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TELECOMMUNICATIONS POLICY REVIEW PANEL

COMMENTS

OF

THE COMMISSIONER OF COMPETITION

TELECOMMUNICATIONS POLICY REVIEW

AUGUST 15, 2005

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* The letter and number in parentheses denote the question in the *Telecommunications Policy Review – Consultation Paper*, dated June 6, 2005, to which the section relates.

EXECUTIVE SUMMARY

1. This is a summary of the views of the Commissioner of Competition (the Competition Bureau or the Bureau) submitted to the Telecommunications Policy Review Panel (the "Panel") in response to the Panel's request for comments on the issues raised in its *Telecommunications Policy Review – Consultation Paper.*[1]

2. The Bureau commends the Panel for its work so far in aptly and comprehensively identifying the issues that will be critical to the development of sound policy objectives and an appropriate regulatory framework for telecommunications in Canada. The Bureau is pleased to provide its views on those issues within its expertise and mandate under the *Competition Act* that it considers most important to the development of competitive telecommunications markets in Canada.

3. In its submission, the Bureau provides comments on the following areas:

4. **Competition issues in an ILEC vs. cable duopoly** – The Bureau is well placed to provide guidance on the analysis that should be undertaken, and the factors that should play a key role, in determining the competitiveness of a duopoly market. Accordingly, in this section of the submission, the Bureau sets out the circumstances under which two competing networks in the same market could be sufficiently competitive to protect the interests of users. The Bureau also highlights the competitive issues that normally arise

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[1] Telecommunications Policy Review Panel, *Telecommunications Policy Review – Consultation Paper*, dated June 6, 2005, online: Telecommunications Policy Review Panel <http://www.telecomreview.ca/epic/internet/intprp-gecrt.nsf/en/rx00016e.html> (last modified: 8 August 2005) [hereinafter, Consultation Paper].

in the telecommunications environment, recognizing that the Bureau maintains authority under the *Competition Act* to address any anticompetitive conduct.

5. **Telecommunications policy objectives** – As the telecommunications sector faces unprecedented change and innovation, a review of Canada's telecom policy objectives is in order. The Bureau believes that in addition to being an objective in its own right, the reliance on market forces will help to achieve other policy objectives. The Bureau proposes regulatory objectives to provide the CRTC with practical guidance in the exercise of its powers in furtherance of the overall telecommunications policy objectives. One such regulatory objective would direct the CRTC to adopt the regulatory measure, or take the decision, that is least intrusive in the marketplace.

6. **Re-imposition of economic regulation** – Given the costs inherent in regulation, the Bureau believes that economic regulation on markets previously forborne should only be re-imposed where there is compelling evidence of market failure following a full review of all relevant circumstances and market facts, including a full competition analysis. The Bureau proposes that predetermined tests, thresholds or triggers for re-regulation should be avoided in favour of a rigorous review of the relevant market using the Bureau's competition analysis.

7. **Wholesale regulation in competitive retail markets** – The Bureau believes that competition at the retail level is likely to reduce the need for continuing to regulate wholesale services and facilities, provided that retail competition is among separate facilities-based providers. However, competition only among stand-alone retailers that

rely on access to a single facilities-based provider will not eliminate any market power that such a facilities supplier possesses. In that scenario, regulation may be beneficial.

8. **Wholesale regulation as a substitute for retail regulation** – The Bureau believes that regulation of underlying wholesale facilities and services can substitute for direct regulation of the retail service only if such regulation can be effectively designed to accommodate competition among separate stand-alone retail providers.

9. **Interconnection and access to facilities** – The Bureau submits that even where a telecommunications market is competitive in all other respects, there are certain circumstances in which mandated interconnection will continue to be warranted in order to allow customers of different networks to communicate with each other. The Bureau also submits that there may be some areas in Canada where sharing of essential facilities on a mandated basis may be necessary for the development of competition sufficient to forbear from regulation.

10. **Social regulation** – The Bureau is not a regulator and therefore does not engage in *ex ante* social or consumer protection regulation. However, through the enforcement of the *Competition Act*, the Bureau plays an important role in protecting consumers against fraud and anti-competitive practices and ensuring that businesses provide accurate information when marketing their products and services. The Bureau believes that, to the extent possible, public policy should attempt to achieve social policy goals through the adoption of mechanisms that are least restrictive to competition.

11. **Role of competition law in telecommunications regulation** – As telecommunications markets become increasingly shaped by technological innovation

and the advent of new services and suppliers, competition principles will need to play an ever greater role in the regulation and oversight of the industry. The challenge for regulators and policy makers will be to establish the framework that will allow regulatory and competition authorities to work in unison. In an environment of overlapping jurisdiction between the CRTC and the Bureau, greater certainty as to when competition principles should prevail would be beneficial. In this regard, where the CRTC finds that rate regulation is no longer warranted, reliance on the general provisions of the *Competition Act* should be sufficient to address any concerns about anticompetitive conduct. In addition to a clarification of responsibility for handling allegations of anticompetitive behaviour, the Bureau believes that its role in applying competition law analysis in telecom forbearance matters should be strengthened, given its substantial expertise in this area.

12. **Competition law principles and the regulatory framework** – In the view of the Bureau, the best regulatory framework will be that which makes the best use of existing knowledge and experience within our agencies; ensures timely and effective responses to industry change; is cost effective; and keeps government intervention to the bare essential. The Bureau outlines several arrangements that may facilitate effective interaction between competition law authorities and telecom regulators based on a commissioned comparative study of other jurisdictions. Improved information sharing and access to confidential information would enhance the effectiveness of the Bureau's involvement in CRTC proceedings, pursuant to section 125 of the *Competition Act*, which grants the Bureau the right to intervene in CRTC proceedings. In keeping with the principle of best use of expertise, it would also be appropriate to accord greater weight to

the views of the Bureau in competition-related telecom matters. The Bureau presents a range of alternatives to reach these goals.

13. **Foreign investment restrictions** – The Bureau submits that the foreign ownership restrictions have served their intended purpose and are no longer necessary to harmonize Canadian policy with that of our global trading partners. Furthermore, the Bureau is unaware of any articulated concerns to national sovereignty, security or economic, social and cultural well-being that the foreign ownership restrictions are needed or even well-suited to address. Therefore, the Bureau supports the eventual removal of these restrictions in the telecommunications sector.

INTRODUCTION

14. The Bureau is pleased to submit the following comments to the Telecommunications Policy Review Panel pursuant to the procedures outlined in the Panel's Consultation Paper and subsequent letter to parties to the Telecommunications Policy Review.[2]

15. The Commissioner of Competition is responsible for the administration and enforcement of the *Competition Act*. The statutory purpose of the Act is to maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy. The Act also aims to expand opportunities for Canadian participation in world markets while recognizing the role of foreign competition in

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[2] Telecommunications Policy Review Panel, *Letter to Parties to the Telecommunications Policy Review Re: Additional information regarding the Telecommunications Policy Review*, dated July 7, 2005, online: Telecommunications Policy Review Panel <http://www.telecomreview.ca/epic/internet/intprp-gecrt.nsf/en/rx00024e.html > (last modified: 7 July 2005).

Canada, to ensure that small and medium-sized enterprises have an equitable opportunity to participate in the Canadian economy and to provide consumers with competitive prices and product choices.[3]

16. In keeping with the Bureau's mandate and in recognition of the difficult time constraints that the Panel faces in conducting this Review, the Bureau has focused its comments on those areas most relevant to the transition of the telecommunications market from a monopoly environment to one controlled by market forces. To this end, the Bureau has selected only those questions that are particularly germane to its own mandate under the *Competition Act*, and that relate to the areas in which the Bureau has substantial expertise. The Bureau intends to provide its views on the comments of other interested parties in the second round of this Review and would be pleased to provide the Panel with any additional information or participate in any subsequent proceedings or activities at its request.

17. The Bureau agrees with the Panel's observation that "Canada has generally been well served by the policy and regulatory framework that evolved over the last century".[4] Moreover, the Bureau agrees that this framework has allowed for the development of some of the most advanced, ubiquitous and affordable telecommunications networks and services in the world. The Bureau considers as well, that Canada is, in many respects, a world leader in telecommunications development. Canadians are, and should be, proud of our telecommunications innovation and heritage.

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[3] *Competition Act*, RSC 1985, c. C-34, as amended, sections 1.1 and 7(1).

[4] Consultation Paper at p. 4.

18. Over the past twenty years under this evolving policy and regulatory framework, the telecommunications sector has migrated from a monopoly service delivery model to a more consumer-driven market. As the Panel noted, this migration has generally been quite successful.[5]

19. Indeed, since the early 1980s the Canadian Radio-television and Telecommunications Commission (CRTC) and Industry Canada have done an admirable job of opening up telecommunications markets to competition. The CRTC has forborne from aspects of regulation in voice and data long distance communications and prices continue to fall. The same applies to terminal equipment, international, broadband, and wireless communications. Industry participants have responded to these opportunities with investment in networks and services to provide choice to consumers. Consumers, in turn, are taking advantage of their alternatives.

20. However, in this climate of globalization, deregulation and rapid technological change, it is incumbent upon governments and regulators to scrutinize policies and regulation to ensure that they are forward-looking, necessary, and as narrowly drawn as possible to serve their needed purpose. Accordingly, the Review comes at an important time in the evolution of Canadian, and global, telecommunications markets.

21. The Bureau commends the Panel for its work so far in aptly and comprehensively identifying the issues that will be critical to the development of sound policy objectives and an appropriate regulatory framework for telecommunications in Canada and is pleased to provide its views on those issues within its mandate and expertise that it

[5] Consultation Paper at p. 7.

considers most important to the development of competitive telecommunications markets in Canada.

I. THE CHANGING TELECOMMUNICATION ENVIRONMENT

COMPETITION ISSUES IN AN ILEC VS. CABLE DUOPOLY

A.5 ***Is the Canadian competitive environment in telecommunications likely to evolve into a form of duopoly (i.e. incumbent local exchange carriers (ILECs) versus cable companies)? If so, what would be the implications for the telecommunications and ICT markets? What would be the implications for the regulatory framework?***

22. While the Bureau is not in a position to predict the likely evolution of the telecommunications market, it does recognize that new technologies have already shown the potential to break down traditional barriers to entry in the local telecommunications market, and make broader local competition more attainable. The Bureau expects that any forecasting of the telecommunications market of the future should bear such technological developments in mind.

23. The ongoing CRTC Local Forbearance proceeding[6] is considering the issue raised in this question. The Commission's proceeding will likely clarify whether a duopoly exists, or is likely to evolve, and whether such a duopoly provides sufficient competition to justify deregulation.

24. Assuming, for the purposes of this question, that the market does evolve into a form of duopoly between Incumbent Local Exchange Carriers (ILECs) and cable companies, the implications for the telecommunications market could be substantial

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[6] *Forbearance from regulation of local exchange services*, Telecom Public Notice CRTC 2005-2, dated April 28, 2005 [hereinafter CRTC Local Forbearance proceeding].

improvements over the monopoly conditions that have, for so long, dominated this sector.[7]

25. The Bureau considers that the potential positive outcomes of a cable/ILEC duopoly might include a decreased likelihood for unilateral effects (i.e., that a firm could profitably raise prices above competitive levels) due to the degree of rivalry between the cable companies and the ILECs.[8] Aggressive price competition and innovation are other potential benefits that could be expected since most of the costs of service provision (i.e., network costs) by either the ILECs or the cable companies are fixed and sunk, the cost to provision VoIP would be incremental and the services offerings would be of similar quality.

26. Notwithstanding the theoretical potential for positive outcomes of a cable/ILEC duopoly, without detailed information regarding the market in question, the Bureau cannot provide a definitive answer as to whether the environment contemplated by the Panel's question would be sufficiently competitive to protect the interests of users.

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[7] The Bureau notes that after it has had the opportunity to review the record in the CRTC's Local Forbearance proceeding, it may conclude that the benefits of a duopoly are sufficient to justify effective deregulation in many areas of ILEC local service offerings.

[8] In its review of the acquisition of Microcell Telecommunications Inc. by Rogers Wireless Communications Inc., the Bureau found that the competitive history of Bell, Telus and Rogers in the mobile telecommunications market supported the conclusion that there would continue to be vigorous and effective competition remaining following the merger. The Bureau further concluded that Telus and Bell would compete aggressively for the former Microcell subscribers, and viewed Rogers' absence from the wireline market as providing an incentive for it to continue to offer some of the more aggressive marketing features from Microcell in a effort to move customers away from the traditional services offered by incumbent local exchange competitors. Competition Bureau Canada, *Technical Backgrounder to the Acquisition of Microcell Telecommunications Inc. by Rogers Wireless Communications Inc.*, online: Competition Bureau Canada <http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=257&lg=e> (date accessed: August 13, 2005).

However, the Bureau is well placed to provide guidance on the analysis that should be undertaken, and the factors that should play a key role, in determining the competitiveness of a duopoly market.

27. The Bureau has substantial expertise and experience in analyzing the competitiveness of a wide range of markets across a variety of industry sectors and routinely performs competitive analyses in accordance with its mandate under the *Competition Act*. Defining relevant product and geographic markets, and the assessment of market power within those markets, are key steps in the analysis that underpins the enforcement of both the merger and abuse of dominance provisions of the Act. Moreover, the techniques and analytical tools that the Bureau employs are constantly updated and refined to reflect advances in economic and antitrust theory. In this regard, the Bureau recently released a revised version of its *Merger Enforcement Guidelines* (MEGs)[9].

28. In the paragraphs that follow, and in an attempt to shed light on the potential market implications of a cable/ILEC duopoly, the Bureau sets out the circumstances under which two competing networks in the same market could be sufficient to warrant forbearance.

29. Two competing networks in the telecommunications market may provide sufficient competition where:

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[9] The MEGs provide general guidance on the Bureau's analytical approach to the assessment of market power. The MEGs provide guidance on market definition and the factors to be considered in assessing the anti-competitive effects in markets. The factors set out in the MEGs also have useful application to general competition analysis in various markets; Competition Bureau Canada, *Merger Enforcement Guidelines*, September 2004, online: Competition Bureau Canada <http://www.competitionbureau.gc.ca/internet/index.cfm?itemid=1245&lg=e> (date accessed: August 13, 2005);

i. At least two unaffiliated networks, where the entrant is capable of providing access at a lower cost to each potential location where access to the PSTN is demanded. The area for which forbearance applies will be the geographic region for which the two networks have relatively similar geographic footprints, either actual or potential locations that can be added to a network at relatively low cost.

ii. From the perspective of consumers, both networks have similar features available and equivalent quality of access.

iii. Industry characteristics are such that the coordinated exercise of market power is not likely to be a significant issue.

30. To assess the degree of competitiveness in a duopoly market, the Bureau would look to a number of factors, including the degree of rivalry between the competing firms; the nature of change and innovation in the market; the stage of market growth; barriers to entry; and the presence of strong potential facilities-based entrants.

31. In practical terms, the Bureau would also look to the competitive issues that are typically raised by stakeholders in the telecommunications market. The main areas of concern tend to be predation, consumer poaching and cross-subsidization.

32. The Bureau considers that certain of these competitive concerns are less likely to arise in the context of a cable/ILEC duopoly. For example, if the cable companies have already invested in a sunk network that is ubiquitous and exists for reasons other than to supply telecommunications services, possible attempts at predation by the ILECs would be unlikely to induce exit. For predation to induce exit in this scenario, the ILEC's prices would have to fall below the rival's average avoidable costs. Depending on the magnitude of the fixed and sunk capital costs of the network, this could be substantially lower than long run average incremental cost, and such a tactic may not be profitable for

ILECs. The existence of a ubiquitous network serving residential customers[10] suggests that the cable companies may require only incremental investment to adapt their networks to provide local telecommunications services to residential customers. The capitalization and stability of the cable companies also suggests that they may not be at a disadvantage to ILECs with respect to access to capital. A similar analysis would be required for business customers.

33. With respect to consumer poaching, the Bureau notes that these concerns arise when the firms compete customer by customer by offering very low prices. The result is that the rival may not have sufficient gross profits to recover its sunk costs and will be forced to exit even though the ILEC's prices are not predatory. In the case of an ILEC/cable duopoly, the scale at which the cable companies could roll out telecommunications services and their potentially lower costs suggest that this concern may not be justified.

34. Nevertheless, the Bureau retains the authority under section 79 of the *Competition Act* to investigate alleged claims of predation, whether carried out through direct price cuts, price squeezes, or consumer poaching. The Bureau is committed to exercise its responsibilities in this area. It will continue to assess evidence of unduly aggressive pricing, capacity expansion, or other practices instituted to drive out entrants. It will examine claims that entrants have inadequate access to capital markets to allow them the funding to survive attempts at predation. The Bureau also assesses evidence of the

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[10] Canadian Cable Telecommunications Association 2004-5 Annual Report, online: Canadian Cable Telecommunications Association <http://www.ccta.com/CMFiles/AR_Final_e52JRN-522005-7638.pdf> (date accessed: August 15, 2005).

alleged predator's ability to recoup lost profits from predation through charging higher prices after the predation is successful. An important aspect of assessing that evidence is to determine if those high post-predation prices will themselves encourage new entry. Such assessments are well within the Bureau's authority and expertise, and need not be retained by a price regulator.[11]

II. THE REGULATORY FRAMEWORK

TELECOMMUNICATIONS POLICY OBJECTIVES

B.1 *Should the existing policy objectives set out in Section 7 of the Telecommunications Act be changed? If so, what should they be?*

35. Since the embodiment in 1992 of the set of policy objectives in section 7 of the *Telecommunications Act*, technological innovation and changes in telecommunications services, equipment, markets, user demographics and global trade have considerably altered the telecommunications landscape. The Bureau considers that the relevance and importance of the social and economic problems and industry activity that the Act was originally designed to address in 1992, are likely to have changed significantly as well. Therefore, as the telecommunications sector faces even more tumultuous change in the coming years, a review of Canada's telecom policy objectives is in order.

36. Parliament's first steps must be to anticipate the new social and economic problems that this evolution is likely to bring about, and to formulate the long-range objectives for telecommunications in Canada. Ideally, these objectives and issues should

[11] See the observations below in response to questions B.6 and B.8 that regulation itself can make predation more likely by creating circumstances in which cross-subsidization may be feasible.

be carefully identified in the statute and, where relevant and possible, some indication of the relative importance of individual goals should be included.[12] In this way, the objectives are more likely to provide useful guidance to the CRTC in its exercise of the discretion conferred on it under the *Telecommunications Act*.

37. Setting these objectives is a matter of public policy that should be decided on the basis of careful study, forecasting and public consultation and debate. The Bureau is best placed to comment on how the objective of a competitive telecommunications sector might be enhanced, and how competition may in turn help to achieve other telecommunications policy objectives.

38. The Bureau recognizes the complex and multi-dimensional character of the problems and objectives that the telecommunications regulatory framework must attempt to resolve and achieve. These objectives often compete with one another and it is almost always difficult, and sometimes impossible, for the regulator to reconcile or balance them.

39. The Bureau believes that in addition to being an objective in its own right, the reliance on market forces to drive telecom services provision, will help to achieve other policy objectives. For example, competition in telecom services is likely to stimulate research and development and encourage innovation in the field of telecommunications, which is the objective set out in subsection 7 (g) of the Act. Competition may also drive service providers to develop solutions for social needs (e.g., reliable and high quality

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[12] See Ruth Sullivan, ed., *Sullivan and Driedger on the Construction of Statutes*, 4th ed. (Markham, Ont.: Butterworths, 2002) c. 8. for further discussion on the importance of identifying legislative purpose and principles.

emergency response services) since their ability to respond to those needs will be a competitive advantage.

40. Therefore, the set of telecommunications policy objectives that Parliament chooses to adopt would benefit from a direction to the regulator to adopt only those regulatory measures that are least intrusive in the marketplace. One way to provide such direction would be to establish separate regulatory objectives to guide the CRTC in its exercise of discretion and powers under the *Telecommunications Act*.

41. The *Broadcasting Act* provides a useful precedent. Subsection 5 (2) sets out the regulatory policies that should guide the CRTC in the performance of its regulatory functions and decisions in broadcasting matters. The Bureau considers that a similar framework could be set out in the *Telecommunications Act*, whereby regulatory objectives would provide the CRTC with practical guidance in the exercise of its powers in furtherance of the overall telecommunications policy objectives.

42. In this regard, the Bureau proposes the adoption of telecommunications regulatory objectives, one of which would direct the CRTC to adopt the regulatory measure, or take the decision, that is the least intrusive in the marketplace. Therefore, when the CRTC is choosing from among several regulatory tools that could achieve the same regulatory end or policy objective, it would be required to use the tool that most relies on market forces.

43. Other regulatory objectives might involve directions to the CRTC to tailor regulation, where needed, to particular segments of the telecom sector (e.g., residential or business) and to be sensitive to the administrative burdens of regulation on the regulated when choosing a regulatory measure.

ECONOMIC REGULATION

Re-imposition of Economic Regulation in Forborne Markets

B. 6 ***Should economic regulation ever be re-imposed on carriers or services that have been deregulated? If so, what principles, and tests should be used to come to such a determination?***

Costs of Regulation

44. In weighing whether regulation should be re-imposed, the Bureau would first consider whether regulation would be warranted regardless of whether that service had previously been forborne. It is important to note that the presence of some market power in and of itself is not sufficient to justify re-regulation. Generally, before price regulation can be considered, the provider must have a "natural monopoly" in the service (i.e., it can supply the entire market at a lower cost per unit than could two or more separate suppliers). When natural monopoly conditions are present to a significant degree (i.e., when one supplier has a substantial cost advantage over potential small suppliers), one will expect that competition will provide little discipline over prices.

45. However, natural monopoly, even a substantial cost advantage, is insufficient in and of itself to justify regulation. The regulatory process is fraught with well-known difficulties. As part of their determinations, regulators require up-to-date information on cost and demand. As a public process for which opportunities for all interested parties to participate are appropriate and necessary, regulation is inherently slow and typically much less responsive to changes in market circumstances than are private firms that can make price and product design decisions independently. If processes are slow, price and demand data are likely to be inapplicable to the market going forward.

46. This is why regulation is imposed only in traditional utility sectors where one sees significant natural monopoly, consumers vulnerable to potential exploitation, and technology and demand sufficiently stable to make costs and price predictable. Even at its best, regulation is less likely to be effective the more rapidly technological advances change costs and service offerings. When the telecommunications sector consisted largely of relatively stable "plain old telephone service" supplied under clear natural monopoly conditions, the costs associated with delay may well have been worth incurring. To the extent that the sector features rapidly changing technology and service offerings, it will be harder to justify regulation.[13] The existence of substitutes, even if not perfect, may make the benefits of regulation less than the cost. Moreover, as technological change plays a greater role in a sector, it becomes more difficult to balance the static benefits of low prices against the dynamic benefits associated with preserving profit-oriented incentives to innovate.[14]

47. Regulation brings about additional costs when imposed on specific markets within a sector (e.g., on prices paid by retail competitors for access to underlying facilities).[15] If access to the facilities has not traditionally been offered (e.g., because retail service had

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[13] A useful case in point may be computer operating systems. A variety of circumstances combine to suggest quite strongly that the production of computer operating systems is a natural monopoly. Economies of scale are compelling, as development costs for operating systems are very high, but the cost of producing additional units is virtually zero. In addition, operating systems are subject to "network externalities," (i.e., the desire of most consumers to use the same system that most others are using). Finally, switching costs are very high, as consumers will not want to use a different operating system if it will not support their applications and file formats. However, computer operating systems are not regulated, in part because regulators would find it difficult if not impossible to define the product—what should go into an operating system—ascertain its production cost, and estimate demand before technological change renders the old operating system obsolete.

[14] One sees this with computer operating systems and pharmaceuticals.

[15] Our answers to B.8 and B.9 also highlight the costs of regulation when one attempts to impose it at a boundary between wholesale and retail service.

been regulated), an entire new set of costs and demand information must be calculated to ascertain what the regulated price should be. If the facilities provider is also a participant in the related market (e.g., retailing of the service), then wholesale price regulation will create incentives to exploit market power in facilities. One such method would be discriminating against unaffiliated retailers in access provision. A second might be cross-subsidization of retail operations by misallocating costs of those operations to the facilities. Such cost misallocation can lead to "regulation-induced predation," discussed below in our answer to B.8. Retaining or re-imposing price-regulation means either that the retail operations of the regulated firm have to be separated from the facility operations, functionally or through divestiture, or that the regulator must be vigilant about preventing discrimination and cross-subsidization.

Re-imposition of Economic Regulation in Forborne Markets

48. Given the costs inherent in regulation noted above, the Bureau believes that economic regulation on markets previously forborne should only be re-imposed where there is compelling evidence of market failure following a full review of all relevant circumstances and market facts, including a full competition analysis. In keeping with this principle, the Bureau proposes that predetermined tests, thresholds or triggers for re-imposing economic regulation should be avoided in favour of a rigorous review of the relevant market using the Bureau's competition analysis routinely applied for merger review. Even where the evidence suggests a need to re-impose some degree of economic regulation, it is the Bureau's view that the regulator should adopt the least intrusive form of regulation possible.

Full Competition Analysis versus Predetermined Tests, Thresholds or Triggers

49. In principle, the Commission has endorsed an approach to forbearance determinations in *Review of Regulatory Framework*, Telecom Decision CRTC 94-19, dated September 16, 1994 (Decision 94-19) that supports the kind of broad consideration of all relevant factors and prevailing circumstances that the Bureau adopts in its *Merger Enforcement Guidelines* and that the language of subsection 34(2) of the *Telecommunications Act* appears to warrant. The requirements of subsection 34(2) to forbear in circumstances where, as a question of fact, the Commission finds that there is, or will be, "competition sufficient to protect the interests of users" are best met in the context of competition analysis that entails a broad review of all relevant factors and evidence.

50. In the Bureau's opinion, the same conclusion holds true in any consideration of whether a market or service previously determined to be sufficiently competitive to warrant forbearance ought to be subjected once again to economic regulation. While the Bureau, as noted, regards the re-imposition of economic regulation as highly undesirable, nonetheless, it is conceivable that such a step could be warranted in certain circumstances where the market has reverted to monopoly supply without reasonable prospects for new entry. However, the Bureau submits that it is equally important in the context of deciding to re-regulate a forborne market as it was in the context of the original forbearance decision to undertake a full competition analysis with the broadest possible consideration of all relevant factors and prevailing circumstances.

51. For this reason, the Bureau does not favour pre-determined tests or threshold "triggers" developed, for example, in an original forbearance decision. Reliance upon pre-determined triggers or thresholds can dictate an altogether incorrect outcome or, at least, one that is rooted more in the circumstances prevalent at the time of the original forbearance decision than the decision to re-regulate. Perhaps the simplest example occurs when a regulator determines a market structure or market share test as a basis for its original forbearance decision, and determines further that economic regulation may or will be re-imposed should in future the test no longer be satisfied. Among the problems with this approach is the fundamental one of whether the test itself is of continued relevance and usefulness given the passage of time and the developments in the market since its establishment.

52. What's more, tests or triggers for re-regulation have the potential to create perverse incentives for incumbents with market power to keep their prices higher and quality levels lower than they might otherwise be, allowing competitors to maintain just enough market share so as not to trip the trigger for re-regulation. Therefore, an automatic trigger or pre-determined test for the re-imposition of economic regulation may be beneficial to entrants but will induce high prices and low quality to the detriment of consumers.

Wholesale Regulation in Competitive Retail Markets

B.8 ***If a service is sufficiently competitive at the retail level (i.e. in the market for end users) to warrant deregulation, is there a continuing need to regulate the wholesale services and facilities underlying the service? If so, under what circumstances would such regulation be required, and what form should it take?***

53. Generally speaking, the Bureau believes that competition at the retail level is likely to reduce the need for continuing to regulate wholesale services and facilities, provided that retail competition is among separate facilities-based providers. However, competition only among stand-alone retailers that rely on access to a single facilities-based provider will not eliminate any market power that such a facilities supplier possesses.

54. At the outset of this discussion, the Bureau notes that the term "retail competition in the market for end users" can take one of two meanings and the chosen interpretation will affect the answers to this, and the following question, B.9. "Retail competition in the market for end users" may be characterized by:

> i) Separate independent facilities-based suppliers of services to end-users (e.g., broadband over ILEC DSL or via cable modems). The Bureau refers to this as "facilities-based retail competition."
>
> ii) Separate retail providers of a service using the same underlying facilities (e.g., VoIP providers all using broadband service over a single cable system or ILEC DSL). The Bureau refers to this as "stand-alone retail competition."

55. The Bureau interprets "wholesale services" as the facilities needed to provide retail service on a stand-alone basis.[16] Facilities-based retail competition does not require a separate wholesale market. An example would be competition at retail in broadband

[16] The Bureau's answers to questions B.8 and B.9 also apply if stand-alone retail competition amounts to nothing more than resale without significant value-added capabilities (e.g., purchasing local telephone service at wholesale so as to offer it at retail, perhaps as part of a bundle of communications offerings).

Internet service between a cable company and an ILEC, each of which is using its own facilities. By definition, stand-alone retail competition depends on the existence of a wholesale market whereby stand-alone retail providers can offer their services over underlying facilities. An example of this would be Internet service providers or VoIP providers that offer services at retail, but depend upon access to the facilities supplied by a cable company or ILEC.

i) Where there is facilities-based retail competition, is there a need for wholesale regulation?

56. The Bureau believes that competition at the retail level among separate facilities-based providers is likely to reduce the need for continuing to regulate wholesale services and facilities.

57. Where there is sufficient competition among facilities-based retail providers down to the end user level, consumers will benefit, as they do in other markets, regardless of whether stand-alone retailers also offer service. That said, owners of the facilities may well find it profitable to provide access at wholesale rates to other stand-alone service providers. If those stand-alone service providers can add value that the facilities-based providers cannot supply themselves, such resale will typically increase the economic value and profitability of the underlying facilities.

58. Consequently, a decision by a facilities-based retailer to deny others wholesale access indicates that the benefits of the added value of having additional stand-alone providers are less than the benefits to that facilities-based provider of going it alone. For that reason, the incremental benefits of attempting to force these carriers to provide

access to stand-alone retailers, when there already is competition at the facilities level, are likely to be less than the costs associated with creating a separate wholesale market with a regulated price and terms and conditions for access.

59. One of the costs associated with creating a separate regulated wholesale market is the possibility that wholesale price regulation may induce rational predation by enabling recoupment in the regulated market. If the market power of a firm in its regulated markets is effectively controlled by cost-based regulation, a firm has an incentive to try and circumvent this restraint by entering into an unregulated or forborne market.[17] The monopolist can subvert effective cost-based regulation by reallocating costs from its competitive market to its regulated markets. This has the effect of relaxing the price constraint in the regulated market and increasing profits — provided costs are only reallocated from competitive markets and not increased. Transferring costs increases the price in the regulated market and the profits from doing so are realized in the competitive market. The transferring of costs creates or widens the differential between the revenues and accounting costs of the regulated firm in the unregulated market. To the extent that prices are set independently of costs, as with ideal price cap regulation, the incentive for this predation by cross-subsidization is reduced. Breaking the link between costs and prices in the regulated market reduces the ability to recoup nominal losses incurred in the unregulated market.

[17] See Church, J.R., and R. Ware, (2000), *Industrial Organization: A Strategic Approach*, Chapter 26 and references therein for a more detailed discussion.

ii) Where there is stand-alone retail competition, is there a need for wholesale regulation?

60. The Bureau believes that regulation may be beneficial where there is competition only among stand-alone retailers that rely on access to a single facilities-based provider. In a retail telecommunications market with no facilities-based competition, stand-alone retailers or value-added providers (e.g., VoIP service companies) in and of themselves will not provide a competitive outcome. The monopoly facilities provider can set the wholesale price to exploit its market power, and the stand-alone providers will pass that high price on to consumers.

61. The benefits of stand-alone retail competition in this setting will depend on effective regulation of the price paid for wholesale services. Imposing wholesale price regulation, if the facilities-based provider also sells at retail, requires additional regulatory vigilance to prevent discrimination and cross-subsidization. In such circumstances, the facilities owner would have an incentive to engage in non-price discrimination (i.e., in the quality or timeliness of access to its facilities) against its stand-alone retail competitors. Moreover, if the regulated access price of the facilities is cost-based, the facilities-based carrier may have the ability and incentive to cross-subsidize its retail operations by misallocating retail-specific costs to the regulated facilities service.

62. The effect of such cross-subsidization would be to inflate the facility access price and create an artificial competitive advantage that distorts the retail market, but it may give the facilities-based carrier a credible predatory threat. The latter effect is the reason that cost-based price regulation is at least as likely to induce predation as it is to prevent

it. If the facility monopolist is allowed to enter the retail market, vigilant regulation of cost allocation and the timeliness and quality of access will be necessary to prevent anti-competitive conduct.

Wholesale Regulation as a Substitute for Retail Regulation

B.9 ***If a service is not sufficiently competitive at the retail level to warrant deregulation, to what extent can regulation of the underlying wholesale services and facilities be relied upon as a substitute for direct regulation of the retail service?***

63. In general, the Bureau believes that regulation of underlying wholesale facilities and services can substitute for direct regulation of the retail service only if such regulation can be effectively designed to accommodate competition among separate stand-alone retail providers. If the retail market would not be competitive despite such regulation, wholesale regulation will not in and of itself produce ideal results.

64. As with the Bureau's response to question B.8 above, the response to this question depends on whether the deficiency is in facilities-based or stand-alone retail provision.

65. To gain some insight into the question, suppose first a market has insufficient stand-alone retail competition, despite competition among facilities-based providers. For example, one could imagine a separate relevant product market at the retail level with only one provider that customers would need to use regardless of their choice in underlying facilities (i.e., DSL, cable, or wireless broadband). In such circumstances,

competition among multiple facilities carriers would not eliminate any market power that the stand-alone provider might possess.[18]

66. The market outcome would be no different if the same monopolist stand-alone retail provider were forced to use a single upstream provider's facilities, but where wholesale regulation took the place of competition. Even if such regulation were not subject to the flaws noted above, it would not in and of itself counteract any of the lone stand-alone retail provider's market power. Such regulation could, however, guard against "double marginalization", which occurs when the retail monopolist sets its price on top of the price charged by the facilities monopolist.

67. We now turn to the more likely scenario, in which the absence of retail competition arises because the retail monopolist is a single integrated facilities-based provider. In that case, wholesale competition also would not substitute for direct regulation of the retail service. The single firm would retain its retail monopoly even if regulation within the single firm at the wholesale level were feasible. The general effect would be the same as in the preceding example where a monopolist stand-alone retail provider uses the wholesale facilities of a facilities-based monopolist at a regulated rate.[19]

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[18] For reasons set out in the response to question B.6, one might still not want to regulate the stand-alone monopolist.

[19] Though the general effect would be the same, there may be some specific differences between the two scenarios (e.g., using separate providers may be somewhat more expensive if savings from joint production or coordination are foregone).Vertical separation could result in cost savings if the integrated facilities-based provider is not as efficient as others at being the single retail monopoly. However, if that were the case the facilities-based provider, if unregulated, would have an incentive to let the more efficient retailer into the market and capture the benefits through facilities access fees that capture, at least in part, that retailer's competitive advantage.

68. Wholesale regulation is a substitute for direct regulation of the retail service only if it can be designed to accommodate competition among separate stand-alone retail services competitors rather than a single facilities-based provider. The Bureau notes, however, that the primary source of the gain is not in expanding the retail sector from a single facilities based-provider to multiple stand-alone providers. Rather, the benefit comes from controlling the monopoly over the facility. Stand-alone retail competition would then extend the benefits of that regulation to consumers.

69. Again, it is important to remember the difference between benefits of wholesale regulation in theory and benefits in practice, recognizing the difficulties in implementation. As the Bureau observed in its answer to B.6, effective regulation may not be feasible if technology and demand change too quickly. In addition, a prerequisite for the practical benefit of wholesale regulation is the feasibility of vertical separation between the retail and wholesale levels of the service. Regulation may not be beneficial if maintaining a separate retail sector requires foregoing economies of scope in production and coordination. Finally, effective market performance requires here, as mentioned in the Bureau's response to B.8, the ability to ensure the effectiveness of wholesale regulation by preventing discrimination and cross-subsidization, either by non-price regulation or more invasive forms of separation.

TECHNICAL REGULATION

Interconnection and Access to Facilities

B. 17 ***Should any changes be made to the regulatory framework for interconnection?***

70. Interconnection ensures that entrants do not need to have their own facilities to terminate calls to all subscribers to telecommunications services in a given region. This grant of access to parts of the ILEC network may lower barriers to entry and facilitate competition.

71. In addition, since effective competition in the telecommunications services market depends upon the ability of customers of different service providers to communicate with one another, the Bureau submits that even where a telecommunications market is competitive in all other respects, there are certain circumstances in which mandated interconnection will continue to be warranted in order to allow customers of different networks to communicate with each other.

72. For example, in principle, a group of telecommunications providers could exploit the consumer need for interconnection by charging each other mutually high rates for interconnection, raising service prices to the monopoly level. In effect, the sector as a whole could act as a cartel.

73. The current framework has resulted in zero price "bill and keep" interconnection where each carrier bills for origination and keeps all of the fees. If interconnection costs are small and demand is roughly symmetrical (i.e., A's subscribers call B's subscribers as much as B's call A's), then the outcome will be roughly efficient, particularly when the costs of administering a scheme with revenue transfers are taken into account. The

Bureau is of the view that the CRTC should ensure that "bill and keep" interconnection remains in force and not reduce oversight even if the industry becomes more competitive over time.

74. The subtitle to question B.17, "Network Interconnection and Access to Facilities of Dominant Carriers", implies that the question also relates to the framework for access to essential facilities.

75. The Bureau submits that there may be some areas of Canada where a competing service is only likely to develop through sharing of essential facilities on a mandated basis. In such cases, as noted in the Bureau's responses to questions B.8 and B.9, getting the wholesale access price right will be critical. This is a difficult exercise that will require ongoing regulation and supervision by the Commission.

76. For example, as noted in response to question B.8 above, the benefits of stand-alone retail competition with market power at the wholesale level may well depend on effective regulation of the price paid for wholesale services. An unregulated monopoly provider of facilities used by stand-alone retail competitors could effectively subvert overall competition in charging its profit-maximizing price. However, this possibility alone does not necessitate the separate regulation of facilities prices. This is especially so considering the fact that regulation may not be effective, even with a clear natural monopoly, if underlying technology and demand conditions move too quickly to allow an administered price for an administratively defined product to be determined.

77. With respect to access, the Bureau endorses the Panel's observation that the shift to IP may create new challenges. The Panel observed that:

> It is important to acknowledge that this scenario where "a thousand applications bloom" is premised on an open access, open standards approach to IP networks. Applications providers, Canadian businesses and consumers will all have an interest in ensuring that network providers facilitate – rather than limit – access to innovative new technologies and services. And network providers will equally have an interest in achieving a return on their investments in advanced infrastructure.
>
> What remains less clear is the extent to which some applications may need to rely more closely on integration with the underlying network, for example for reasons of quality of service or security. If network intelligence (i.e. information processing capacity) is enhanced and, as a result, applications development requires coordination with this network intelligence, this may have the practical effect of limiting the number of applications available over any one network. In this type of network environment, regulation may be required to maintain open access for applications providers.[20]

78. The Bureau notes that a number of parties in the CRTC's recent proceeding to determine the regulatory framework for VoIP[21], raised concerns that high-speed Internet access providers may give preference to packets transmitted for their own VoIP services and even block consumers' access altogether to the services of independent, third-party VoIP providers. Bell, Telus and Rogers each acknowledged that building packet prioritization abilities into the network was technologically feasible though the companies did not, at that time, have plans to do so.[22]

79. In light of these concerns, the Bureau considers that the application by the CRTC of conditions with respect to access, interconnection and wholesale services are warranted. Such conditions would ensure that no provider of local exchange services is permitted to offer a local exchange service which blocks or degrades access to any other service providers.

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[20] Consultation Paper at p. 8.

[21] *Regulatory framework for voice communication services using Internet Protocol*, Telecom Public Notice CRTC 2004-2, dated April 7, 2004 [hereinafter PN 2004-2].

[22] PN 2004-2; Transcript of the proceeding at paras. 795-799 (Bell), 1461 (Telus), and 4196 (Rogers).

80. However, the Bureau notes that in forborne markets, the provisions of the *Competition Act* should be relied upon to discipline service providers that engage in anti-competitive blocking or degradation of access to the services of other providers.

SOCIAL REGULATION

Institutional Roles in Social Regulation

B. 30 ***What should be the roles of the CRTC, Industry Canada, the Competition Bureau and consumer protection agencies in dealing with consumer protection and other social regulation issues?***

81. The Competition Bureau is an independent law enforcement agency responsible for the administration and enforcement of the *Competition Act*, the *Consumer Packaging and Labelling Act*, the *Textile Labelling Act* and the *Precious Metals Marking Act*. Headed by the Commissioner of Competition, the Bureau investigates anti-competitive practices and promotes compliance with the laws under its jurisdiction.

82. The Bureau is not a regulator and therefore does not engage in *ex ante* social or consumer protection regulation. However, through the enforcement of the *Competition Act*, the Bureau plays an important role in protecting consumers against fraud and anti-competitive practices and ensuring that businesses provide accurate information when marketing their products and services.

83. In this regard, the Bureau has obtained successful resolutions for consumers in the telecommunications sector through its work in combating anti-competitive behaviour and fraud.

84. For example, in July 2004, the Bureau resolved a complaint relating to allegations of misleading representations by a telecommunications company in relation to its high speed Internet advertisements. A Bureau examination revealed that the company's advertisements comparing their speed of service to their competitors' could not be substantiated. In response to Bureau concerns, the company changed the offending advertisement and instituted a multi-level compliance program to ensure that its future advertising materials would respect the Act and follow the Bureau's advertising guidelines.

85. In December 2002, the Bureau investigated a complaint alleging that a promotional contest run by a telecommunications retailer was not in compliance with the *Competition Act*. A Bureau examination conducted under the promotional contests provision of the Act (s. 74.06) revealed that the contest did not provide adequate and fair disclosure of the approximate value of the prize and other information relating to the chances of winning. In addition, the distribution of the prize was unduly delayed. As a result of these discussions between the Bureau and the company's management, the company agreed to satisfy all of the information disclosure requirements in future promotional contests and supply prizes without undue delay.

86. The Bureau also conducts investigations into claims of deceptive telemarketing practices. Several of these investigations have led to key convictions of telemarketers to the benefit of Canadian consumers. For example, in June 2004, directors and employees of several Toronto-based telemarketing firms pleaded guilty to using deceptive telemarketing practices that targeted Canadian and U.S. consumers. Over the course of

three years, the telemarketers had used false and misleading sales techniques to induce U.S. and Canadian organizations to purchase various business supplies. The firms were fined a total of $100,000.

87. As part of its work combating deceptive marketing, the Bureau chairs the Fraud Prevention Forum. The Forum is a group of private sector firms, consumer and volunteer groups, government agencies and law enforcement organizations committed to fighting fraud aimed at consumers and businesses. Its mandate is to prevent Canadians from becoming victims of fraud through awareness and education, as well as to increase reporting when fraud does occur. A significant portion of the Forum's work involves educating consumers on how to protect themselves against deceptive telemarketing, phishing and spoofing, and other fraudulent activity that occurs through the use of telecommunications networks.

88. As noted above, *ex ante* social or consumer protection regulation by the Bureau is not within the purview of the *Competition Act*. The purpose of the *Competition Act* is to maintain and encourage competition in Canada in order to enhance the efficiency and adaptability of the Canadian economy, expand opportunities for Canadian participation in world markets and provide businesses and consumers with competitive prices and product choices. The Act clearly favours market forces, as opposed to government intervention, as the best means of achieving these goals. As such, the Bureau considers that its current role in "consumer protection", as set out above, is entirely appropriate.

89. The Bureau recognizes that the goals of the CRTC go beyond the promotion of competition alone and extend to social and cultural objectives which often require

regulatory intervention to ensure their attainment. It is worth noting, however, that allowing market forces, rather than regulation, to dictate service considerations may in some cases ensure that social needs are met sooner than they would otherwise be if subject to regulatory controls.

90. The Bureau believes that, to the extent possible, public policy should attempt to achieve social policy goals (e.g., universal service, quality of service, affordable telephone service, emergency services, and services for the disabled) through the adoption of mechanisms that are least restrictive to competition. And, where such mechanisms are deemed to be necessary, they should apply in as neutral a manner as possible, to all suppliers provisioning over all sorts of technology platforms. In this regard, as noted in response to question B.1, regulatory policy objectives should be used to provide practical guidance to the CRTC in the exercise of its powers in furtherance of Canada's overall telecommunications policy objectives.

III. REGULATORY INSTITUTIONS

ROLE OF COMPETITION LAW IN TELECOMMUNICATIONS REGULATION

C.2 ***Should general competition law principles have a role in the regulation of the telecommunications sector? If so, to what extent should the provisions of the Competition Act apply and to what extent should sector specific regulation continue to apply?***

91. As telecommunications markets become increasingly shaped by technological innovation and the advent of new services and suppliers, competition principles will need to play an ever greater role in the regulation and oversight of the industry. However, the characteristics of certain markets, and the continuing importance of supporting broader

policy objectives, mean that market oversight and regulation for the industry as a whole cannot yet be left to competition law principles alone. The challenge for regulators and policy makers in planning for, overseeing and supporting the continuing transformation of the telecommunications industry from a fully regulated industry to one directed by market forces, is establishing a framework that will allow regulatory and competition authorities to work in unison.

92. Competition law principles already play a significant role in the regulation of the telecommunications sector. The Bureau has primary and direct responsibility for certain aspects of this sector (e.g., market oversight in those areas of the industry where the CRTC has completely forborne from regulation and for merger review) and shares responsibility with the CRTC in dealing with deceptive marketing practices and other anti-competitive concerns such as the control of predatory behaviour and abuse of dominant position. In addition to the role played by the Bureau directly, competition policy plays a significant role in market oversight and regulation by the CRTC, given the language in sections 7(c) and (f) of the *Telecommunications Act*, although, unlike the Bureau, the CRTC is also guided by a broader range of legislative goals and policy objectives.

93. While competition policy principles thus have a role to play in the regulation of the telecom sector, whether it is the Bureau or the CRTC that is exercising its jurisdiction, it is not always clear in which circumstances competition principles will take precedence over competing policy objectives. In the Bureau's view, it would be

beneficial to the continued growth and development of the telecom sector if greater certainty could be provided as to when competition principles should prevail.

94. Prior to forbearing under subsection 34(2) from the exercise of its powers under subsection 27(1) to ensure just and reasonable rates, the CRTC must conclude that the service is or will be subject to competition sufficient to protect the interests of users. Once it reaches this conclusion, it follows that the Commission should equally forbear from the exercise of all of its powers under section 27 of the *Telecommunications Act.* This is the case since it is not clear how competition sufficient to protect the interests of users with respect to rates under subsection 27(1) would be insufficient to protect users' interests with respect to subsection 27(2). Indeed, once regulated companies are no longer found to have market power, reliance on the general provisions of the *Competition Act*, rather than sector-specific regulation under the *Telecommunications Act* would be more appropriate.

95. The disadvantage of the CRTC retaining jurisdiction under subsection 27(1) is the uncertainty it creates as to which agency should address issues arising in areas of overlapping jurisdiction. For example, allegations of denial of access to essential facilities, predatory pricing, margin squeezing of unintegrated competitors, and anti-competitive price discrimination could be pursued under the abuse of dominance provisions of the *Competition Act* and might also raise claims under subsection 27(2) of the *Telecommunications Act.* In the Bureau's view, such complaints concern the activities of a company that is abusing its dominant position in the marketplace in an anti-

competitive fashion and would best be handled by the Competition Bureau, with its expertise in carrying out a competition analysis.[23]

96. The OECD also identified the disadvantages of partial forbearance. In its 2002 report on regulatory reform in Canada, the OECD referred to conditional forbearance as a "Damocles sword for the market"[24]:

> Unlike a number of regulators in the OECD area the CRTC has consistently tried to streamline regulatory processes and forbear from regulation. However, it often forbears on a conditional basis creating uncertainty in the market as to whether competition policy will come into play if market competition issues arise, or if sector specific regulation will be reintroduced. The CRTC should try and forbear unconditionally allowing the specified market to come fully within the ambit of the Competition Bureau.[25]

97. In addition to supporting a clarification of responsibility for handling allegations of anti-competitive behaviour, the Bureau believes that regulators and industry participants would benefit from a formalization and strengthening of the Bureau's role in applying competition law analysis in telecommunications forbearance matters.

98. That role is currently defined by section 125 of the *Competition Act* which grants the Bureau a statutory right to participate in proceedings before the CRTC. Over the years, the Bureau has sought to share its economic expertise and analytical tools with the CRTC and to provide guidance to the CRTC in competition matters through participation in a broad range of CRTC proceedings. Notably, the Bureau has made submissions to the

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[23] While the Bureau is better equipped to determine matters requiring a competition analysis, the CRTC should retain any jurisdiction to set prices, for example, should the Bureau conclude that access to an essential facility was denied.

[24] OECD Report on Regulatory Reform in Canada, 2002, at p. 15.

[25] OECD Report on Regulatory Reform in Canada, 2002, at p. 50.

CRTC in connection with forbearance decisions, with a view to assisting the CRTC in conducting the competition analysis.

99. Applying the appropriate competition analysis is the most critical aspect of the forbearance process. Still, the CRTC is not required to give any special consideration to the Bureau's submissions and must also carry out its own competition analysis, as well as its analysis of social and policy considerations. In addition, the CRTC is not permitted to share confidential information with the Bureau making it more challenging for the Bureau to contribute effectively to the CRTC's competition-related decisions.

100. The Bureau believes that it is uniquely well-positioned to provide critical input into the competition analysis in forbearance proceedings. The Bureau has accumulated substantial expertise and experience in competition analysis through the application of its analytical tools to a numerous and diverse range of industries. The Bureau's competition analysis considers a number of demand and supply factors including the market shares of the firms within the market; countervailing power; the availability of substitutes, the ease of customer mobility between competitors; the anticipated supply expansion responses of existing firms to price increases; the potential for new firms to enter the market; evidence of rivalry; the nature of innovation and technological change; and the potential impact of a behavioural or structural change on a firm or industry.

101. Moreover, the Bureau's techniques and analytical tools are continually being updated and refined to incorporate advances in economic and antitrust analysis. In this regard, the Bureau's *Merger Enforcement Guidelines* were recently significantly revised following a comprehensive consultation process with a broad range of stakeholders,

policy makers, practitioners and researchers studying competition policy. The Bureau also frequently consults with, and relies on, outside economic experts to confirm and refine its application of these tools. The competition authorities of Canada's major trading partners all follow similar guidelines.

102. The CRTC has itself demonstrated its preference for the Bureau's approach to competition analysis in forbearance matters. In 1994, the CRTC outlined the criteria that it would apply in forbearance decisions, adopting the Bureau's model.[26] Similarly, in the 1997 landmark long distance forbearance case, the CRTC adopted a relevant product and geographic market consistent with the Bureau's analysis.[27] However, the CRTC's competition analysis is limited by its own lack of resources and expertise in relation to competition matters and by statutory constraints that limit the Bureau's ability to share its knowledge and expertise with the CRTC.

103. These constraints, and possible proposals for remedying them, are discussed in greater detail in the Bureau's response to question C.3, dealing with proposals for a regulatory framework conducive to the application of competition law principles to the telecommunications sector.

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[26] Telecom Decision CRTC 1994-19.

[27] *Forbearance – Regulation of Toll Services Provided by Incumbent Telephone Companies*, Telecom Decision CRTC 97-19, dated December 18, 1997.

COMPETITION LAW PRINCIPLES AND THE REGULATORY FRAMEWORK

C. 3 *Taking into account the experience of other jurisdictions, what is the best regulatory framework for the application of competition law principles to the telecommunications sector?*

104. The experiences of other jurisdictions can provide Canadian regulators and policy makers with important insights into the types of arrangements that may facilitate and promote effective interactions between competition law authorities and telecommunications regulatory bodies. Attached as Appendix A is a study commissioned by the Bureau, entitled *Comparative Study on the Interaction Between Competition Law Authorities and Telecommunications Regulators in Australia, the United Kingdom, Germany and the United States of America* (the "Comparative Study" or "Study")[28], which reviews the telecommunications regulation experiences of a number of foreign jurisdictions.

105. While some of the jurisdictions reviewed in the Study have established regulatory structures with substantial similarities to the Canadian system, other jurisdictions have adopted significantly different approaches. Not every situation reviewed in the Study concerns the roles and responsibilities of different government bodies for local telecom forbearance decisions but each jurisdiction reviewed does provide an illustration of a mechanism for co-ordinating the exercise of jurisdiction by the telecommunications regulator and the competition authority. The Bureau believes that this international experience can be helpful in developing possible solutions to some of the specific issues

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[28] Dunbar, L.J.E. & Milton, L.J., *Comparative Study on the Interaction Between Competition Law Authorities and Telecommunications Regulators in Australia, the United Kingdom, Germany and the United States of America*, August 12, 2005.

noted in the Bureau's response to question C.2., namely, strengthening the role of the Bureau in telecommunications forbearance matters and abuse of dominance complaints.

106. As discussed in the Study, there is a continuum of possibilities to encourage better use of the Bureau's expertise. This ranges from an enhancement of the current role, through greater sharing of information, to the creation of a significantly more active role, whereby the Competition Bureau would be solely responsible for undertaking the competition analysis.

Improved Sharing of Information

107. As discussed in its response to question C.2, under section 125 of the *Competition Ac,* the Bureau has a statutory right to participate in proceedings before the CRTC. Through its involvement in a large number of telecom matters, the Bureau has sought to share its economic expertise and analytical tools and to provide guidance to the CRTC in competition matters, and particularly, in forbearance proceedings. However, there are several limitations in the current framework which diminish the quality of the competition analysis that the Bureau is capable of providing.

108. In particular, both the *Competition Act* and the *Telecommunications Act* establish restrictions on the disclosure of confidential information. Section 39 of the *Telecommunications Act* prohibits the CRTC from disclosing information that is designated as confidential. While the Commission has on a few occasions allowed for limited access to such information on an *in camera* basis, such mechanisms are of limited use and represent a significant constraint on the Bureau's ability to provide comprehensive and timely guidance to the CRTC on telecom matters involving

competition issues. While it is possible for the Bureau to address interrogatories to parties in a specific telecom proceeding, the Bureau is unlikely to have access to a level of company-specific information that would allow a comprehensive competition analysis. The Bureau must, therefore, rely on the public data supplied by the CRTC about the state of competition in general. Such data are often a year or more out of date, do not include forecasts, and are not sufficiently disaggregated for the Bureau to carry out the relevant competition analysis.

109. The Bureau is also restricted in its ability to share information with the CRTC. Section 29 of the *Competition Act* provides for no sharing of information except in very limited circumstances. While there might be some very unusual situations, where the Bureau is of the view that it must provide information to the CRTC for the explicit purpose of administering section 125 of the *Competition Act*, this would occur on a highly exceptional basis.[29]

110. There are several options available to improve information sharing between the CRTC and the Bureau ranging from informal practices within the current framework to legislative amendments. For instance, informal consultations through regular meetings at senior staff levels on general policy matters, and staff exchanges between the Bureau and the CRTC, might help to improve information sharing under the current framework. However, as pointed out in the Comparative Study, informal consultations with respect to

[29] Comparative Study at p. 68.

active files before the CRTC may give rise to issues of procedural fairness in light of the CRTC's status as a quasi-judicial body.[30]

111. If the Bureau is to provide informed and comprehensive advice to the CRTC in telecom proceedings, it must have access to the confidential record before the CRTC. The express statutory prohibitions in the *Telecommunications Act* and the *Competition Act* on disclosure of confidential information mean that legislative amendments will be required to allow for adequate information sharing between the CRTC and the Bureau.

112. The Bureau notes that there is clear legislative precedent in Canada for the sharing of confidential information between agencies. With respect to access to confidential information from the Bureau, the *Competition Act* already contains exemptions, in certain circumstances, from the restrictions on disclosure of confidential information to the Minister of Transport (s. 29.1) and Minister of Finance (s. 29.2). Similar exemptions to allow disclosure to the CRTC could be built into the legislative framework.

113. With respect to access to confidential information by the Bureau, the Bureau has been granted statutory access, subject to certain safeguards, to the confidential record before the Canadian International Trade Tribunal (CITT).[31] Bureau officers, counsel and retained experts working on a case before the CITT are required to sign a confidentiality agreement and the CITT requires the destruction of any copies of confidential materials

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[30] Comparative Study at pp. 62-63.

[31] S. 45, *Canadian International Trade Tribunal Act*, R.S. 1985, c. 47 (4th Supp.), as amended.

in the Bureau's possession after the end of the proceeding. The Bureau has found that this process has enhanced the effectiveness of its presentations before the CITT.

114. Internationally, there are several models that permit information sharing between competition and telecom authorities. In Germany, under the terms of the *Telecommunications Act*, both the telecommunications authority and the competition authority have full access to all information filed with the other agency.[32] In Australia, a right to share information is implied by various statutory provisions that require consultation between the two agencies. In practice, the Australian agencies will ask parties for consent to the sharing of confidential information and consent is almost always given.[33] The U.S. competition authority that has traditionally held the most extensive responsibility for telecommunications, the Department of Justice, has broad powers as a law enforcement agency to obtain information itself. Therefore, in practice, parties generally consent to the FCC releasing confidential information to the DOJ.[34] In the European Community, the *EU Modernisation Regulation* gives the European Commission and designated competition authorities the power to provide one another with confidential information, subject to a number of safeguards, for the purposes of applying national competition law.[35] Finally, in the U.K., the EU provisions for the sharing of confidential information have been expanded by the *Enterprise Act 2002*. The *Enterprise Act* permits the disclosure of information where such disclosure is required for

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[32] Comparative Study at p. 33.

[33] Comparative Study at pp. 11-12.

[34] Comparative Study at pp. 43-44.

[35] Council Regulation (EC) No. 1/2003, December 16, 2002, Article 12.3.

the purpose of fulfilling an EU Community obligation, or to enable another public authority to carry out its statutory functions under certain enumerated statutes including competition legislation.[36]

115. All the national and international models described above provide for greater sharing of information than is permitted between the CRTC and the Bureau. A number of them provide workable mechanisms for permitting access to confidential data and the Bureau recommends that they be explored with a view to finding the proper balance that would allow for greater use of the Bureau's expertise while respecting the rules of natural justice. The appropriate models should then be embodied in amendments to the *Competition Act* and the *Telecommunications Act*.

Strengthening of Bureau Involvement in Competition analysis

116. Improved information sharing would enhance the effectiveness of the Bureau's involvement in CRTC proceedings, pursuant to the existing mechanism under section 125 of the *Competition Act*, which simply grants the Bureau the right to intervene and make representations. However, under the current framework, these representations are accorded the same status as other interventions. The international experience demonstrates that in many other jurisdictions, mechanisms exist to give special status to the views of the competition authority on certain issues. These range from a requirement to accord substantial weight to the views of the competition authority in some telecom matters, to the complete transfer to the competition authority of jurisdiction over

[36] Comparative Study at pp. 25-29.

competition issues in the telecom sector. Several different models are outlined in some detail in Appendix A.

117. One model that indicates a greater role for the competition authority can be found in the regime established in the United States whereby the FCC was required by section 271 of the *Communications Act of 1934* to consult with the USDOJ and accord "substantial weight" to the USDOJ's analysis before a finding that an incumbent's local markets were open to competition to a sufficient degree to allow the incumbent to offer long distance services to its local customers.[37] The "substantial weight" threshold meant specifically that if the FCC rejected the USDOJ's analysis, the FCC would have had to explain the basis for its rejection.[38] In the absence of information sharing between the two agencies, this type of mechanism would be much less effective and potentially detrimental since the competition authority's views would not be based on the best available information. Therefore, any obligation to accord substantial weight to submissions of the competition authority should be accompanied by provisions that allow for adequate information sharing. In addition, as noted in the Comparative Study, some attention must be paid to ensuring that the rules of natural justice are respected.[39]

118. Another model relating more directly to the roles and responsibilities for carrying out a competition analysis in the context of a forbearance application is found in the European Union.[40] In 2003, the European Parliament and Council introduced a directive

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[37] Comparative Study at p. 39 ff.

[38] Comparative Study at p. 40.

[39] Comparative Study at pp. 57-58.

[40] Comparative Study at p. 12 ff.

governing the telecommunications regulatory regime in Europe, with a view to encouraging greater competition both within domestic markets and across national borders. As noted in the Comparative Study, one major aim of the directive was to limit sector-specific regulation to situations where there was evidence of significant market power. Where there is not significant market power, national and EU competition law apply.[41] The European Commission proposed a number of product and service markets that it thought appropriate for *ex ante* regulation and issued guidelines setting out the principles to be employed by domestic telecom regulators in defining relevant markets and assessing market power in those markets.

119. The particular interplay of domestic agencies is determined by individual EU members. In the case of Germany, for example, the telecom regulator is required to obtain the agreement of the competition authority on decisions concerning the definition of markets, the assessment of market power, and principles of frequency allocation that are intended to correct competitive distortions.[42] This statutory requirement entails extensive cooperation between the two agencies throughout telecom proceedings to ensure that sufficient market information is obtained, and ensures that the regulator's decisions are sound from a competition standpoint.

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[41] Comparative Study at p. 15.

[42] Comparative Study at p. 31.

120. The European Commission may review national determinations and require withdrawal of decisions on market definitions and market power if incompatible with European law.[43]

Determining the "best framework"

121. The "best framework" for the application of competition law principles to the telecommunications sector is a matter of public policy that must ultimately be determined by Government. In the view of the Bureau, the best framework will be that which makes the best use of existing knowledge and experience within our agencies; ensures timely and effective responses to industry change; is cost effective; and keeps government intervention to the bare essential.

122. As noted in the Comparative Study[44], it might be possible for several steps to be taken to facilitate exchanges between the CRTC and the Competition Bureau, even in the absence of statutory amendments. The authors suggest, for example, that informal consultations between the CRTC and the Bureau might take place on general competition issues or the Bureau might provide to the CRTC guidelines on market definition and assessments of market power. However, such steps have already been taken in large measure[45] and, in any event, these suggestions will have limited usefulness if the ultimate

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[43] Comparative Study at pp. 16-17. The authors indicate that this may have occurred with respect to four decisions of the German regulator.

[44] Comparative Study at pp. 61-63.

[45] CRTC and Bureau staff have held several joint meetings over the last year or so and the CRTC has participated in Bureau initiated consultations with members of the telecom industry on the impact of technological change and globalisation in their sector. Meanwhile, the Merger Enforcement Guidelines are available on the Bureau's website at: <http://www.competitionbureau.gc.ca/internet/index.cfm?itemid=1245&lg=e>.

objective is that the Bureau will carry out the full competition analysis. In the Bureau's view, legislative amendments would be preferable in a number of areas.

123. At a minimum, the Bureau suggests that mechanisms to improve information sharing between the Bureau and the CRTC would give meaning to the involvement of the Bureau, under the current framework, in telecommunications proceedings. In addition, the Bureau suggests that it might be worthwhile to legislate formal or structured mechanisms for drawing upon its expertise. Two approaches are highlighted above, each with strengths and weaknesses.

124. In one case, the legislation could stipulate that "substantial weight" must be accorded the Bureau's competition analysis, with an obligation on the CRTC to provide a detailed explanation of why it has rejected any of the determinations. In this situation, the Bureau would be responsible for meeting the competition objectives in subsections 7(c) and (f) of the *Telecommunications Act,* while the CRTC would determine whether any other objective should be given greater consideration.

125. Alternatively, the legislation could provide that the CRTC must accept the Bureau's conclusions concerning the definition of markets and the assessment of market power, or, at a minimum, secure the Bureau's agreement on these matters. In this case, such conclusions would determine whether or not the Commission's continued exercise of its rate regulation and tariffing powers under sections 25 and 27 of the *Telecommunications Act* were warranted. For greater clarity, under this approach the CRTC could continue to exercise its powers under sections 24, 29 and 31 in appropriate

circumstances. A number of procedural issues might arise with this model, as outlined in the Comparative Study.[46]

126. Whatever route is preferred, the Bureau believes that the legislative framework should provide it with a greater role in carrying out the competition analysis.

IV. MAKING THE MOST OF TECHNOLOGY

FOREIGN INVESTMENT RESTRICTIONS

E. 6 ***Should the foreign investment restrictions be removed? What would be the implications of this for future telecommunications investment, as well as ICT investment as a whole? What other effects would the removal of such restrictions have?***

127. Foreign ownership restrictions are a barrier to entry that can provide incumbents with absolute cost advantages over potential entrants that present considerable, and in some cases insurmountable, impediments to entry. That foreign ownership restrictions are a barrier to entry is simply a statement of economic principle.

128. The provision of telecommunications is extremely capital intensive and entry into, and survival within, the telecommunications services market will depend in large part on service providers having access to equity capital and debt at the lowest possible cost. Foreign ownership restrictions increase the cost of capital and this increase is ultimately passed on to consumers.

129. However, whether foreign ownership restrictions are negative in all circumstances depends on the public policy objectives that they are designed and intended to achieve. In

[46] Comparative Study at pp. 52-54.

this regard, the Bureau notes that in 1987, when the government first placed foreign ownership restrictions on facilities-based telecommunications carriers, the restrictions were justified by the government as a means of "harmoniz[ing] Canadian policy with that of other countries and ensur[ing] our national sovereignty, security and economic, social and cultural well-being."[47]

130. Ten years later, Canada and many countries belonging to the World Trade Organization adopted the Agreement on Basic Telecommunications (ABT) to liberalize trade and investment in basic telecommunications services. Under the ABT, many member countries of the OECD have reduced or eliminated their foreign ownership restrictions. Some of these countries concluded that the benefits of increasing access to foreign capital outweigh the implicit costs of any associated loss in sovereignty. Almost all other OECD countries now have more liberal telecommunications foreign investment regimes than Canada.[48]

131. The Bureau submits that the foreign ownership restrictions have served their intended purpose and are no longer necessary to harmonize Canadian policy with that of our global trading partners. In fact, in light of the abolishment of foreign ownership restrictions in most other OECD countries, Canada's maintenance of the restrictions is

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[47] Standing Committee on Industry, Natural Resources, Science and Technology, *Report on the Study on the Foreign Investment Restrictions Applicable to Telecommunications Common Carriers*, dated , online: Standing Committee on Industry, Natural Resources, Science and Technology <http://www.parl.gc.ca/InfoComDoc/37/2/INST/Studies/Reports/instrp03/06-toc-e.htm.> (date accessed: August 9, 2005).

[48] Standing Committee on Industry, Natural Resources, Science and Technology, *Report on the Study on the Foreign Investment Restrictions Applicable to Telecommunications Common Carriers*, dated , online: Standing Committee on Industry, Natural Resources, Science and Technology <http://www.parl.gc.ca/InfoComDoc/37/2/INST/Studies/Reports/instrp03/06-toc-e.htm.> (date accessed: August 9, 2005).

inimical to the latter policy rationale for their imposition. Furthermore, the Bureau is unaware of any articulated concerns to national sovereignty, security or economic, social and cultural well-being that the foreign ownership restrictions are needed or even well-suited to address.

132. The Bureau supports the eventual removal of the foreign ownership restrictions in the telecommunications sector. However, the Bureau notes that changing the rules overnight may not be the best policy. Rather, the process that should guide this transition is a matter of public policy that will require thoughtful public consultation and debate.