number translation services - 27 March 2002 (<http://www.ofcom.org.uk/static/archive/oftel/publications/numbering/2002/nts0302.htm>). The markets referred to in those documents were not the market considered as part of this market review which is the market for services in relation to NTS calls provided between OCPs and TCPs. Rather these reviews considered the market for services sold by TCPs to NTS SPs. As outlined in Section 3 and Section 4, competitive conditions differ widely between fixed geographic and NTS call termination, due to the fact that the calling party pays arrangement only plays an important role in the former case.
- 3.9 Ofcom's view is that the market for the service sold by TCPs to NTS SPs is much broader in scope than "termination" and should properly be termed the market for NTS service hosting (although Ofcom is of the view that Ofcom's previous *analysis* of this market if not the name given to it remains valid).

General approach to market definition

- 3.10 There are two dimensions to the definition of a relevant market: the relevant products to be included in the same market and the geographic extent of the market. Ofcom's approach to market definition follows that used by UK competition authorities, see Office of Fair Trading Market Definition Guideline, OFT 403, March 1999, <http://www.ofcom.gov.uk/NR/rdoonlyres/972AF80C-2D74-4A63-84B3-27552727B89A/0/oft403.pdf> which is in line with those used by the European Commission (as set out in its Notice on the definition of the relevant market [http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y1209\(01\)&model=quicheti](http://europa.eu.int/smartapi/cgi/sga_doc?smartapi!celexapi!prod!CELEXnumdoc&lg=EN&numdoc=31997Y1209(01)&model=quicheti) for the purposes of Community competition law) and US competition authorities.

- 3.11 Market boundaries are determined by identifying constraints on the price-setting behaviour of firms. There are two main competitive constraints to consider: how far it is possible for customers to substitute other services for those in question (demand- side substitution); and how far suppliers could switch, or increase, production to supply the relevant products or services (supply-side substitution) following a price increase.
- 3.12 The concept of the 'hypothetical monopolist test' is a useful tool to identify close demand-side and supply-side substitutes. A product is considered to constitute a separate market if a hypothetical monopoly supplier could impose a small but significant, non-transitory price increase (SSNIP) above the competitive level without losing sales to such a degree as to make this unprofitable. If such a price rise would be unprofitable, because consumers would switch to other products, or because suppliers of other products would begin to compete with the monopolist, then the market definition should be expanded to include the substitute products.
- 3.13 In this section, the market will be defined first on the demand-side. The analysis of demand-side substitution will be undertaken by considering if other services could be considered as substitutes by consumers, in the event of the hypothetical monopolist introducing a SSNIP above the competitive level.
- 3.14 Supply-side substitution possibilities will then be assessed to consider whether they provide any additional constraints on the pricing behaviour of the hypothetical monopolist, which have not been captured in the demand-side analysis. In this assessment, supply-side substitution will be considered as a low cost form of entry, which could take place within a relatively short period of time. That is, for supply side substitution to be relevant, there would need to be additional competitive constraints arising from entry into the supply of the service in question, from suppliers who are able to enter quickly and at low cost, by virtue of their existing position in the supply of other services.
- 3.15 There might be suppliers who provide other services but who might also be materially present in the provision of demand-side substitutes to the service for which the hypothetical monopolist has raised its price. However, such suppliers are not relevant to supply-side substitution since they supply services already identified as demand-side substitutes. As such their entry has already been taken into account and so supply-side substitution cannot provide an additional competitive constraint on the hypothetical monopolist. However, the impact of expansion by such suppliers can be taken into account in the assessment of market power.
- 3.16 A third factor that is sometimes an additional consideration is whether there exist common pricing constraints across customers, services or areas such that they should be included within the same relevant market even if demand- and supply- side substitution are not present.

Background and previous market definitions

- 3.17 The services offered in NTS markets can involve a number of participants, including some or all of:
- end users (i.e. consumers who dial NTS numbers)
 - OCPs
 - transit providers;
 - TCPs; and

- NTS service providers.

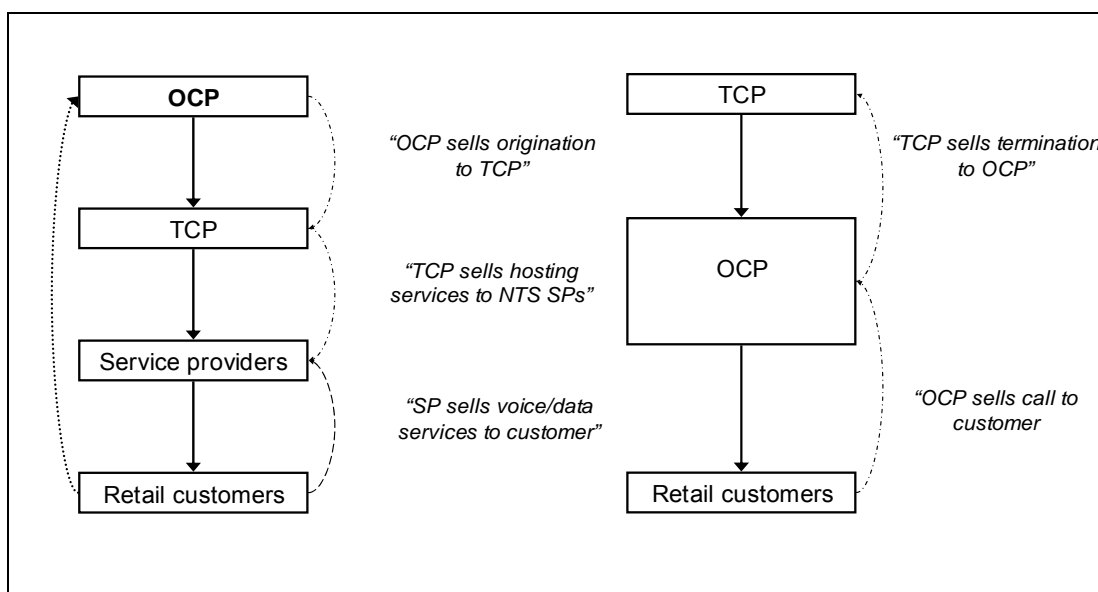
3.18 So there are a number of possible transactions that may take place, up to four (it is useful to simplify by not focusing on the role of traffic being transited via a third party transit provider at this stage); namely transactions between:

- end users and OCPs;
- OCPs and TCPs;
- TCPs and NTS SPs; and
- end users and NTS SPs.

3.19 It is useful to consider two distinct vertical linkages, since, as outlined above, there are effectively two distinct services that are sold to end users (one by OCPs and one by NTS SPs), and NTS call termination plays a slightly different part in each. The figure below demonstrates the key vertical linkages involved in NTS services. In this diagram:

- solid arrows indicate the direction of services that are further downstream; and
- dashed arrows indicate the direction of flows of payments between parties.

Figure 2: Vertical relationship in NTS calls



3.20 Figure 2 shows that, potentially, (absent the existence of billing arrangements of the type that are currently predominant in NTS markets), two distinct participants, the SP and the OCP, might be expected to have a billing relationship with end users. This market analysis focuses on the transactions that take place between OCPs and TCPs. The service in question, at the top of both of the vertical chains shown in the figure above, can be characterised in two ways, namely:

- the sale of origination of NTS calls by OCPs to TCPs; or equivalently
- the sale of termination of NTS calls by TCPs to OCPs.

3.21 For the remainder of this market review, this service will be referred to as “NTS call termination”, and the revenue earned by the TCP will be referred to as the “charge” for termination, including in cases where it refers to revenues that, under current arrangements, are passed from OCPs to TCPs – under such circumstances, a TCP

“increasing the charge” for termination means demanding a greater absolute amount of the per minute revenue collected by OCPs (or TCPs in the case of freephone calls). In the following analysis Ofcom focuses on the predominant case whereby revenue is collected by the OCP. However, it is of the view that its market analysis is equally applicable to all NTS call types. Unless the OCP in question changes its approach to retail pricing, the total amount from which the TCP is entitled to a share remains fixed. So any discussion of a TCP attempting to increase the charge for termination will refer to a TCP attempting to force an OCP to hand over more revenue in exchange for the termination of traffic. It is important to repeat, as stated above in paragraph 3.8 and 3.9 that the following analysis does not refer to the services sold by the TCP to the NTS SP, but rather to the NTS services provided between OCPs and TCPs.

3.22 Ofcom has previously assessed the following markets:

- the markets for the services sold between TCPs and SPs – see paragraph 3.8 for reference; and
- wholesale call origination, i.e. the service used by retail operators as an input in the provision of retail NTS calls, amongst other call types. BT was found to have SMP in the market review carried out in 2003, based on its high market share and high barriers to entry, factors that result from legacy incumbent status. See Ofcom’s market review, *Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets* published 28 November 2003 (http://www.ofcom.org.uk/legacy_regulators/oftel/narrowband_mkt_rvw/fixednarrowbandstatement.pdf)

3.23 Ofcom does not consider it necessary to revisit either of these market definitions or SMP assessments at present (although the NTS Policy Options Consultation does examine several options that might change the NTS call origination remedy). In the remainder of this market review Ofcom analyses the market for NTS call termination, defined as the service sold to OCPs by TCPs.

NTS number ranges and call types

3.24 Ofcom’s market definition and SMP assessment analysis is based on a single market for NTS calls, which is termed, “NTS call termination”. The reason for Ofcom not distinguishing between different call types (e.g. premium rate and so on) is discussed below.

3.25 NTS numbers are used for a wide range of purposes⁵, and SPs choose different NTS number ranges as listed below on which to provide their services in accordance with their differing requirements. The revenues available and wholesale payment arrangements vary substantially by number range, as summarised in the table below (in the interests of brevity, BT’s role as a transit provider is not shown in this figure).

Figure 3: NTS number ranges and call types

NTS number range	Typical retail price	Wholesale payment arrangements
080	Free of charge for calls originating on fixed networks	- SP makes payment to TCP; - TCP makes payment to OCP; - TCP-OCP payment is set by regulation for BT originated calls

⁵ Annex 5 of the NTS Policy Options consultation contains a more detailed description of the uses of NTS.

NTS number range	Typical retail price	Wholesale payment arrangements
0845	Charged at BT's standard local geographic rate for calls originating on the BT network	<ul style="list-style-type: none"> - Customer makes payment to OCP; - OCP makes payment to TCP; - TCP may make a payment to SP; - For BT originated calls, OCP-TCP payment is the difference between the BT retail price and amount BT is allowed by regulation to keep for call origination
0870	Charged at BT's standard national geographic rate for calls originating on the BT network	- As per 0845
0844	Up to and including 5p per minute or per call for calls originating on the BT network	<ul style="list-style-type: none"> - TCP chooses a price point for BT customers in accordance with the designations set out in the Plan; - OCP makes a payment to TCP; - TCP may make a payment to SP; - For BT originated calls, OCP-TCP payment is the difference between the BT retail price and amount BT is allowed by regulation to keep for call
0871	Up to and including 10p per minute or per call for calls originating on the BT network	- As per 0844
09	Generally over 10p per minute or per call for BT customers. Sometimes very high prices (currently up to £1.50 per minute or per call)	- As per 0844

3.26 OCPs typically (e.g. for 084x, 087x and 09 calls) hand a share of the payments made by callers over to TCPs, and this amount represents the charge for termination. In other cases, notably 080 calls, the flow of payments is from SPs to TCPs to OCPs. In this case, the proportion of the payment received from SPs that is kept by the TCP rather than handed over to the OCP represents the “charge for termination”.

3.27 Ofcom's view is that it is not appropriate to distinguish between the number ranges above, i.e. 0845, 0870, etc; in defining the market(s) for NTS call termination. This is on grounds of both demand- and supply-side substitutability, as outlined below.

- 3.28 Ofcom's view is that, from an end user perspective, there is likely to be a degree of demand-side substitutability between calls to all of the above number ranges. Ofcom's consumer research (see Annex 7 of the NTS Policy Options Consultation) shows that some customers have certain perceptions regarding, notably, the relative cost to them of calling each of the number ranges, and as such some may have a preference for calling (or not calling) services hosted on a particular number range.
- 3.29 The basic functionality, however, that is required by customers calling NTS numbers, namely access to the services offered by SPs, remains the same regardless of what number range is used. As outlined in Annex 5 of the NTS Policy Options Consultation, there is a tendency for certain types of NTS SP and/or certain types of service to be hosted on particular number range. However, there are few "hard and fast" rules in this respect. Ofcom's view is that there is almost a continuous range of different services available, each offering a different price-quality mix. The most expensive NTS calls, i.e. calls to premium rate numbers, are likely to be valued most highly by callers, as evidenced by a higher average willingness to pay, and the least expensive, i.e. calls to freephone numbers, are likely to typically be valued more highly by recipients than callers. With the increasing usage of the 0844 and 0871 number ranges by NTS SPs and TCPs, NTS calls are now charged at a large number of different rates, ranging from calls that are free to callers to ones that are charged at over a pound a minute. Whilst a calling customer demanding access to a particular type of service may have some preference for making calls to services hosted on a particular number range, such preferences are likely to be undermined by a SSNIP. In the light of these factors outlined above, Ofcom's view is, based on this availability of a chain of differentiated numbers, that there is likely to be a degree of substitutability between calls to each of the NTS number ranges from the perspective of end users.
- 3.30 A further source of competitive constraint is likely to come from supply-side substitution. For example, if a hypothetical monopolist supplier of local rate NTS call termination increased the charge for its services it seems likely that TCPs providing freephone, national call rate or PRS termination would be able to quickly switch into supplying NTS for local rate calls without having to make substantial additional investments. Once a TCP has established the network platform needed to terminate NTS calls, it can be used equally for all types of NTS voice calls. In addition, the marketing and distribution arrangements for the various types of NTS are likely to be very similar.
- 3.31 Supply side substitution will place additional constraints on TCPs above those captured by demand side analysis only to the extent that there are additional players not already in the market, or equivalently, that are in the market but have a very small presence and therefore do not impose an effective constraint. Such a situation is likely to exist in the case of NTS call termination, since, to some extent, some TCPs specialise in the termination of a certain type of traffic (e.g. only 0845 traffic). This is demonstrated in the table below, which shows that, currently, TCPs terminate quite different mixes of each traffic type. The table shows the percentage split of total terminated minutes of the six largest terminators of NTS traffic between each number range, based on the most recent full year of data.
- 3.32 It is clear from the table below that, in particular, there are a number of terminators of 0845 traffic that do not terminate significant volumes of the other traffic types, The implication of this is that a monopoly supplier of termination on 09 or 0870 ranges

could be additionally constrained by supply side substitution from CPs currently providing termination on 0845 number ranges⁶.

Figure 4: Mix of NTS traffic terminated by six large TCPs

• NTS number range	• TCP1	• TCP2	• TCP3	• TCP4	• TCP5	• TCP6
• Freephone	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%
• Special services basic rate (0845)	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%
• Special services higher rate (0870)	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%
• Premium rate (09)	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%	• [X]%

3.33 Given the above factors, in the market definition and SMP assessment analysis set out below, Ofcom only considers a single product, NTS call termination, which covers all of the NTS number ranges. This market has been identified on the basis of the scope for demand and supply side substitution between number ranges.

3.34 Ofcom is of the view that competitive conditions are likely to be broadly similar across all number ranges, meaning that its SMP analysis is equally applicable to all call types, meaning that its identification of SMP would produce the same results regardless of whether the market was analysed on an aggregate or number range specific basis.

Voice and data traffic

3.35 As outlined in Annex 5 of the NTS Policy Options Consultation NTS is used to support a wide range services, including both voice traffic and narrowband data services. Ofcom’s view is that, in the context of the termination market, it is inappropriate to distinguish between these two traffic types. This is principally because of the existence of a common pricing constraint between the two traffic types. In practice, Ofcom is unaware of any instances of TCPs discriminating between voice and data traffic.

Call termination and the calling party pays arrangement

Introduction

3.36 Before undertaking a fuller discussion of the relevant markets, it is worth briefly discussing the impact of the calling party pays (“CPP”) arrangement that exists in a

⁶ It should be noted that none of the TCPs from which Ofcom has collected data terminated exactly no minutes to a particular number range - the figures in the table below are all rounded to the nearest whole percentage point, meaning that in cases where less than 0.5% of a TCP’s total traffic is to a particular number range the figure is listed as 0% (and also that, in some cases, the row entries in a particular column do not sum to 100%). However, it is clear that there are currently TCPs who are very small players in the context of certain traffic types, and as such will not currently be exerting a significant competitive constraint.

number of telephony markets. Under certain circumstances the CPP arrangement gives rise to an externality (i.e. a benefit arising from transactions that fall on parties who do not participate in it) that can have a significant impact on market boundaries. In the context of the markets for call termination to geographic numbers on fixed networks, and call termination to mobile phones, the externality means that markets are defined on a network specific basis. The extent to which the same set of circumstances might be considered to apply to NTS call termination is discussed below.

- 3.37 Under the CPP arrangement, the calling party, and not the called party, pays the total price of a retail call. This means that the call termination charge is included in the OCP's cost base and is reflected in the retail price paid by its customers for calls originating on its network. CPP can therefore lead to a disconnect between the person paying for the calls and so, indirectly, for the termination charge (the "calling party") and the person who makes the choice of TCP and could thereby influence the level of the termination charge (the "called party").
- 3.38 In the context of calls to fixed geographic numbers and calls to mobile phones, the net effect of this arrangement in the relevant wholesale termination markets is such that TCPs have little incentive to keep call termination charges low. This is because OCPs will pay high charges (and pass these on to their customers), since OCPs have a commercial interest in ensuring that all calls made by their customers are terminated. Customers will be willing to pay higher charges in most cases since from their perspective there are no substitutes for calling a particular subscriber on his or her fixed geographic or mobile number.

Determinants of substitutability

- 3.39 As outlined above, in the context of fixed geographic and mobile call termination, there is a "disconnect" between the party that pays call charges and the party that chooses the network on which calls are terminated. This results in the definition of termination markets on a network specific basis. The text below considers, in relation to NTS calls, the extent to which the CPP arrangement leads to a disconnect in the context of the termination of calls to NTS numbers.
- 3.40 The text below briefly outlines the circumstances under which the CPP arrangement is more or less likely to lead to a disconnect between the parties that pay call prices and those responsible for the choice of terminating network. Starting from a market definition defined on a receiving party-specific (and hence network-specific) basis, the factors outlined below would tend to broaden the market beyond a network specific basis.

Retail demand side substitution by calling parties

- 3.41 This type of substitution is likely to be widespread, i.e. the CPP arrangement will not have a significant impact, in cases where, inter alia:
- callers are aware that they are calling a particular network and have some awareness of the prices that it charges; and
 - callers are sensitive to changes in price caused by the TCP.

Wholesale demand side substitution and retail/wholesale supply side substitution

- 3.42 These types of substitution are typically not feasible in the context of call termination because the receiving party has a unique relationship with a single TCP. This means

that no other parties can provide termination, so the one TCP cannot be bypassed absent retail demand-side substitution (see above).

Likelihood of substitution

3.43 The extent to which the CPP arrangement has an impact on some example call types is outlined in the table below (which simplifies a number of key issues in relation to each call type but highlights the basic principle).

Examples - different call types

Figure 5: CPP and call types

Example of call type	Extent to which CPP leads to a disconnect between caller & the party that chooses the termination network	Extent of substitutability between call types
(i) Calls to a specific person on a fixed geographic or mobile number (e.g. call between friends)	High – no substitutes, caller awareness of price is low, receiving party does not choose network on basis of inbound call price	No competition between TCPs for this particular call, hence no demand side substitution.
(ii) Calls to fixed geographic number (call to a London minicab firm chosen at random from phone book)	Low – substitutes are available (but caller awareness of price is low), and receiving party puts a very high value on receiving call	This type of call <u>alone</u> ⁷ might suggest that demand side substitution is present
<ul style="list-style-type: none"> (iii) Calls to NTS number (e.g. a customer’s telephone banking line with his or her high street bank) 	Fairly high – customer is “captive” and is unlikely to switch supplier of the underlying service (e.g. banking) on the basis of call price, although receiving party may take the impact of the price for such calls on its customer service into account.	<ul style="list-style-type: none"> Some, albeit limited, competition between TCPs for this particular call type,

⁷ This call type is in a small minority in the wider context of calls to geographic numbers.

Example of call type	Extent to which CPP leads to a disconnect between caller & the party that chooses the termination network	Extent of substitutability between call types
<ul style="list-style-type: none"> (iv) Calls to NTS number (a particular ISP) 	<ul style="list-style-type: none"> Low – substitutes are readily available, caller will have a good idea of call prices, and will spend a lot on this particular number, making him likely to switch. Receiving party puts a very high value on receiving call (business model is entirely dependent on it) 	<ul style="list-style-type: none"> Likely to be competition between TCPs, i.e. demand side substitution, for this call type.

3.44 The figure above shows that, while cases (iii) and (iv) are both examples of calls to NTS numbers, they differ in potentially important ways. Since both cases are very common it is desirable, to the extent that such differences matter, to reflect them in the market analysis where practicable.

3.45 The difference between cases (iii) and (iv) in the figure above, i.e. the “retail bank” and “ISP” cases is intuitively straightforward.

3.46 In case (iii), it will be difficult for callers to substitute the service provided by one NTS SP (retail banking services provided by their current bank) with another (retail banking services provided by another bank). They are therefore likely to have little choice about the number they call and, in extreme cases, may have virtually no choice but to use a particular number (this concept is also discussed in Section 4 paragraph 4.33 of the NTS Policy Options Consultation) meaning that there is likely to be very little retail demand side substitution between calls terminated via different TCPs. Additionally, calls to the bank are likely to form a very small proportion of each customer’s total expenditure on telecoms services. Such factors would be likely to point to a narrow (called party or network specific) market definition. It is worth noting, however, that, unlike most call recipients in the fixed geographic and mobile termination cases, different high street banks are ultimately substitutable. Additionally, for example, a bank that wanted to be “customer friendly” might want to use low calling prices as a part of its marketing strategy. In such cases there may be a degree of competition, meaning that the disconnect referred to above could have a limited role to play.

3.47 In case (iv), on the other hand, it seems likely that customers are likely, to some extent, to switch between ISPs, or make fewer calls to their ISP if charges become more expensive. Because of this, there is likely to be some demand side substitution between calls terminated via different TCPs. The question of whether this would be sufficient to define a broad market is discussed below.

3.48 A market definition and SMP assessment should attempt to capture all of the relevant competitive constraints. In the context of NTS calls it might therefore be expected to

distinguish between widely differing cases such as the “retail bank” and “ISP” cases above. However, Ofcom’s view is that such a distinction would not be appropriate, and would not reflect the realities of the NTS marketplace, since:

- technical billing constraints are such that TCPs are in practice obliged to charge the same amount for terminating calls to all numbers within a number range and are not therefore able to differentiate between calls to individual numbers that correspond to different cases; and
- although it might be possible to create an artificial separation between call cases by the use of designations in the Plan, Ofcom's view is that such an arrangement would be very difficult to implement and maintain in practice because it is not possible to separate services into the differing cases with any certainty.

- 3.49 It therefore appears that TCPs face competitive pressures on the basis of the “average” call type.
- 3.50 One way in which it might be possible to take account of customers with few immediate substitutes would be to distinguish between calls terminated on behalf of ‘ECS’ as against ‘non-ECS’ providers.
- 3.51 ECS (electronic communications service) is a concept that is set out in section 32(2) of the Act and which ultimately comes from the Framework Directive. In essence it is a reference to a service, having as its principal feature, the conveyance of signals via an electronic communications network. This concept does not include content services. The logical extension of this definition is that an ECS provider would be a provider of a service that principally consisted of conveying signals over a network. Whether a particular provider would be considered to be an ECS provider as defined by the Act would depend on a factual analysis of the service provided in any given case.
- 3.52 A distinction between ECS and non-ECS providers would be based on the idea that all or at least the majority of callers to ECS providers such as ISPs would have immediate substitutes available, whereas most callers to non-ECS providers such as retail banks would not have any immediate substitutes. Such a distinction would arguably be accurate to some extent since, for example, ISPs are the best-known (and numerous, by traffic volume) example of ECS providers. However, data provided to Ofcom by TCPs shows that non-ECS providers use NTS numbers for a very wide range of purposes. These purposes include calls made by significant numbers of callers who do have immediate substitutes for the numbers in question. This suggests that, an “ECS versus non-ECS” distinction would be a crude means by which to distinguish between cases where callers did and did not have immediate substitutes available (and indeed a split into only two categories seems overly simplistic). As outlined in Annex 5 of the NTS Policy Options Consultation, NTS numbers support a very wide variety of services, and the extent to which customers have immediate substitutes available will vary in each case.
- 3.53 Ofcom’s view is therefore that, since, in practice, TCPs will not be able to discriminate in order to charge higher rates to OCPs for the termination of calls originated by customers who have no immediate substitutes (since they host too many services for such discrimination to be feasible as a profitable strategy), and that calls originated by callers with no immediate substitutes are in a minority, that the competitive conditions associated with the availability of immediate substitutes are likely to be dominant. In this context, the calling party pays externality is likely to play a limited role in the context of the termination of NTS calls. Given this situation, in the following section Ofcom considers the likelihood of a hypothetical monopolist of NTS call termination on a particular network being constrained when attempting a 5-10% price increase (the

SSNIP test) and hence whether a narrow (network specific) or broad market definition is appropriate.

Ofcom's initial view on the likely substitutability of NTS calls

- 3.54 In the following text Ofcom considers the case whereby a TCP offering a standard range of NTS services on an NTS number range increases the termination price charged to OCPs by 5-10%. As will be discussed at greater length in the discussion of SMP that follows the market definition, Ofcom is of the view that the most likely way in which such behaviour would be constrained is by OCPs passing this price increase on to their retail customers. The TCP's price increase would be constrained if call volumes fell to such an extent that the TCP's overall profits were to fall following the price increase.
- 3.55 The demand for calls made to the NTS numbers of a particular TCP by end users is likely to be determined by, inter alia, the following factors (in the case of a constant elasticity demand curve, the elasticity of demand would be determined by the last two factors, whereas in the case of a variable elasticity demand curve it would be determined by all three factors):
- the price charged by the OCP, which is determined by factors including:
 - the termination price charged by the TCP;
 - any other costs incurred by the OCP;
 - the proportion of callers' income that is spent on the call type (the lower this is the lower the elasticity would be); and
 - the closeness and availability of substitutes (the more substitutes were available, the higher the elasticity would be).
- 3.56 The extent to which the TCP would be constrained would depend on the determinants of elasticity outlined in the previous paragraph. If the OCP's retail prices are set equal to the TCP's termination charges (this assumption is unrealistic but useful for illustrative purposes), then, in very simple terms, if callers' price elasticities of demand were greater in magnitude than one, the TCP would not find it profitable to increase its prices. This result assumes a constant elasticity/revenue demand curve, and that the TCP did not achieve any cost savings via producing a lower output, i.e. a marginal cost of zero.
- 3.57 Ofcom's view is that it is likely that the degree of substitutability between TCPs would be sufficient for them to be regarded as being in the same market. This is based on the view, as outlined above, that substitutes are available for a significant proportion of NTS calls. The most important examples of call types where a wide range of substitutes are available are (mainly) those services supplied by ECS providers such as ISP.

Initial conclusion

- 3.58 Based on an analysis of demand side substitution above, Ofcom has explained why it is of the view that there is a single market for NTS call termination on all networks.
- 3.59 Given the range of choices available to callers that face differing availabilities of immediate substitutes, if there were only, for example, a few hundred NTS numbers that were consistently and transparently used for easily classifiable purposes, then

Ofcom might expect TCPs to price differently according to the extent of substitutes available to callers. Under such circumstances, Ofcom might, for example, arrive at a market definition along the following lines (for simplicity, callers here are split into two categories, “limited ability to choose substitute services” and “able to choose substitute services”):

- network specific markets for termination of calls on the network of each TCP made by callers for whom no immediate substitutes for the numbers they were calling were available; and
- a single market for the termination of NTS calls made by callers for whom immediate substitutes for the numbers they were calling were available.

3.60 However, due to the size and complexity of the market, such price discrimination by TCPs is not feasible. In this context, TCPs have to price according to the dominant characteristics of the market, and, based on this type of pricing, Ofcom is of the view that the definition of a single market for NTS call termination is appropriate.

The geographic boundaries of the market

Introduction

3.61 The geographic boundaries of the relevant market, like those of the product market, are defined by means of the identification of all relevant competitive constraints.

3.62 As with the product market definition, the SSNIP test is a useful analytical tool in identifying constraints. Again, it is conventional to begin with a relatively narrowly defined hypothesised market. The profitability of a SSNIP by a hypothetical monopoly supplier of services in a particular geographic area would then be undermined if it induced:

- a sufficient switch of customer demand to suppliers outside the area (demand side substitution); or
- a sufficient supply-side response within the area from suppliers currently operating outside the area (supply side substitution).

3.63 The geographic dimension of the product market identified above is considered in the following paragraphs.

Applicability to NTS call termination

3.64 In other termination markets (i.e. fixed geographic and mobile), Ofcom has previously defined termination markets on a network-by-network basis (see the above discussion of the impact of calling party pays in the context of the product market), meaning that each TCP (e.g. BT, Vodafone, NTL, Kingston Communications) has SMP in the termination of traffic on its own network. The spatial, i.e. geographic boundaries of these termination markets therefore reflect the physical coverage of each network.

3.65 In a number of origination and retail markets, Ofcom has previously defined the Kingston upon Hull area as forming a distinct economic market, based, primarily, on one or both of the results of the SSNIP test and the very different competitive conditions exhibited in this area. Kingston Communications has been found to have SMP in many of the markets identified within the Kingston upon Hull area, due to its status as a legacy monopolist in this area. Such a delineation is not appropriate or necessary in the termination markets referred to above, due to the network specific nature of each product market.

- 3.66 A key feature of the NTS call termination market relative to other termination markets is that the relationships NTS SPs have with TCPs are not based on geographic considerations, since, for example:
- an NTS SP that is physically located in the Kingston upon Hull area (e.g. an ISP based in Hull) is able to buy services from any TCP, and is not restricted to ones located within the Hull area;
 - callers in the Hull area are not restricted to making calls to NTS numbers that are terminated on Kingston's network and as such are in a comparable position (as far as NTS call termination is concerned) to callers in other parts of the country; and
 - Kingston Communications is not subject to NTS specific regulation for wholesale call origination (as discussed in Section 4, this regulation is a contributory factor to BT's position of SMP).
- 3.67 The implication of the above factors is that termination on the network of Kingston Communications is substitutable, from both an NTS SP and caller perspective, with that of termination on the network of any other TCP. Kingston Communications faces much the same set of constraints as the other non-BT TCPs since most of its interconnection for NTS traffic is with BT, meaning that it relies on BT as a transit provider, and additionally it is not subject to NTS specific regulation at the origination level. This means that a national market definition and hence SMP assessment will correctly capture all the constraints faced by TCPs. Ofcom has therefore concluded that there is a single national market for NTS call termination in the UK.

Market definition – initial conclusion

- 3.68 Ofcom's view is that the relevant market is that for NTS call termination in the UK. The market is not defined with reference to "fixed" services since in general NTS numbers do not terminate on mobile networks.

Question 1: *Do stakeholders agree with Ofcom's initial view that the termination of all NTS call types (0845/0870, etc, also voice and data calls) should be included within the same market?*

Question 2: *Do stakeholders agree with Ofcom's initial view that there is a single market for NTS call termination, i.e. that the market should not be defined on a TCP specific basis?*

Section 4

Market Power determinations

Introduction

Market Power determinations

- 4.1 Section 45 of the Act details the various conditions that may be set under the new regime. Section 46 details whom those conditions may be imposed upon. In relation to SMP services conditions, section 46(7) provides that they may be imposed on a particular person who is a communications provider or a person who makes associated facilities available and who has been determined to have significant market power in a “services market” (i.e.: a specific market for electronic communications networks, electronic communications services or associated facilities). Accordingly, having identified the relevant market as discussed in Section 3, Ofcom is required to analyse the market in order to assess whether any person or persons have significant market power as defined in section 78 of the Act (Article 14 of the Framework Directive).

Approach used to assess Significant Market Power

- 4.2 Under section 78 of the Act and Article 14 of the Framework Directive, SMP has been defined so that it is equivalent to the competition law concept of dominance. Article 14(2) of the Framework Directive states that:

"An undertaking shall be deemed to have significant market power if, either individually or jointly with others, it enjoys a position equivalent to dominance, that is to say a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers."

- 4.3 Further, Article 14(3) of the Framework Directive states that:

"Where an undertaking has significant market power on a specific market, it may also be deemed to have significant market power on a closely related market, where the links between the two markets are such as to allow the market power held in one market to be leveraged into the other market, thereby strengthening the market power of the undertaking".

- 4.4 The Framework Directive and the Commission's SMP Guidelines state that a market shall be deemed effectively competitive if no communications provider in that market, either individually or collectively, has SMP.
- 4.5 Therefore, in the relevant market, one or more undertakings may be designated as having SMP where that undertaking, or undertakings, enjoys a position of dominance. Also, an undertaking may be designated as having SMP where it could lever its market power from a closely related market into the relevant market, thereby strengthening its market power in the relevant market.
- 4.6 In assessing whether an undertaking has SMP, this review takes the utmost account of the Commission's SMP Guidelines as well as Oftel's equivalent guidelines, as referred to in Section 2.

- 4.7 This section considers the assessment of significant market power (SMP) in the market for NTS call termination defined in Section 3. The SMP analysis is based on the evidence presently available to Ofcom. Ofcom's view is that, given the unique situation faced by BT relative to other TCPs, an assessment of collective dominance would not be appropriate in this market (for example see paragraph 4.8 below).

Summary list of SMP designations

- 4.8 Section 4 analyses whether any operator either individually or jointly possesses SMP in the relevant market(s). This equates to concepts of single firm dominance and collective dominance in competition law. Ofcom's provisional view is that BT has SMP in the market for NTS call termination in the UK. BT, as a vertically integrated TCP and OCP, is able to act independently of its competitors because of BT's position as at the OCP level and its status as a TCP. This interaction works in the following way
- because of its SMP in wholesale call origination and the regulation imposed on it as a result (the BT NTS Call Origination Condition), BT as a TCP is in the unique position of being able to increase its termination prices to its OCP competitors;
 - when BT does increase its termination prices to non-BT OCPs, OCPs can only constrain BT by passing this price increase on to their end user customers via higher call prices, potentially lowering the volume of traffic received by BT; and;
 - if OCPs do pass a BT price increase through to end user customers, any losses BT might make at the termination level are likely to be offset by the fact that by passing the price increase on, rival OCPs will become less competitive relative to BT.
- 4.9 This situation is discussed at greater length in the subsequent sections.

Further background

- 4.10 As outlined Section 2 paragraph 2.18, with the introduction of its NCCN 500 charge rises on 1 May 2004, BT departed from its previous voluntary practice of not setting differential termination charges. As a result of this action, Ofcom has examined the competitive dynamics of this market, and considered whether BT or any other TCP could be in a position that would enable it to behave independently of competitors, customers and ultimately consumers.
- 4.11 The SMP assessment that follows is split into the following key sections:
- *Market shares and barriers to entry* - a discussion of these factors typically forms a key element of an SMP assessment;
 - *Constraints on TCPs* – following the introduction of differential charging by BT, Ofcom has carried out a detailed assessment of the constraints that apply to the pricing behaviour of all TCPs, including BT; and
 - *Forward look* - the existing framework plays an important role in determining the competitiveness of the market for NTS call termination. Ofcom has therefore considered the likely impact of new policy developments (specifically the potential adoption of Ofcom's preferred option from the NTS Policy Options Consultation – known as Option 2 (extended retail price competition)) on the competitiveness of NTS call termination.
- 4.12 As suggested in the market definition above, there are good reasons to think that very distinct competitive conditions might exist for certain NTS call types (specifically, the issue of the extent to which callers have limited ability to choose substitutes for the services they are dialling is an important one) if TCPs were able to price discriminate

between different call types. However, as outlined above, such price discrimination is not feasible, and, as outlined above, the definition of a single market is appropriate.

Market shares and barriers to entry

Market shares

4.13 While market share is, in many cases, an important factor in the assessment of SMP, it does not on its own determine whether an undertaking will have SMP. As set out at paragraph 3.13 of the OFT's Competition Act *guideline The Chapter II Prohibition* (<http://www.offt.gov.uk/NR/rdonlyres/esmzu5iqdeetjdh4b55az2zqex5rmrct7d5cugokx7e aikls45z4qwuvlthsgbjceericeiju37ssom5ifmrqh6coih/oft402.pdf>) ("OFT Guideline"), it is also necessary to consider the position of other undertakings operating in the same market and how market shares have changed over time. The OFT Guidelines further state that although the Director General of Fair Trading considers it unlikely that:

"(...) an undertaking will be individually dominant if its market share is below 40 per cent, (...) dominance could be established below that figure if other relevant factors (such as the weak position of competitors in that market) provided strong evidence of dominance."

4.14 As mentioned Paragraph 3.1 of the Commission's Recommendation states that:

"[a]s the market analyses carried out by NRAs have to be forward-looking, markets are defined prospectively. Their definitions take account of expected or foreseeable technological or economic developments over a reasonable horizon linked to the timing of the next market review."

4.15 Ofcom has taken this into consideration in its analysis. Based on information submitted to it by TCPs following a formal information request sent out in July 2004, Ofcom has calculated BT's volume market share of NTS call termination (for all traffic types in sum). This information showed that BT's market share was 32% in both 2002 and 2003. The shares of other TCPs were smaller.

4.16 Ofcom has not used BT's revenue market share for this assessment since this will be distorted by a number of factors, particularly the mix of traffic type, i.e. 0845/0870, day/evening/weekend terminated by each TCP. Presenting revenue market shares that differed from volume shares on the basis of these factors would not yield any meaningful information about BT's position in the market. However, following NCCN 500, BT's termination prices for certain types of NTS call traffic originated by other OCPs have become higher than those that other OCPs can charge BT for calls originated by or transited via BT and terminated on their networks. This means that BT's revenue market share on a forward-looking basis, might be expected to be higher than its current volume market share. For example, if, to begin with, all TCPs charged a single uniform price of 1ppm with no time of day gradient, and BT terminated 10 minutes and other TCPs collectively terminated 90, then BT's revenue market share would be 10%, i.e. $(10 \div 100)$. However, if BT increased its price to 2ppm whilst other TCPs kept their prices at 1ppm, then BT's revenue market share would increase to 18%, i.e. $(20 \div 110)$.

Barriers to entry

4.17 The threat of competitors entering into a market may prevent firms from raising prices above the competitive level. However, if there are significant barriers to entry, this threat is likely to be weak or absent. Incumbent firms may then be able to raise prices

and make persistent excess profits without attracting additional competition that would reduce them again.

- 4.18 Ofcom's view is that the barriers to entry are relatively low in this market, for the reasons outlined below.
- 4.19 In simple terms, the process for a firm wishing to enter this market and sell termination services to OCPs in competition with those sold by the existing set of TCPs is as follows:
- invest in obtaining access to the necessary network infrastructure including switching equipment;
 - obtain NTS number ranges from Ofcom;
 - invest in any additional hardware and software needed to support particular types of NTS services;
 - interconnect with BT (or another CP); and
 - market new termination offerings to service providers.
- 4.20 The above description shows that, whilst a degree of investment in various hardware and software items is required, the costs involved are unlikely to be prohibitive. The technology used to offer NTS services is well established and for instance is available in entry-level PC based switches. Furthermore, the software required to provide the most common features of NTS services is an "off the shelf" feature of much network switching equipment. TCPs do not need to build networks out to a large number of end users, and typically interconnect only with BT (although extensive interconnection with BT may represent a barrier to entry from the perspective of very small players).
- 4.21 An additional factor that may be worth considering is that, as described in Annex 5 of the NTS Policy Options Consultation, certain types of NTS call are declining in volume. In cases where a market is declining in size, it is likely to be more difficult for new entrants to capture a significant share of the market, since, as a proportion of the total market, new additions to the customer base, which will be more easily addressable by new entrants, are likely to be relatively small. Ofcom, however, does not consider that this factor is a key consideration in this market, since, as outlined in Annex 5 of the NTS Policy Options Consultation, many of the more lucrative NTS products are currently growing in size and on the 0845 range (on which volumes are declining) there are significant levels of churn for ISP services which are the largest category of service by volume. This is likely to make entry relative attractive to prospective entrants, supporting Ofcom's view that the barriers to entry are relatively low in this market.

Initial conclusion on barriers to entry and market share analysis

- 4.22 The analysis of market shares and sunk costs as a barrier to entry is, in many cases, a key factor in the assessment of SMP. Based on these factors, a sensible a priori expectation might be that all players in the market for NTS call termination would be subject to fairly substantial competitive pressures, given that barriers to entry are relatively low. The initial picture therefore is arguably one of a market in which no single TCP would be likely to enjoy a position of SMP.

Constraints on TCPs

- 4.23 The analysis in the following sections considers the constraints faced by all TCPs, including BT, in setting prices for termination.
- 4.24 Various CPs have suggested to Ofcom that the combination of BT's strength in the origination market and existing NTS regulation are such that BT (only) may nonetheless have SMP in the market for NTS call termination. This possibility is discussed below, by means of an analysis of all of the likely sources of competitive pressure that might apply to TCPs.
- 4.25 As is discussed below, the price charged for terminating traffic that is originated by BT is indirectly set by the BT NTS Call Origination Condition. The detailed analysis presented below therefore focuses on the case of traffic that is originated on the networks of other OCPs (and also, as is explained below, traffic that is not transited via BT's network).

Special cases – traffic originated by and transited via BT

Traffic originated by BT

- 4.26 BT originates [X] of NTS traffic. This is the case because of BT's status as the legacy incumbent CP, and consequent high share of the origination of all traffic types (as is outlined in Annex 5 of the NTS Policy Options Consultation, a relatively small proportion of NTS traffic is originated on mobile networks). Since 1996 an NTS regulatory regime has been in place, based on BT's dominance in wholesale call origination, and designed to encourage innovation in the provision of value added services.
- 4.27 From the perspective of other TCPs, the key feature of the existing regulatory position is that in the case of 0845 and 0870 calls they are unable to set their own termination charges for NTS calls originating on BT's network. This is mainly because:
- BT's tariffs for calls to 0845 and 0870 numbers are linked to BT's standard local and national call charges which are themselves subject to the Retail Charge Control⁸; and
 - the BT Call Origination Condition requires that BT's origination retention is cost-based.
- 4.28 In other words TCPs are unable to ask to receive a larger proportion of the retail price paid to BT by its end user customers in the same way that BT has done with its NCCN 500 price increase.
- 4.29 The next section discusses the bargaining position of non-BT TCPs with regard to OCPs other than BT.

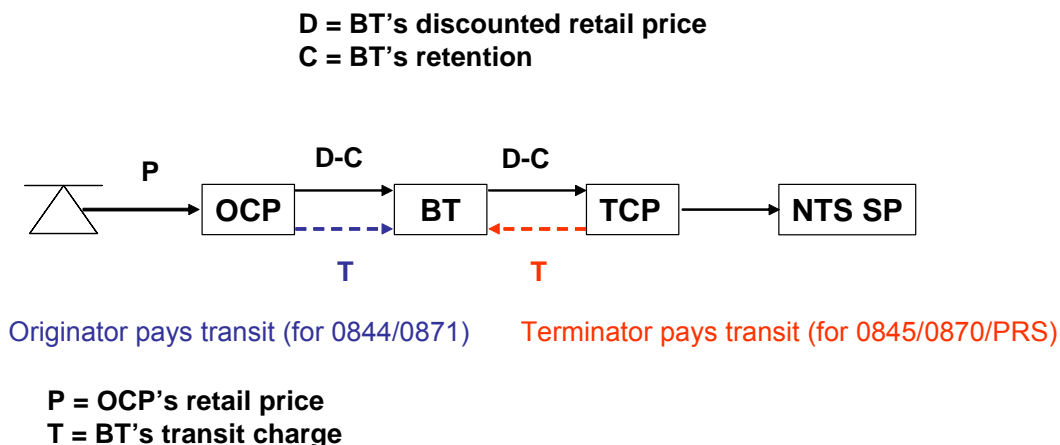
Traffic that is transited via BT's network

- 4.30 The majority of NTS traffic that is both originated and terminated by CPs other than BT is transited via BT. This is because, with a small number of exceptions, TCPs do not as rule interconnect directly with OCPs other than BT for the delivery of NTS traffic, because of:

⁸ The charge control for certain retail services is set out in SMP Condition D1 of the 'Review of Fixed Narrowband Retail Services Markets' published by the Director on 28 November 2003 ('the Retail Charge Control')

- the fixed cost associated with each interconnection point; and
 - the opportunity to use BT as a transit operator (see below).
- 4.31 In cases where traffic is transited via BT (for 0845/0870 calls), the revenue that TCPs can earn from termination of a particular class of NTS call is identical to that earned for calls originated by BT (see below for an explanation). Additionally, even in those cases where TCPs can terminate NTS traffic via direct interconnection with OCPs, the prices they can charge for a particular class of NTS call are in practice constrained by the ability of the OCP to route NTS calls to BT for transit, thereby obtaining the BT price for transit and termination.
- 4.32 The diagram below shows that, when functioning as a transit provider, the amount that BT pays to TCPs, equal to $(P-C)$ in the diagram is (ignoring the transit payments made to BT by various parties):
- the same as the amount that BT pays to a TCP when BT operates as an OCP, i.e. BT's discounted retail price less a retention payment for BT's retail and network costs; and
 - the same as the amount that OCPs pays to BT in BT's capacity as a transit provider.

Figure 6: NTS transit arrangements



- 4.33 The above arrangement means that all TCPs other than BT are currently constrained in their charging to non-BT OCPs. When agreeing terms with non-BT OCPs, TCPs need to make these OCPs an offer that is at least as attractive as the one that the OCP can get if traffic is transited via BT. This means a set of terms under which the amount the OCP is required to pay the TCP will be no more than the OCP would have to pay to BT as a transit provider ($(D-C)$ in the diagram above). This is also the amount that BT will pay the TCP if the OCP chose to route the calls to BT for onward transit to the TCP. The margin that the TCP can earn over and above the payment that BT will make to it is therefore restricted to being equal in size to the transit payment.

Initial conclusion – BT originated and transited traffic

- 4.34 TCPs other than BT are, in most cases, constrained in their pricing behaviour as a result of BT's dominance at the origination level and the remedies applied to BT in respect to this, and also BT's billing practices in relation to transit calls. The resulting remedies applied to BT at the origination level (i.e. the wholesale charge control and

the BT NTS Call Origination Condition) prevent other TCPs from attempting to increase prices above their current level.

4.35 The above constraints do not apply to the following traffic types:

- traffic that is terminated but not originated by BT; and
- traffic that is neither originated nor terminated by or transited via BT (although other constraints may apply here, as will be discussed below).

4.36 With this in mind, the section below considers how the actions of OCPs, SPs, and other TCPs might place constraints upon TCPs.

Constraints that apply in the case of non BT originated or transited traffic

Introduction

4.37 Various CPs have suggested that BT's NCCN 500 price change provides prima facie evidence that BT has market power in setting its own termination rates unconstrained by competitive pressures from any source. One of the CPs that competes with BT as both an OCP and a TCP has claimed that, faced with this price change, it and other OCPs are unable to respond in any way other than absorbing BT's price increase.

4.38 This proposition, together with arguments made by BT, and Ofcom's own views, is considered in the pages that follow.

4.39 As discussed, Article 14 (2) of the Framework Directive states that an individual undertaking shall be deemed to have SMP if it enjoys a position of economic strength affording it the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers. This reflects the Competition Law understanding of what a dominant position is.⁹

4.40 Based on a definition such as the one in the previous paragraph, for the conditions under which the consequences of BT's termination price increase might be considered to be suggestive of it enjoying a position of economic strength in NTS call termination are clear. If BT (or any other TCP) were in a dominant position, then any such price increase (up to the monopoly level) would be profitable regardless of the actions of its customers (OCPs), assuming that these customers were behaving optimally. That is, that position of economic strength would afford BT the power to behave to an appreciable extent independently of competitors, customers and ultimately consumers.

4.41 Ofcom considers the likelihood of such an outcome being realised as set out below.

OCP responses to a price increase by a TCP

4.42 Ofcom has considered the possible responses by OCPs following a price increase by a TCP. In the summary matrix below, each column corresponds to an OCP in a different starting position, and each row corresponds to a TCP in a different starting position. So, for example, the bottom left cell relates to the situation in which BT as a TCP increases the prices it charges to a non-BT OCP. The matrix below ignores the role of BT as a transit provider, a case that has already been considered. This means that all of the cells in the matrix below refer to direct interconnection between OCPs and TCPs.

⁹ E.g. see (Case 27/76) *United Brands v Commission* [1978] ECR 207, [1978] 1 CMLR 429. (Case 85/76) *Hoffmann-La Roche v Commission* [1979] ECR 461, [1979] 3 CMLR 211, para 38

Figure 7: Responses available to OCPs following a price increase by a TCP

	Responses available to non-BT OCP - OCP(A)	Responses available to OCP – BT
A non-BT TCP increases its termination prices (TCP (B))	refuse to carry traffic pass price increase on to own retail callers; absorb increased cost; increase own termination rates (assumes that TCP (B) is also an OCP, & that OCP (A) is also a TCP)	The BT NTS Call Origination Condition means that OCPs cannot increase their NTS call termination charges to BT. This is because the retention retained by BT is fixed, meaning that, for a given call type, as an OCP BT cannot hand over either less (since a minimum amount is specified) or more (since retention is based on cost) to a TCP.
BT increases its termination prices	refuse to carry traffic pass price increase on to own retail callers; absorb increased cost; increase own termination rates in response – cannot do this because of the BT NTS Call Origination Condition	N/A

4.43 As indicated in the matrix above, following a TCP price increase, up to four strategies/responses, marked (a) to (d) above, are likely to be available to OCPs. A discussion of each of these is provided below. A fuller discussion is preceded by the summary table below, in which the short-term impact of alternative strategies for an OCP responding to a price increase by a TCP are summarised.

4.44 As stated above, the starting position for this analysis is that BT, in its capacity as a TCP, increases its termination charge to a CP (here acting as an OCP). However, the responses available to the CP and the consequent net impact on BT may involve the CP’s status as a TCP, or BT’s status as an OCP. This means that, for each of the rows in Figure 8 corresponding to the options available to the CP as an integrated OCP and TCP, the impact on both BT and the CP as both an OCP and a TCP is considered. The fact that OCPs and TCPs, and in particular BT, are vertically integrated is a key feature in Figure 8, and plays a significant part in Ofcom’s analysis. If BT’s TCP business were not a part of the same group as BT’s origination business then BT and other TCPs would face a similar set of constraints.

Figure 8: Options available to OCP following a price increase by BT as a TCP

	CP (A) (OCP)		CP (A) (TCP)		BT (OCP)		BT (TCP)		Impact
	Traffic volume	ppm margin	Traffic volume	ppm margin	Traffic volume	ppm margin	Traffic volume	ppm margin	
(a) absorb increased cost		↓						↑	(i) CP (A) (OCP) is worse off (ii) BT (TCP) is better off
(b) Refuse to carry traffic	↓				↑ (?)		↓		(i) CP (A) (OCP) is worse off (ii) BT (OCP) may gain (iii) BT (TCP) is worse off
(c) Pass price increase on to own retail callers	↓ (?)				↑ (?)		↓	↑	(i) CP (A) (OCP) may lose (ii) BT (OCP) may gain (iii) BT (TCP) may gain or lose
(d) Respond by increasing own termination rates			↓	↑	↓	↓			(i) CP (A) (OCP) is worse off (ii) BT (OCP) is worse off

4.45 The arrows in the figure above indicate the movement of the following parameters, relative to a situation in which BT does not increase its termination prices (the inclusion of a question mark in this table indicates a degree of uncertainty as to the consequences of a price change):

- revenue per minute (net of termination payments to BT in the case of the CP) earned from NTS traffic; and
- volumes of NTS traffic.

4.46 The starting point is the volumes and retail call margins available to both the CP and BT prior to the termination price increase made by BT. The sections below present a short discussion of each of the four options available to the CP following a termination price increase by BT.

4.47 The purpose of this section is to identify constraints on BT when it raises its termination charges. Each option faced by a CP is examined to see whether the pursuit of that option would constrain BT, i.e. make its price increase unprofitable, in either the immediate or longer term. It is also important to consider whether each strategy would be likely to be optimal to the CP responding to BT's price rise.

Absorbing increased costs

4.48 Under this strategy the CP maintains its retail prices at the levels that prevailed prior to BT's termination price increase. Following such a course of action, relative to a situation under which BT's termination prices remain constant, little changes, except

that some of the surplus that would be retained by the CP (acting as an OCP) absent a price increase is transferred to BT. This strategy, while it may be optimal for the OCP under certain circumstances (i.e. where increasing prices or refusing to connect calls is not a commercially viable strategy) will not serve to constrain BT's activities under any circumstances. If this strategy were the only one available to OCPs, then all TCPs (in the case of non-BT TCPs this would be restricted to the case of non-BT originated traffic where direct interconnection, unconstrained by transit, is used) would not face any constraints, and hence would have SMP. However, as is discussed below, other strategies are available. These are discussed in turn below.

Refuse to carry traffic

- 4.49 Under this strategy, the CP refuses to connect its retail customers to NTS SPs that use BT as a TCP. If its customers attempt to dial an NTS number that is terminated on BT's network then the customer would receive a 'number unobtainable' tone or verbal equivalent.
- 4.50 In the immediate term, BT as a TCP clearly loses revenue under this strategy, since it no longer terminates traffic from the OCP. Similarly, the OCP loses revenue even relative to the scenario under which it absorbs the increased termination charge.
- 4.51 In the longer term, the basket of services sold to customers by the OCP becomes less attractive to customers. This is because customers are no longer able to access a subset of services which form a fairly substantial proportion of the overall basket of calls and access services that they demand. For example, based on a very simple calculation, dividing total minutes by total lines, Ofcom has calculated that in 2003/04 the average BT customer (business and residential combined) spent in the region of £[] per quarter on NTS calls to 0845 and 0870 numbers (the market share data above implies that in the region of [] of these would be to BT numbers). Customers will react to this development in one of the following ways:
- i. continue to use the CP's service as before but no longer making calls to the blocked NTS numbers;
 - ii. continue to use the CP's service as before but switching to other NTS SPs that do not use BT as a TCP (some of which may be terminated by the CP);
or
 - iii. switch to another OCP, by means of which the blocked NTS numbers can be reached (this is likely to be BT, particularly if, unlike BT when acting as an OCP, all non-BT OCPs face the newly increased higher termination prices).
- 4.52 Under the third of these scenarios, the CP clearly loses out, and, potentially, BT gains as an OCP. The more customers that are in this category, the less likely the "refuse to connect" response would be to constrain BT's behaviour.
- 4.53 If most customers fall into the first two categories, the CP's response may constrain BT. It must be noted, however, that this response is, from the perspective of the CP, unlikely to be optimal. The CP refusing to connect the numbers does mean that BT loses revenues but the CP is interested in its own profitability rather than BT's. In the immediate term, i.e. before customers have reacted to its refusal to connect calls to BT numbers, the CP will always earn higher profits under the "absorb price increase" option (as long as the margin earned on calls does not become negative). This will continue to be the case unless BT's loss of revenue as a TCP, and pressure applied by its NTS SPs as a consequence, causes it to reverse its price increase.

- 4.54 Ofcom's view is that OCPs are unlikely to pursue this strategy. It may be optimal for it to do so if a refusal to carry traffic were to persuade BT to reverse its price increase. This may happen if the OCP does not lose a significant number of customers (and hence BT does not gain at the origination level) as a result of refusing to connect to BT's NTS numbers. The OCP will tend to lose fewer customers where calls to NTS numbers that BT terminates are not a vital part of the OCP's offering to customers. This is likely to be the case where the OCP's customers are willing to switch to calling NTS numbers terminated by other TCPs.
- 4.55 The extent to which customers will be willing to switch to calling numbers terminated by other TCPs is likely to be determined by a range of factors. The extent to which customers have limited choice as to suitable substitute services to dial is likely to be crucial (see the earlier part of this market review on market definition for a fuller discussion of this). Customers might not be willing to switch to other NTS numbers in cases where:
- calls relate to NTS services in which the customer has no immediate substitute (e.g. calling to check the balance on a bank account) and the cost to the customer of dialling the NTS number is not likely to materially affect the choice of overall service package (e.g. choice of bank account); or
 - customers are tied into long-term contracts, e.g. with a particular cheap international call SP using an NTS access number (or equivalently are unwilling to switch SP for whatever reason).
- 4.56 An example of a situation in which OCPs refused to carry calls to a particular number range and none of their customers were tied in to calling these ranges is provided by the DQ liberalisation in 2003, whereby the old 192 DQ number, which was controlled by each OCP with an access network (except those offering services via indirect access) with regards to its own customers, was replaced by a range of competitively provided 118 numbers. In this case, some OCPs did not allow their end users to access certain of the new DQ numbers, for example BT's new 118500 DQ service. In this instance, all callers who had previously used the 192 code all had to start dialling new codes, and (to varying extents, depending on which network they were calling from) had a wide range of near-identical alternative products to choose from, so that, effectively, none of the new 118 DQ SPs had any captive customers at all. Ofcom's view is that this unique situation means that the recent DQ liberalisation experience does not provide a useful guide as to whether OCPs would pursue this strategy in the context of NTS calls.
- 4.57 Based on the information it has received from CPs, Ofcom considers it unlikely that OCPs would adopt this strategy. Given the non-trivial number of calls made to NTS numbers by customers, a service offering under which, for example in the case of BT as TCP, in the region of [] of such numbers could not be reached would not be attractive to callers and would see any OCP that adopted this strategy lose market share. Customer annoyance in cases where they were unable to call numbers for which they had no convenient substitute (e.g. their telephone banking service) would be significant, seriously undermining the attractiveness of the OCP's retail offering. In this context, Ofcom considers it very unlikely that this strategy would be adopted by any OCP, and hence considers that conduct of this sort would be very unlikely to constrain the pricing of TCPs. This means that, if this strategy were the only one available to OCPs (and was unlikely to be adopted), then all OCPs would absorb increased termination charges, meaning that all TCPs (in the case of non-BT TCPs this would be restricted to the case of non-BT originated traffic where direct interconnection, unconstrained by transit, is used) would not face any constraints, and hence would have SMP. TCPs could increase prices as far as the monopoly level.

Pass price increase on to own retail callers

- 4.58 Under this strategy, the OCP increases the retail price of the NTS calls that it originates on behalf of its retail customers to reflect the increased input costs implied by BT's price increases. Since the marginal cost of inputs, including termination payments, will influence the OCP's retail pricing decision, a response of this type might be expected. Although competing retail OCPs typically charge significantly higher prices than BT for NTS calls (e.g. a comparison of BT's rates for 0845 with those of the two cable companies plus two of the largest indirect access operators shows that, even before discounts, BT's competitors' prices are up to 60% more expensive than those of BT, even before discounts), they compete with BT on retail price in terms of the entire basket of services sold to end users.
- 4.59 In the market definition analysis set out above (under the subheading Ofcom's initial view on the likely substitutability of NTS calls of Section 3), Ofcom discusses the likely responses of end users following a price increase by TCPs. This section argues that, following a small increase above the competitive price level by TCPs, if these price increases are passed on to callers by OCPs, that the TCP may be constrained.
- 4.60 Under BT's recent NCCN 500 price increase, it has increased its termination charges for certain types of NTS calls by something in the region of 50% (the exact amount varies depending on the call type (short or long duration) and the time of day. BT clearly has some expectation that there is a good chance that this price increase will be profitable. Some OCPs, who are customers of BT's TCP business in addition to being competitors of BT at the retail level, have argued that they will be not be able to react profitably in a manner that will constrain BT following the price increase. The current behaviour of BT's OCP competitors following NCCN 500 is unlikely to be a reliable guide as to their optimal responses absent regulation, since the major OCPs are unquestionably waiting for a response from Ofcom following Ofcom's commitment to examine the competitive implications of this issue. This means that any analysis of possible OCP behaviour must necessarily involve an element of speculation.
- 4.61 Ofcom's view is that it is vital to consider BT's position in the origination market at the same time as its position as a TCP. SSNIP analysis, such as that considered in Section 3 above, can be used to consider the constraints placed on a TCP following a price increase, without considering the impact that its conduct might have on the same company at the origination level if the TCP is vertically integrated, i.e. is both a TCP and an OCP.
- 4.62 As outlined in Figure 7 when an OCP passes on TCP (e.g. BT) price increases to its retail customers, the following will happen to some extent:
- the demand for NTS calls to BT's NTS numbers will fall (if it does not then BT will clearly not be constrained at all by this strategy and it will be able to act independently of OCPs); and
 - facing increased prices of calls to NTS number ranges, the OCP's overall package will become less attractive to customers relative to BT, and BT is likely to gain market share and revenue in the origination market.
- 4.63 Ofcom's view is that this second point is key. Following BT's NCCN 500 price increase, if all OCPs pass the increase on to customers (and, as is argued above, there is no other way in which BT's conduct as a TCP can be constrained), BT's price competitiveness as a retail operator will have improved vis-à-vis all of its rivals. This is because, as outlined above, other TCPs are unable to respond with termination price increases of their own that could reduce the competitiveness of BT's overall package

of calls and access. So, even if OCPs are able to lower BT's revenues as a TCP by passing on price increases to end users, BT's revenues at the retail level are likely to increase, compensating it for any losses that it incurs at the TCP level. Given this situation, Ofcom's view is that it is unlikely that BT's behaviour as a TCP will be constrained.

- 4.64 A final point to note is that freephone NTS calls represent something of a special case with regards to passing on price increases, since all fixed networks currently offer calls to 08 numbers free of charge. This means that, in the case of fixed OCPs, the pass on price increases option is not available.

Respond by increasing own termination prices

- 4.65 For completeness, Ofcom has considered a fourth possible strategy that might be available to OCPs following a price increase by TCPs. An OCP (assuming that it is also a TCP) might increase its own termination charges to BT as an OCP in response to BT's price increase. However, as shown in Figure 7 above, TCPs do not set (and are unable to alter) the charges they make to BT for terminating 0845 and 0870. This means that this strategy is not available to non-BT OCPs, and that it is therefore not able to provide any constraints on BT. In some cases TCPs could increase their per minute revenues from termination by moving to other number ranges, but such a migration would lead to a significant disruption of the TCP's service. Additionally, any TCP following such a strategy would be disadvantaged with respect to BT, since, in the majority case of retail customers calling from BT lines, calls to services hosted by that TCP would be more expensive than calls to services hosted by BT as a TCP.

Constraints imposed by NTS service providers

- 4.66 The previous sections show how, based on an analysis of the constraints imposed on TCPs by OCPs, that of the TCPs, only BT is likely to be in a position to levy higher charges than its competitors.
- 4.67 A possibility considered by Ofcom is that NTS SPs might be able to constrain BT's ability to set excessive termination charges by demanding a higher share of the termination revenues earned by BT as a TCP. For example, other CPs have suggested that one of the objectives of BT's NCCN 500 price increase might be to enable it to make higher payments to NTS SPs, enabling it to increase its market share by attracting more NTS SP customers.
- 4.68 On balance, Ofcom's view is that NTS SPs are unlikely to be in a position to constrain BT's ability to set prices above the competitive level. If BT as a TCP were to increase its termination prices and OCPs were to absorb this price increase, then NTS SPs would be receiving the same volume of minutes as had previously been the case and, since as outlined above other TCPs would be unable to increase their prices, the NTS SP would not be able to get a better deal elsewhere and hence would not be able to constrain BT. If BT as a TCP were to make an increase to its termination prices that was passed on by OCPs, causing BT to lose volumes as a TCP, then, if NTS SPs were to receive the same per minute payment from BT they would be worse off than was previously the case. In such a case, they might consider establishing relationships with other TCPs that would charge lower termination prices to OCPs and hence guarantee greater volumes and revenues for the NTS SP. However, assuming that BT's price increase were profitable, it would be able to offer the NTS SP a smaller percentage share of its revenues from termination, while still offering the NTS SP a larger **absolute** amount of revenue (even if volumes declined) and retaining more revenue for itself.

4.69 On balance, Ofcom's initial view is that BT's position as a TCP is not and will not be constrained by the activities of NTS SPs.

Initial conclusion on the constraints faced by TCPs

4.70 The previous sections make the arguments set out in the following paragraphs in the context of NTS call termination.

4.71 Following a price increase by TCPs, a number of strategies are likely to be available to the wholesale customers of TCPs, i.e. OCPs, and following the response of OCPs, to the retail level customers of OCPs, i.e. end users. Ofcom's view is that these strategies are unlikely to be able to constrain the pricing behaviour of BT as a TCP, and that BT will therefore be able to set a price for NTS call termination that is above the competitive level. In summary:

- absorbing termination price increases will not constrain the pricing behaviour of TCPs;
- a refusal to carry NTS traffic terminated by a particular TCP (unless perhaps its market share was extremely small) is unlikely to be a viable strategy, hence it will not be used to constrain the pricing of TCPs;
- OCPs passing on TCP price increases to end-users might constrain non-BT TCPs. However, BT is unlikely to be constrained in this way; and
- BT cannot be constrained by termination price increases carried out by other vertically integrated OCP/TCPs.

4.72 Additionally, the actions of NTS SPs will not constrain BT's behaviour.

4.73 The implication of this analysis is that BT has SMP in the termination of NTS traffic, and that other TCPs do not. All TCPs are likely to be constrained to some extent. But BT is in a different position to the other TCPs since:

- other TCPs cannot increase their termination prices since:
 - their prices to BT are effectively fixed; and
 - BT's position as a transit CP prevents TCPs from applying selective price increases; and
- a price increase by BT at the termination level may, uniquely, lead to benefits at the origination level, mitigating any losses incurred at the termination level. There is no similar mechanism in place for other TCPs.

4.74 As outlined above, Ofcom's view is that BT is likely to be unconstrained because, in Ofcom's view there is a strong likelihood that OCPs will absorb its price increases. Even if OCPs pass on BT's price increases, any losses incurred by BT will be mitigated by gains at the origination level.

Forward look

4.75 During the SMP analyses undertaken in this section, Ofcom has considered the likelihood of any relevant competitive and technical developments that might affect the provisional SMP designations.

- 4.76 Ofcom will, however, keep market conditions under review and considers that, given the available information, it has fully taken into account likely competitive and technical developments within the relevant markets for the next 18-24 month period.
- 4.77 BT's SMP at the origination level, and the regulation that is currently in place to address this position, plays a key role in Ofcom's explanation of why it considers that BT has SMP in the market for NTS call termination.
- 4.78 In the NTS Policy Options Consultation Ofcom proposes to make a number of modifications to how the existing regulation imposed on BT at the origination level functions. Ofcom's view is that there is scope for the new arrangements at the origination level to have an impact on the competitiveness of the market for NTS call termination. It is not possible for Ofcom to be definitive on this subject prior to the implementation of the preferred option for the new arrangements.
- 4.79 There is likely to be a time lag before the modifications proposed in the NTS Policy Options Consultation come into operation since changes to the regulatory framework will need be put in place after the completion of the NTS Policy Options Consultation and the proposed option may also require BT to make changes to its billing and interconnect systems. It is Ofcom's view therefore that it is appropriate to proceed with this market review rather than to wait to see whether the modifications proposed in the NTS Policy Options Consultation have the desired impact on the competitiveness of the market for NTS call termination.
- 4.80 However, Ofcom's view is that Ofcom's preferred option from the NTS Policy Options Consultation - Option 2 if implemented has key features that may mitigate BT's position of SMP on a forward-looking basis. Specifically, this includes the scope for retail prices to be set on the BT network at the 10k number block level (for 0845/0870 calls). Under this arrangement TCPs will be able to change the call prices that are charged to customers who make calls via BT as an OCP whilst retaining exactly the same NTS telephone numbers (subject to the retail price ceiling for the range). Under these circumstances, the interaction of factors leading to BT having a position of SMP at the TCP level becomes less clear, since BT's advantage at the origination level may be diminished.
- 4.81 Ofcom considers therefore that, if Option 2 is introduced, it may enable the relaxation of proposed ex ante regulation on BT in the market for NTS call termination on a forward looking basis. This might occur either through the lifting of the SMP designation on BT or by reducing the number of regulatory obligations imposed on BT. However, Ofcom would of course need to conduct a market review to assess the continued appropriateness of ex ante regulation.

Definition of the Dominant Provider

- 4.82 Section 46 of the Act provides that a person to whom an SMP services condition is applied must be a "communications provider" or a "person" who makes associated facilities available and a "person" who Ofcom has determined to have SMP in a specific market for electronic communications services, networks or associated facilities.
- 4.83 Article 16 of the Framework Directive requires that, where a national regulatory authority determines that a relevant market is not effectively competitive, it shall identify "undertakings" with significant market power on that market and shall on such "undertakings" impose appropriate specific regulatory obligations. For the purposes of EC competition law, "undertaking" includes companies within the same corporate

group,¹⁰ for example, where a company within that group is not independent in its decision making.

Question 3: *Do stakeholders agree with the approach to SMP assessment that Ofcom has used, especially the fact that an analysis of market shares has not been decisive to the proposed finding of SMP?*

Question 4: *- Do stakeholders agree with Ofcom's assessment of SMP in the NTS call termination market?*

Question 5: *How do stakeholders think the position is likely to change, if at all, during the next 18 months to two years?*

Question 6: *What impact, if any, do stakeholders think that Option 2 from the NTS Policy Options Consultation, if implemented, will have on the competitiveness of this market?*

¹⁰ *Viho v Commission* Case C-73/95 P [1996] ECR I-5447

Section 5

Proposed Regulatory Remedies - SMP services conditions

Introduction

The legal framework for imposing regulatory remedies

- 5.1 As explained in Section 4, Ofcom proposes that BT has SMP in the market for NTS call termination in the UK.
- 5.2 In this section, Ofcom proposes the SMP conditions to be set as the regulatory remedies appropriate to address BT's proposed position of SMP. As explained at paragraph 3.1 of this document, the draft notification and proposed SMP service conditions are set out at Annex 4.
- 5.3 Section 87(1) of the Act provides that, where Ofcom has made a determination that a person has SMP in a particular market, it must set such SMP conditions as it considers appropriate and as are authorised in the Act. This implements Article 8 of the Access Directive.
- 5.4 Paragraphs 21 and 114 of the Commission's SMP Guidelines state that NRAs must impose one or more SMP conditions on a dominant provider, and that it would be inconsistent with the objectives of the Framework Directive not to impose any SMP conditions on an undertaking that has SMP. Thus, Ofcom is under an obligation to impose at least one appropriate SMP condition where SMP is confirmed.
- 5.5 The Act (in particular sections 45-50 and 87-92) sets out what obligations Ofcom can impose if it finds that any undertaking has SMP. Sections 87 to 92 implement Articles 9 to 13 of the Access Directive and Articles 17 to 19 of the Universal Service Directive.
- 5.6 In particular, as well as being appropriate (see section 87(1)), each SMP condition must also satisfy the tests set out in section 47 (2) of the Act, namely that each condition must be:
 - objectively justifiable in relation to the networks, services or facilities to which it relates;
 - not such as to discriminate unduly against particular persons or a particular description of persons;
 - proportionate to what the condition is intended to achieve; and
 - in relation to what it is intended to achieve, transparent.
- 5.7 It is Ofcom's view that the proposal contained in this section satisfies the relevant requirements specified in the Act and relevant European Directives. This view is explained in detail in the following paragraphs.

Communications Act tests

- 5.8 Section 3 (1) of the Act sets out what Ofcom's principle duty is – to further the interests of citizens in relation to communications matters; and to further the interests of consumers in relevant markets, where appropriate by promoting competition. Section 3

(2) of the Act sets out the things which Ofcom is required to secure in carrying out its functions. Section 3 also sets out certain matters to which Ofcom must have regard in performing its duties.

- 5.9 Ofcom considers that its proposed remedies fulfil its obligations under section 3 of the Act, having regard to the outcome expected to be achieved by the outlined proposals. In considering which remedies to impose, Ofcom has had regard to these matters, in particular to the matters in section 3(4) of the Act, including the desirability of promoting competition in relevant markets, and the interests of consumers in respect of choice, price, quality of service and value for money, as required by section 3(5) of the Act. In this context, Ofcom also notes that section 3(6) of the Act requires it to prioritise its duties under section 4 of the Act, if these conflict with any of its general duties under section 3 of the Act.
- 5.10 Section 4 of the Act sets out the Community requirements on Ofcom which flow from Article 8 of the Framework Directive. In considering which, if any, SMP services conditions to propose, Ofcom has taken account of all of these requirements. In particular, Ofcom has considered the requirement to promote competition and to secure efficient and sustainable competition for the benefit of consumers.

Relative efficiency of competition law and complementary ex ante regulation

- 5.11 Recital 27 of the Framework Directive provides that ex ante regulation should only be imposed where there is not effective competition and where competition law remedies are not sufficient to address the problem. In order to provide a full analysis, Ofcom has, therefore, also considered the option of no ex- ante regulation, and whether it would be sufficient to rely on competition law alone (see Option a – at paragraphs 4.28 to 4.32).
- 5.12 Where markets are effectively competitive, ex post competition law is sufficient to deal with any competition abuses that may arise. However, without the imposition of ex ante regulations to promote actively the development of competition in a market that is not effectively competitive, it is unlikely that ex post general competition law powers will be sufficient to ensure that effective competition becomes established. For example, this is because ex post powers prohibit abuse of dominance rather than the holding of a dominant position. Ex ante powers can be utilised to reduce the level of market power in a market and thereby encourage effective competition to become established.
- 5.13 Generally, the case for ex ante regulation in telecoms markets is based on the existence of market failures which, by themselves or in combination, mean that competition might not be able to become established if the regulator relied solely on its ex post competition law powers established for dealing with more conventional sectors of the economy. Therefore, it is appropriate for ex ante regulation to be used to address these market failures and entry barriers that might otherwise prevent effective competition from being established. By imposing ex ante regulation that will promote competition, it may be possible to reduce the need for such regulation as markets become more competitive, with greater reliance on ex post competition law.
- 5.14 The European Commission has also stated that ex ante regulation is justified, “[...] where the compliance requirements of an intervention to redress a market failure are extensive (e.g. the need for detailed accounting for regulatory purposes, assessments of costs, monitoring of terms and conditions [...])” (See page 11 of the Commission’s Recommendation.) This is the case for many markets where persistent SMP leads to a risk of a firm setting excessive prices and the need for efficiency incentives, where a

price control would be justified, or where there is likely to be a need for intervention to set detailed terms and conditions for access to networks.

Aims of the conditions being proposed

- 5.15 In Section 4 Ofcom explains why it considers currently that BT holds a position of SMP in the market for NTS call termination.
- 5.16 In considering its sections 3 and 4 duties Ofcom considers that, in view of these findings, ex ante regulation of the wholesale market for NTS call termination is required in order to ensure, in particular, that BT is not able to exploit its position of SMP by unduly favouring its own origination business, leading to a distortion of competition in those markets in which NTS call termination is an input.
- 5.17 The Commission has noted in its Recommendation at Paragraph 4, and Ofcom agrees, that in most cases it is preferable to apply regulation at the wholesale level. This will serve a twofold purpose: it will address SMP problems in the relevant wholesale market and it will in turn feed through to the level of competition in the downstream markets that rely on these wholesale inputs.
- 5.18 The application of regulation at the wholesale level rather than at the retail level, also fits with the Community requirement that National Regulatory Authorities (NRAs) take measures which meet the objective of encouraging efficient investment in infrastructure and promoting innovation. The introduction of regulation in wholesale markets will encourage providers to purchase wholesale products and combine them with their own networks and where possible create products in competition with BT.
- 5.19 It will also help to ensure that the objectives of for example sections 4 (7) and (8) of the Act are met, namely that NRAs take measures which encourage the provision of Network Access and service interoperability for the purpose of securing efficiency and sustainable competition and the maximum benefit for the persons who are customers of Communications Providers and of persons who make such facilities available. Regulation at the wholesale level will, as noted above, help to promote competition in the relevant downstream market(s) and this will in turn help to ensure that the benefits in terms of price, choice and quality are optimised for retail consumers of NTS services.
- 5.20 In assessing the level of regulation to be applied in this market, Ofcom has also taken into account the Commission's SMP Guidelines which state at paragraph 15 that regulation should aim to promote an open and competitive market, and at paragraph 16 that ex ante regulations should be imposed to ensure that an SMP provider cannot use its market power to restrict or distort competition on the relevant market or leverage market power onto adjacent markets.
- 5.21 Ofcom has also taken full account of Oftel's guidelines, Imposing access obligations under the new EU Directives, dated 13 September 2002 (the "Access Guidelines"), and Interconnection of public electronic communications networks, May 2003 (the "Interconnection Guidelines"). These can be found at http://www.ofcom.org.uk/static/archive/oftel/publications/ind_guidelines/acce0902.htm and http://www.ofcom.org.uk/static/archive/oftel/publications/eu_directives/2003/intercon0503.htm respectively.
- 5.22 These describe the circumstances in which Ofcom would consider the imposition of wholesale access obligations to be appropriate, give guidance on the nature of the

wholesale products Ofcom would expect to be supplied as a result of an obligation to provide access, and describe the conditions under which products should be made available.

Regulatory impact assessment

5.23 The analysis presented in this Section, when read also with the previous Sections, represents a Regulatory Impact Assessment (RIA), as defined by section 7 of the Act. You should send any comments on this RIA to us by the closing date for this consultation. We will consider all comments before deciding whether to implement our proposals.

5.24 RIAs provide a valuable way of assessing different options for regulation and showing why the preferred option was chosen. They form part of best practice policy-making and are commonly used by other regulators. This is reflected in section 7 of the Act, which means that generally we have to carry out RIAs where our proposals would be likely to have a significant effect on businesses or the general public, or when there is a major change in Ofcom's activities. In accordance with section 7 of the Act, in producing the RIA in this document Ofcom has had regard to such general guidance as it considers appropriate, including related Cabinet Office guidance.

5.25 In considering what regulation to propose to remedy BT's proposed SMP in the market for NTS call termination, Ofcom has specifically considered a number of possible remedies separately. The obligations considered by Ofcom are

- a transparency obligation
- a general obligation to provide Network Access on reasonable request;
- requirement not to discriminate unduly; and
- basis of charges

5.26 A brief summary of the workings of each of the above remedies is provided in the table below.

Figure 9: Summary of possible obligations

Remedy	Description
Network Access	BT is obliged to satisfy all reasonable requests for Network Access on fair and reasonable terms (but not including charges).
Transparency (charge publication/notification)	BT is obliged to make charges for the provision of Network Access publicly available and to publish charge changes a certain number of days prior to that change becoming effective.
No undue discrimination	BT is obliged not to unduly discriminate against particular persons (including itself or a member of its corporate group) in relation to the provision of Network Access (including the level of charges).
Basis of charges	BT is obliged to provide Network Access on the basis of the charges as set out in the condition e.g. charges are required to be based on costs.

5.27 In considering how to ensure that competition in the market for NTS call termination is promoted, Ofcom has considered a range of options to address this issue. These options are listed below, and summarised in the table below.

- option (a) – impose no ex ante regulation;
- option (b) - impose Network Access and non-discrimination obligations;
- option (c) – as (b) plus a transparency obligation;
- option (d) – as (c) plus a basis of charges obligation.

Figure 10: Summary of options for remedies

Option	Network access	Non-discrimination	Transparency	Basis of charges
(a)				
(b)	✓	✓		
(c)	✓	✓	✓	
(d)	✓	✓	✓	✓

5.28 The following paragraphs will consider these options.

Option (a) – No ex ante obligations

5.29 Under section 6 of the Act, Ofcom has a duty to ensure that it does not impose or maintain unnecessary regulatory burdens. Ofcom has considered whether the most appropriate course of action would be, despite its proposed finding that BT has SMP in this market, to impose no ex ante obligations on BT. The analysis set out in this document demonstrates that there are currently significant competition problems in this market. Ofcom has therefore rejected this option. A brief summary of the pros and cons of this option are set out below.

5.30 Additionally, as set out in paragraph 5.4 above, where Ofcom finds a communications provider with SMP it must impose at least one SMP condition.

Advantages of option (a)

5.31 Having no ex ante obligations should minimise the regulatory burden on both BT and Ofcom.

Disadvantages of option (a)

5.32 A failure to impose any ex ante obligations by Ofcom would lead to a number of problems, notably:

- the absence of a requirement to provide Network Access means that BT could refuse reasonable requests for access, or alternatively provide access on unreasonable terms. In order to compete effectively at the retail level, retail providers must be able to source wholesale inputs on reasonable terms in order to offer a full range of services; and
- the absence of a requirement not to unduly discriminate would give a vertically integrated CP such as BT the ability to distort the retail market by offering different terms, conditions and prices to its retail competitors in wholesale markets where it is the dominant provider.

5.33 While it might be possible to address both of these issues under general competition law, Ofcom considers that this approach is likely to be less certain and less effective than an ex ante approach. Ofcom notes that BT's NCCN 500 charges were introduced in the absence of ex ante regulation.

Option (b) – Network Access and non-discrimination obligations

- 5.34 As is set out below, Option (b) is Ofcom’s preferred option. Whilst it is a more interventionist option than Option (a), leading to a greater regulatory burden on BT, Option (b) should increase the competitiveness of related markets by precluding the possibility of BT engaging in discriminatory charge changes and refusing to supply access.
- 5.35 As outlined in the discussion of Option (a), the introduction of any ex ante obligation is likely to have a cost for Industry associated with it. However, as outlined below, Ofcom’s view is that both Network Access and non-discrimination obligations are essential to prevent the exploitation of BT’s position of SMP.

Requirement to provide Network Access on reasonable request – SMP condition L1

- 5.36 Section 87(3) of the Act authorises the setting of such SMP services conditions requiring the dominant provider to provide Network Access as Ofcom may, from time to time, direct. These conditions may, pursuant to Section 87(5), include provision for securing fairness and reasonableness in the way in which requests for Network Access are made and responded to and for securing that the obligations in the conditions are complied with within periods and at times required by or under the conditions. When considering the imposition of such conditions in a particular case, Ofcom must have regard to amongst other things to the six factors set out in section 87(4) of the Act, including inter alia, the technical and economic viability of installing other competing facilities and the feasibility of the proposed Network Access.
- 5.37 The requirement to provide Network Access on fair and reasonable terms and conditions (but not including charges) ensures that retail providers are able to supply a competitive offering at a downstream retail level. The absence of a requirement to provide Network Access means that BT could refuse reasonable requests for access, or alternatively provide access on unreasonable terms. In order to compete effectively at the retail level, retail providers must be able to access wholesale inputs on reasonable terms and conditions in order to offer a full range of services.
- 5.38 The definition of “access” and the way in which Ofcom might assess reasonable demands for “access” is set out in the Access Guidelines. Ofcom considers that it is appropriate to impose an access obligation formulated in terms of a provider being obliged to meet all reasonable requests for Network Access within the relevant wholesale market in which it has been found to have SMP on fair and reasonable terms and conditions.
- 5.39 However, Ofcom’s view is that the regulation of charges in this market under a Network Access obligation would not be appropriate and is therefore not proposing it be included in the requirement to provide Network Access. As explained in the discussion of regulatory options involving a basis of charges obligation below, a non-discrimination obligation would be sufficient to deter BT from raising its termination charges as per NCCN 500, since such an obligation would mean that BT would have to provide termination at the same or similar charge for all OCPs including itself.

Communications Act tests in relation to proposed SMP Condition L1

- 5.40 As described in Section 4, Ofcom is proposing that BT has SMP in this market. Therefore, Ofcom is currently of the view that a requirement on BT to provide access to its network in the NTS call termination market is appropriate, since such a

requirement would promote competition by enabling OCPs to compete with BT on equal terms.

- 5.41 Under this proposed condition, Ofcom has the power to make certain directions. It is envisaged that this power will be used to deal with issues relating to specific forms of access or the particular terms and conditions on which access is provided. Finally, this proposed condition requires the dominant provider to comply with any such directions. Any contravention of a direction may therefore result in a contravention of the condition itself and thus be subject to enforcement action under sections 94-104 of the Act.
- 5.42 Ofcom has considered all of the Community requirements detailed in sections 3 and 4 of the Act. In particular, the proposed condition satisfies the Community requirements, set out in sections 4 (3), (7) and (8) of the Act. That is, it promotes competition in relation to the provision of electronic communications networks and encourages the provision of Network Access for the purpose of securing efficiency and sustainable competition in the downstream markets for electronic communications networks and services, resulting in the maximum benefit for consumers.
- 5.43 With regard to the tests in section 47 (2) of the Act:
- an obligation to provide Network Access is **objectively justifiable** in that as Ofcom is proposing that BT has SMP in the market, it will allow non-BT CPs access to BT's network on reasonable terms and conditions, which will in turn promote competition;
 - it does not **unduly discriminate** between providers. That is, the proposed obligations are only imposed on BT as the proposed dominant provider in the market (as explained in Sections 2 and 3, Ofcom considers there is a single market for termination in the UK in which no other CP is in a position of SMP);
 - it is **proportionate** in what it is trying to achieve since, while it is directly targeted at addressing the market power that, in Ofcom's view BT holds in the relevant market, it does so without seeking to impose additional unnecessary regulation on BT such as requiring BT in the Network Access condition to provide such access on reasonable charges.
 - it is also **transparent** since what is required by the proposed condition is clear.
- 5.44 The condition meets the requirements of section 87(4) of the Act. In particular, it provides that the SMP provider needs only to meet requests that are reasonable, by which it is meant, inter alia, that they must be technically and economically viable, and feasible. As set out in paragraph 2.7 of the Access Guidelines, Ofcom has taken account of the technical and economic viability of installing and using facilities; and the need to ensure effective competition in the long term.

Requirement not to discriminate unduly – SMP condition L2

- 5.45 Section 87(6)(a) of the Act authorises the setting of an SMP services condition requiring the dominant provider not to unduly discriminate against particular persons, or against a particular description of persons, in relation to matters connected with the provision of Network Access.
- 5.46 The requirement not to unduly discriminate is intended, principally, to prevent dominant providers from discriminating in favour of their own retail activities and to ensure that competing providers purchasing wholesale products from the dominant provider are placed in an equivalent position to the dominant provider's retail arm.

- 5.47 The absence of a requirement not to unduly discriminate would give BT, as a vertically integrated CP, the ability to distort the retail market by offering different terms, conditions and prices to its retail competitors in wholesale markets where it is the dominant provider.
- 5.48 Where dominant providers are vertically integrated in the way that BT is, they may have an incentive to provide wholesale services on terms and conditions that favour their own retail activities, in a way that would have a material adverse effect on competition. In particular, they may charge competing providers more than the amount charged (through transfer charging) to their own retail activities for wholesale services, thereby increasing the costs of competing providers and giving themselves an unfair competitive advantage. They might also provide services on different terms and conditions, for example with different delivery timescales, which would disadvantage their retail competitors and in turn consumers.
- 5.49 In the absence of a non-discrimination condition, Ofcom could be called upon to investigate alleged breaches of the Competition Act prohibition on anti-competitive agreements and abuse of a dominant position, and might be required to resolve successive complaints. As referred to previously, imposing an ex ante condition in this instance will reduce the potential regulatory costs emanating from multiple or successive complaints related to discrimination.
- 5.50 It could be argued that the Competition Act might provide adequate provision to address allegations or evidence of discriminatory behaviour. However, Ofcom considers that at the wholesale level sectoral regulation provides a faster and more secure means of giving effect to decisions and determinations. In addition, it allows Ofcom to place a greater emphasis on promoting competition (for example by restricting the ability of an SMP operator to target segments of the retail market).
- 5.51 A requirement not to unduly discriminate is intended, principally, to prevent dominant providers from discriminating in favour of their own retail activities and to ensure that competing providers are placed in an equivalent position to their retail arms.
- 5.52 A prohibition of discrimination might have disadvantages if it prevented discrimination that was economically efficient or justified. However, the proposed condition provides that there should be no undue discrimination. Oftel's Access Guidelines note that the application of a condition prohibiting undue discrimination does not mean that there should not be any differences in treatment between undertakings, rather that any differences should be objectively justifiable, for example, by differences in underlying costs of supplying different undertakings.
- 5.53 It should be noted that Ofcom intends to consult on non-discrimination guidelines later on in 2004.

Communications Act tests in relation to proposed SMP Condition L2

- 5.54 Ofcom therefore considers that it is appropriate to apply a non-discrimination obligation in this market. This accords with Recital 17 of the Access Directive, which states that non discrimination obligations ensure that undertakings with market power do not distort competition, in particular where they are vertically integrated undertakings that supply services to undertakings with whom they compete on downstream markets.
- 5.55 Ofcom has considered all of the Community requirements detailed in sections 3 and 4 of the Act. In particular, the proposed condition satisfies the Community requirements, set out in sections 4 (3), (7) and (8) of the Act. That is, it promotes competition in

relation to the provision of electronic communications networks and encourages the provision of Network Access for the purpose of securing efficiency and sustainable competition in the downstream markets for electronic communications networks and services, resulting in the maximum benefit for consumers.

5.56 With regard to the tests in section 47(2) of the Act:

- an obligation not to unduly discriminate when providing Network Access is **objectively justifiable** in that given BT's proposed SMP in this market it will ensure that BT offers the same or similar terms and conditions to non-BT CPs as it offers itself as an OCP, in order to promote competition between CPs;
- it does not **unduly discriminate** between communication providers. That is, these obligations are imposed on BT as the proposed dominant provider in the market;
- it is **proportionate** in that it is the minimum necessary to deal with the problem identified in the market, being BT's ability to increase its termination charge to non-BT OCPs in a potentially discriminatory way; and
- it is also **transparent** since it is clear what the condition requires of BT.

5.57 Further Ofcom considers that imposition of this condition satisfies the conditions set out in section 87 of the Act. In particular, that it is fair and reasonable to impose this condition in the interests of securing effective competition in the long term, as it will ensure that non-BT OCPs are able to compete in the provision of NTS services on the same or similar terms as BT.

Option (c) – Network Access, non-discrimination, and transparency obligations

5.58 The additional obligation proposed in Option (c) over Option (b) is a transparency obligation over and above Network Access and non-discrimination obligations.

5.59 Section 87(6)(b) of the Act authorises the setting of SMP services conditions which require a dominant provider to publish all such information, and in such manner as Ofcom may direct, for the purpose of securing transparency.

5.60 If BT was obliged to publish its charges, buyers of NTS call termination from BT would be given full transparency (or advanced warning) of changes to the charge for BT's termination service. Transparency is most likely to be imposed by a regulator as a complement to other obligations in order to make them more effective, e.g. the requirement to behave in a non-discriminatory manner towards competitors would arguably be more effective if all parties could easily compare the factors over which discrimination might take place. Ofcom's view is that this benefit is unlikely to be great in the context of NTS call termination. The level of the payments made by BT as an OCP to TCPs for them to terminate BT-originated NTS calls are well-known and can be found on the Carrier Price List. The level of the payments required by BT as a TCP from other OCPs (including itself) to terminate BT-hosted NTS calls are also available via the "NTS calculator". Therefore Ofcom considers it would be disproportionate to require BT to provide information it already provides.

5.61 While additional disadvantages associated with Option (c), i.e. the additional cost of this obligation, are not likely to be particularly great, in the light of the limited advantages outlined in the previous paragraph. Ofcom does not believe that the imposition of a transparency obligation would be an appropriate obligation in this market.

Option (d) –Network Access, non-discrimination, transparency, and basis of charges obligations

- 5.62 Having established that Option (b) is its preferred choice from Options (a) to (c), Ofcom compares Option (b) against Option (d) below.
- 5.63 The additional obligation proposed in Option (d) over Option (b) is a basis of charges obligation over and above the Network Access and non-discrimination obligations.
- 5.64 Section 87(9) of the Act authorises the setting of SMP service conditions imposing rules regarding the recovery of costs and cost orientation on dominant providers. In a competitive market, the pricing of services on the basis of the commercial judgements of individual companies could be expected to deliver cost-reflective pricing. However, where competition cannot be expected to provide effective pricing constraints, ex-ante regulation is desirable to prevent excessive pricing. Such intervention should also have as its objective the aim of moving the market towards a position where effective competition is realised. Where the competition problem arises at an upstream stage in the production chain, it is likely to be appropriate to regulate the pricing of wholesale inputs, in order to allow effective competition to develop in downstream markets, rather than control downstream prices themselves.
- 5.65 A basis of charges condition would prevent BT from increasing its termination charges outside what is set out in the condition. However, the imposition of a basis of charges obligation in this market would be disproportionate in that Ofcom has no evidence that where a non-discrimination obligation is in place, BT would raise its prices to an anti-competitive level. It would also run contrary to Ofcom's view of the regulatory model for NTS, whereby regulation of the level of charges is restricted to the origination level, termination charges being determined as described in for example Section 2 of this consultation.
- 5.66 In summary, Ofcom does not believe that the imposition of a basis of charges obligation would be an appropriate or proportionate obligation in this market.

Ofcom's initial conclusions

- 5.67 In conclusion, Ofcom's current view is that Option (b) (Network Access and non-discrimination obligations together) is the preferred option for remedies to BT's proposed SMP in the NTS call termination market.

Question 7: *Do stakeholders agree with Ofcom's assessment of the appropriate options for regulatory remedies for the NTS call termination market?*

Question 8: *Do stakeholders consider that there are other regulatory measures that should be imposed as remedies to BT's proposed SMP in the NTS call termination market?*

Communications Act tests in relation to Option (b)

- 5.68 Ofcom considers that the proposed option meets the tests set out in the Act. Ofcom has considered its duty under section 3 and all the Community requirements set out in section 4 of the Act. In particular, the option is aimed at promoting competition and securing efficient and sustainable competition for the maximum benefits of consumers by ensuring that BT must provide termination on the same or similar terms to all OCPs.

5.69 Further, Ofcom considers that imposition of these SMP service conditions satisfies the conditions set out in section 87 of the Act. In particular, that it is fair and reasonable to impose this condition in the interests of effective competition, as it will ensure that other operators are able to make effective use of wholesale inputs and offer products based on these wholesale inputs in competition with BT.

5.70 Therefore Ofcom's proposed decision is that for BT, option (b) represents the appropriate level of regulation to meet the aims set out above. Overall, for the purposes of section 87(1) of the Act, Ofcom considers that this option is appropriate. Ofcom also considers that collectively, the obligations therein meet the tests set out in section 47 (2) of the Act. That is,

- they are **objectively justifiable** as they would together potentially allow CPs to compete with BT in the NTS call termination market by obliging BT to provide termination on the same or similar terms and conditions to its competitors as it provides to itself;
- they do not **unduly discriminate** against BT as there are no other providers in the market with SMP;
- the requirements proposed are **proportionate** in that they are appropriate to address BT's market position and facilitate sustainable competition and the maximum benefit for end users while not obliging BT to do more that is necessary at present. For example, Ofcom is not requiring BT to publish its charges, nor is Ofcom proposing to put in place a basis of charges SMP services condition; and
- they are also **transparent** as the proposed requirements on BT are set out clearly in the relevant annex to this document.

The Access Guidelines

5.71 The Access Guidelines state that obligations relating to the supply of wholesale products must be based on the nature of the problem identified, proportionate and justified in the light of the objectives in Article 8 of the Framework Directive. The proposed SMP conditions have been formulated in accordance with the nature of the problem identified which is BT's SMP in the NTS call termination market. Section 4 of the Act gives effect to Article 8 of the Framework Directive. As section 4 of the Act has been considered above, further analysis of the objectives of Article 8 is not required.

Joint ERG/EC approach on appropriate remedies in the new regulatory framework

5.72 The European Regulators Group and the Commission have recently jointly issued a document entitled Joint ERG/EC approach on appropriate remedies in the new regulatory framework, 23 April 2004, setting out practical guidance on the selection of appropriate remedies to be imposed on undertakings with SMP. Ofcom participated fully in the preparation of that document and believes that the proposals set out are fully compatible with the guidance provided by the ERG and the Commission.

Section 6

Responding to this consultation

How to respond

- 6.1 Ofcom invites written views and comments on the issues raised in this document, to be made by **5pm on 7 January 2005**.
- 6.2 Ofcom strongly prefers to receive responses as e-mail attachments, in Microsoft Word format, as this helps us to process the responses quickly and efficiently. We would also be grateful if you could assist us by completing a response cover sheet (see Annex 2) to indicate whether or not there are confidentiality issues. The cover sheet can be downloaded from the 'Consultations' section of our website.
- 6.3 Please can you send your response to nts@ofcom.org.uk.
- 6.4 Responses may alternatively be posted or faxed to the address below, marked with the title of the consultation.

Geoff Brighton
Competition and Regulation
Fourth Floor
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA

Tel: 020 7783 4175
Fax: 020 7783 4103

- 6.5 Note that we do not need a hard copy in addition to an electronic version. Also note that Ofcom will not routinely acknowledge receipt of responses.
- 6.6 It would be helpful if your response could include direct answers to the questions asked in this document, which are listed together at Annex 3. It would also help if you can explain why you hold your views, and how Ofcom's proposals would impact on you.

Further information

- 6.7 If you have any questions about the issues raised in this consultation, or need advice on the appropriate form of response, please contact Geoff Brighton on 020 7783 4175.

Confidentiality

- 6.8 Ofcom thinks it is important for everyone interested in an issue to see the views expressed by consultation respondents. We will therefore usually publish all responses on our website, www.ofcom.org.uk, ideally on receipt (when respondents confirm on their response cover sheet that this is acceptable).
- 6.9 All comments will be treated as non-confidential unless respondents specify that part or all of the response is confidential and should not be disclosed. Please place any

confidential parts of a response in a separate annex, so that non-confidential parts may be published along with the respondent's identity.

- 6.10 Ofcom reserves its power to disclose certain confidential information where this is necessary to fulfil its functions, although in practice it would do so only in limited circumstances.
- 6.11 Please also note that copyright in responses will be assumed to be assigned to Ofcom unless specifically retained.

Next steps

- 6.12 Following the end of the consultation period, Ofcom intends to publish a statement around the first calendar quarter of 2005.
- 6.13 Please note that you can register to get automatic notifications of when Ofcom documents are published, at http://www.ofcom.org.uk/static/subscribe/select_list.htm.

Ofcom's consultation processes

- 6.14 Ofcom is keen to make responding to consultations easy, and has published some consultation principles (see Annex 1) which it seeks to follow, including on the duration of consultations
- 6.15 If you have any comments or suggestions on how Ofcom conducts its consultations, please call our consultation helpdesk on 020 7981 3003 or e-mail us at consult@ofcom.org.uk. We would particularly welcome thoughts on how Ofcom could more effectively seek the views of those groups or individuals, such as small businesses or particular types of residential consumers, whose views are less likely to be obtained in a formal consultation.
- 6.16 If you would like to discuss these issues, or Ofcom's consultation processes more generally, you can alternatively contact Philip Rutnam, Partner, Competition and Strategic Resources, who is Ofcom's consultation champion:

Philip Rutnam
Ofcom
Riverside House
2A Southwark Bridge Road
London SE1 9HA
Tel: 020 7981 3585
Fax: 020 7981 3333

E-mail: philip.rutnam@ofcom.org.uk

Annex 1

Ofcom's consultation principles

Ofcom has published the following seven principles that it will follow for each public written consultation:

Before the consultation

A1.2 Where possible, we will hold informal talks with people and organisations before announcing a big consultation to find out whether we are thinking in the right direction. If we do not have enough time to do this, we will hold an open meeting to explain our proposals shortly after announcing the consultation.

During the consultation

A1.3 We will be clear about who we are consulting, why, on what questions and for how long.

A1.4 We will make the consultation document as short and simple as possible with a summary of no more than two pages. We will try to make it as easy as possible to give us a written response. If the consultation is complicated, we may provide a shortened version for smaller organisations or individuals who would otherwise not be able to spare the time to share their views.

A1.5 We will normally allow ten weeks for responses to consultations on issues of general interest.

A1.6 There will be a person within Ofcom who will be in charge of making sure we follow our own guidelines and reach out to the largest number of people and organisations interested in the outcome of our decisions. This individual (who we call the consultation champion) will also be the main person to contact with views on the way we run our consultations.

A1.7 If we are not able to follow one of these principles, we will explain why. This may be because a particular issue is urgent. If we need to reduce the amount of time we have set aside for a consultation, we will let those concerned know beforehand that this is a 'red flag consultation' which needs their urgent attention.

After the consultation

A1.8 We will look at each response carefully and with an open mind. We will give reasons for our decisions and will give an account of how the views of those concerned helped shape those decisions.

Annex 2

Consultation response cover sheet

- A2.1 In the interests of transparency, we will publish all consultation responses in full on our website, www.ofcom.org.uk, unless a respondent specifies that all or part of their response is confidential. We will also refer to the contents of a response when explaining our decision, without disclosing the specific information that you wish to remain confidential.
- A2.2 We have produced a cover sheet for responses (see below) and would be very grateful if you could send one with your response. This will speed up our processing of responses, and help to maintain confidentiality by allowing you to state very clearly what you don't want to be published. We will keep your completed cover sheets confidential.
- A2.3 We strongly prefer to receive responses in the form of a Microsoft Word attachment to an email. Our website therefore includes an electronic copy of this cover sheet, which you can download from the 'Consultations' section of our website.
- A2.4 Please put any confidential parts of your response in a separate annex to your response, so that they are clearly identified. This can include information such as your personal background and experience. If you want your name, address, other contact details, or job title to remain confidential, please provide them in your cover sheet only so that we don't have to edit your response.

Cover sheet for response to an Ofcom consultation

BASIC DETAILS

Consultation title: NTS call termination market review

To (Ofcom contact):

Name of respondent:

Representing (self or organisation/s):

Address (if not received by email):

CONFIDENTIALITY

What do you want Ofcom to keep confidential?

Nothing	<input type="checkbox"/>	Name/contact details/job title	<input type="checkbox"/>
Whole response	<input type="checkbox"/>	Organisation	<input type="checkbox"/>
Part of the response	<input type="checkbox"/>	If there is no separate annex, which parts?	

If you want part of your response, your name or your organisation to be confidential, can Ofcom still publish a reference to the contents of your response (including, for any confidential parts, a general summary that does not disclose the specific information or enable you to be identified)?

DECLARATION

I confirm that the correspondence supplied with this cover sheet is a formal consultation response. It can be published in full on Ofcom’s website, unless otherwise specified on this cover sheet, and I authorise Ofcom to make use of the information in this response to meet its legal requirements. If I have sent my response by email, Ofcom can disregard any standard e-mail text about not disclosing email contents and attachments.

Ofcom seeks to publish responses on receipt. If your response is non-confidential (in whole or in part), and you would prefer us to publish your response only once the consultation has ended, please tick here.

Name Signed (if hard copy)

Annex 4

Consultation questions

Question 1: Do stakeholders agree with Ofcom's initial view that the termination of all NTS call types (0845/0870, etc, also voice and data calls) should be included within the same market?

Question 2: Do stakeholders agree with Ofcom's initial view that there is a single market for NTS call termination, i.e. that the market should not be defined on a TCP specific basis?

Question 3: Do stakeholders agree with the approach to SMP assessment that Ofcom has used, especially the fact that an analysis of market shares has not been decisive to the proposed finding of SMP?

Question 4: - Do stakeholders agree with Ofcom's assessment of SMP in the NTS call termination market?

Question 5: How do stakeholders think the position is likely to change, if at all, during the next 18 months to two years?

Question 6: What impact, if any, do stakeholders think that Option 2 from the NTS Policy Options Consultation, if implemented, will have on the competitiveness of this market?

Question 7: Do stakeholders agree with Ofcom's assessment of the appropriate options for regulatory remedies for the NTS call termination market?

Question 8: Do stakeholders consider that there are other regulatory measures that should be imposed as remedies to BT's proposed SMP in the NTS call termination market?

Annex 5

Details of proposed remedies

Draft Notification – for information purposes only

DRAFT NOTIFICATION UNDER SECTIONS 48 (2) AND 80 OF THE COMMUNICATIONS ACT 2003

Proposals for identifying a market, making a market power determination and the setting of SMP conditions in relation to BT

1. The Office of Communications (“OFCOM”), in accordance with sections 48(2) and 80 of the Communications Act 2003 (the ‘Act’) hereby makes the following proposals for identifying markets, making market power determinations and the setting of SMP services conditions by reference to such determinations (“SMP conditions”).
2. OFCOM are proposing to identify the following market for the purpose of making market power determinations:
 - 2.a NTS call termination in the United Kingdom;
3. OFCOM are proposing to make a market power determination that the following person has significant market power:
 - 3.a in relation to the market set out in paragraph 2(a) above, BT.
4. OFCOM are proposing to set SMP conditions on the person referred to in paragraph 3(a) above as set out in Schedule 1 to this Notification.
5. The effect of, and OFCOM’s reasons for making, the proposals to identify the market set out in paragraph 2 (a) above and to make the market power determination set out in paragraph 3 (a) above are contained in Sections [...] and [...] of the explanatory statement published with this Notification.
6. The effect of, and OFCOM’s reasons for making, the proposals to set the SMP conditions set out in Schedule 1 to this Notification are contained in Section [...] of the explanatory statement published with this Notification.
7. In identifying and analysing the market referred to in paragraph 2 above, and in considering whether to make the proposals set out in this Notification, OFCOM have, in accordance with section 79 of the Act, taken the utmost account of all applicable guidelines and recommendations which have been issued or made by the European Commission in pursuance of a Community instrument, and relate to market identification or analysis.
8. OFCOM considers that the proposed SMP conditions referred to in paragraph 4 above comply with the requirements of sections 45 to 50, 78 to 92 of the Act as appropriate and relevant to each such SMP condition.
9. Representations may be made to OFCOM about any of the proposals set out in this Notification and the accompanying explanatory statement by [...].

10. Copies of this Notification and the accompanying explanatory statement have been sent to the Secretary of State for Trade and Industry in accordance with section 50 (1) (a) of the Act, the European Commission, and to the regulatory authorities of every other member State in accordance with sections 50 (3) and 81 of the Act.
11. Save for the purposes of paragraph 2 of this Notification and except as otherwise defined in this Notification, words or expressions shall have the same meaning as they have been ascribed in the Act.
12. In this Notification:
 - a. “**BT**” means British Telecommunications plc whose registered company number 1800000, and including any of its subsidiaries or holding companies, or any subsidiary of such holding companies, all as defined by section 736 of the Companies Act 1985, as amended by the Companies Act 1989;
 - b. “**NTS**” means number translation services;
 - c. “**NTS Call**” means a call to a number identified in the Numbering Plan for the United Kingdom as a Special Service number or a Premium Rate Service number:
 - plus calls to 0500 Freephone numbers;
 - excluding calls to 0844 04 numbers for Surftime Internet access services and calls to 0808 99 numbers for FRIACO; and
 - d. “**United Kingdom**” has the meaning given to it in the Interpretation Act 1978.

Caroline Wallace, Director of Competition Policy

A person authorised by Ofcom under paragraph 18 of the Schedule to the Office of Communications Act 2002

[... 2005]

Schedule 1

The conditions proposed to be imposed on BT under sections 45 and 87 of the Communications Act 2003 as a result of the analysis of the NTS call termination market in the United Kingdom (“SMP condition”)

Part 1: Application, definitions and interpretation of these conditions

1. These conditions shall apply to the market for NTS Call termination provided by the Dominant Provider (“the Market”).
2. For the purpose of interpreting the conditions imposed on the Dominant Provider following a review of the Market, the following definitions shall apply:
 - a. “**Act**” means the Communications Act 2003;
 - b. “**Director**” means the Director General of Telecommunications as appointed under section 1 of the Telecommunications Act 1984;
 - c. “**Dominant Provider**” means British Telecommunications plc whose registered company number is 1800000, and any British Telecommunications plc subsidiary or holding company, or any subsidiary of that holding company, all as defined by Section 736 of the Companies Act 1985 as amended by the Companies Act 1989;
 - d. “**NTS**” means number translation services;
 - e. “**NTS Call**” means a call to a number identified in the Numbering Plan for the United Kingdom as a Special Service number or a Premium Rate Service number
 - plus calls to 0500 Freephone numbers;
 - excluding calls to 0844 04 numbers for Surftime Internet access services and calls to 0808 99 numbers for FRIACO;
 - f. “**Third Party**” means either:
 - a person providing a Public Electronic Communications Network; or
 - a person providing a Public Electronic Communications Service.
3. Except insofar as the context otherwise requires, words or expressions shall have the meaning assigned to them and otherwise any word or expression shall have the same meaning as it has in the Act.
4. The Interpretation Act 1978 shall apply as if each of the conditions were an Act of Parliament.
5. Headings and titles shall be disregarded.

Part 2: The conditions

Condition L1 – Requirement to provide Network Access on reasonable request

L1.1 Where a Third Party reasonably requests in writing Network Access, the Dominant Provider shall provide that Network Access. The Dominant Provider shall also provide such Network Access as Ofcom may from time to time direct.

L1.2 The provision of Network Access in accordance with Condition L1.1 shall occur as soon as reasonably practicable and shall be provided on fair and reasonable terms and conditions (however not including the charge for providing Network Access) and on such terms and conditions as Ofcom may from time to time direct.

L1.3 The Dominant Provider shall comply with any direction Ofcom may make from time to time under this Condition.

Condition L2 – Requirement not to unduly discriminate

L2.1 The Dominant Provider shall not unduly discriminate against particular persons or against a particular description of persons, in relation to matters connected with Network Access (including the level of charges for the provision of Network Access).

L2.2 In this Condition the Dominant Provider may be deemed to have shown undue discrimination if it unfairly favours to a material extent an activity carried on by it so as to place at a competitive disadvantage persons competing with the Dominant Provider.

Annex 5

The BT NTS call origination condition

Note: the paragraph numbering used in this Annex is the paragraph numbering used in the Review of the fixed narrowband wholesale exchange line, call origination, conveyance and transit markets published by the Director on 28 November 2003. Since Ofcom has now assumed its powers under the Act (which the Director carried out on Ofcom's behalf for a transitional period under section 408 of the Act), references to the Director should be read as references to Ofcom.

Condition AA11

Requirement to provide NTS Call Origination

AA11.1 The Dominant Provider shall provide NTS Call Origination as soon as it is reasonably practicable to every Third Party who reasonably requests it in writing.

AA11.2 Without prejudice to paragraphs AA11.3 and AA11.4 below and where a request is covered by paragraph AA11.1 above, the Dominant Provider shall provide NTS Call Origination on fair and reasonable terms, conditions and charges and on such terms, conditions and charges as the Director may from time to time direct.

AA11.3 The Dominant Provider shall pass the Net Retail Call Revenue to the Third Party that is purchasing the NTS Call Origination, less the charges referred to in Condition AA11.4 below.

AA11.4 The Dominant Provider shall make no charges for providing NTS Call Origination covered by paragraph AA11.1 except for:

- a charge for the Call Origination Service used to originate the NTS Call;
- a charge for the NTS Retail Uplift; and
- a charge for bad debt relating to the retailing by the Dominant Provider of Premium Rate Services calls.

AA11.5 The Dominant Provider shall comply with any direction the Director may make from time to time under this Condition AA11.

AA11.6 This Condition AA11 is without prejudice to the generality of the provisions in Conditions AA1(a) to AA7 above.

Relevant definitions

“Net Retail Call Revenue” means the retail revenue for calls, excluding VAT and after any applicable discounts;

“NTS” means number translation services;

“NTS Calls” means a call to a number identified in the Numbering Plan for the United Kingdom as a Special Service number or a Premium Rate Service number plus calls to 0500

Freephone numbers; excluding calls to 0844 04 numbers for Surftime internet access A8.9.3 services and calls to 0808 99 numbers for FRIACO;

“NTS Call Origination” means originating NTS Calls and retailing those NTS Calls to the End-User on behalf of the Third Party who has requested NTS call origination;

“NTS Retail Uplift” means the charge for retailing