



Telecom Public Notice CRTC 2005-4

Ottawa, 13 May 2005

Proceeding to consider extending the price regulation regime for Télébec and TELUS

Reference: 8678-C12-200505737

In this Public Notice, the Commission invites comments on extending the current price regulation regime for Télébec and TELUS.

Background

1. In *Review of regulatory framework*, Telecom Decision CRTC 94-19, 16 September 1994 (Decision 94-19), the Commission developed a regulatory framework for the telecommunications industry intended to allow all Canadians, over time, ubiquitous and affordable access to an increasing range of competitively provided telecommunications services. At the time of its release, the Decision 94-19 framework applied to certain large incumbent local exchange carriers (ILECs).
2. In 1994, following the release of the Supreme Court of Canada's decision in *Attorney-General of Quebec et al. v. Téléphone Guèvremont Inc*, Québec-Téléphone (now TELUS Communications Inc. (TCQ)) and Télébec ltée (now Société en commandite Télébec (Télébec)) began to be regulated by the Commission under the *Telecommunications Act*. An initial question faced by the Commission was whether Télébec and TCQ (collectively, "the Companies") should be subject to the regulatory regime outlined in Decision 94-19.
3. In *Regulatory Framework for Québec-Téléphone and Télébec ltée*, Telecom Decision CRTC 96-5, 7 August 1996, the Commission decided that the regulatory framework set out in Decision 94-19 would apply to the Companies. Under that framework, the Companies would eventually be subject to, among other things, price regulation.
4. In *Implementation of price regulation for Télébec and TELUS Québec*, Telecom Decision CRTC 2002-43, 31 July 2002 (Decision 2002-43), the Commission established the principles, components and framework for the price regulation for the Companies.

Objectives of the Current Regime

5. In *Regulatory framework for the second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002 (Decision 2002-34), the Commission set out, among other things, the second price regulation regime for the other large ILECs. In light of the Commission's view in Decision 2002-43 that the Companies should be subject to the same general regulatory regime as the other large ILECs, the Commission considered it appropriate to set the same objectives for the Companies' price regulation regime as for the regime applicable to the other large ILECs. Those objectives were as follows:

- 1) to render reliable and affordable services of high quality, accessible to both urban and rural area customers;
 - 2) to balance the interests of the three main stakeholders in telecommunications markets, i.e., customers, competitors and incumbent telephone companies;
 - 3) to foster facilities-based competition in Canadian telecommunications markets;
 - 4) to provide incumbents with incentives to increase efficiencies and to be more innovative; and
 - 5) to adopt regulatory approaches that impose the minimum regulatory burden compatible with the achievement of the previous four objectives.
6. To further these objectives, the Commission also decided to adopt a regulatory framework for the Companies which closely resembled the regime established in Decision 2002-34 for the other large ILECs. The price regulation regime for the Companies is sufficiently flexible to accommodate their unique operating circumstances. In addition, the basket structure and pricing constraints ensure that the benefits of productivity gains are equitably distributed across the services offered by the Companies. They also indirectly help foster local competition by ensuring that the Companies cannot reduce prices in a competitive market and recoup the lost revenues by raising prices in a market where competition is weak or absent.

Basket structure, local competition and the application of a productivity offset

7. The price regulation regime includes eight baskets or groups of services: residential local services in high cost serving areas (HCSAs); residential local services in non-high cost serving areas (non-HCSAs); business services; other capped services; Competitor Services; services with frozen rates; public payphones; and uncapped services. Each of these baskets or service groups is subject to pricing constraints tailored to meet the circumstances of the relevant services.
8. The individual basket constraints rely on an inflation factor, a productivity factor and an exogenous factor, as appropriate. The Commission has selected the chain weighted GDP-PI published by Statistics Canada as the inflation measure and it has set the productivity offset at 3.5%. In addition to basket constraints, a variety of rate element constraints were imposed on specific services in light of competitive circumstances and related considerations. These rate element constraints provide customers with additional price protection. Based on the general environment under which the Companies operate, as well as the prospects for the development of local competition in their serving territories, the Commission made several conclusions regarding the general grouping of services into baskets and the need for a productivity offset.
9. In the residential market, the Commission did not anticipate that competition would be sufficient to discipline the Companies' residential local exchange and residential optional local service rates. Accordingly, the Commission considered it appropriate, with the exception of service

provided in HCSAs, to subject these services to a productivity offset. The Commission therefore applied a basket constraint equal to inflation less a productivity factor to the non-HCSA basket of residential local services. The Commission did not consider it appropriate to impose a basket constraint on the HCSA basket of local residential services as such a constraint would have forced down local exchange rates in HCSAs which were already set below cost.

10. However, given the potential for adverse effects on local competition as a result of mandated rate reductions, the Commission implemented a deferral account mechanism to mitigate these potential effects. The deferral account mechanism applies only to revenues from residential local services in non-HCSAs.
11. With a deferral account mechanism, an amount equal to the revenue reduction required by the basket constraint is assigned to the deferral account and retained in that account, instead of reducing the revenues of the basket by means of rate reductions. The Commission considered that the creation of a deferral account for residential local services would assist in achieving the objective of balancing the interests of the three main stakeholders in telecommunications markets: customers, competitors and ILECs.
12. In addition, for the services in the HCSAs and non-HCSA residential sub-baskets, the Commission also decided to apply basket constraints and a number of service-specific rate element constraints in order to provide adequate price protection to subscribers where local competition was expected to develop slowly.
13. In the business market, the Commission was of the view that, in order to ensure a proper balance among stakeholders, and given that competition was likely to develop first in the business market, it was not necessary to subject business services to a productivity offset.
14. With respect to the market for other capped services, the Commission considered that market forces could not be relied upon to sufficiently discipline the prices of these services and anticipated that the Companies would continue to achieve productivity and efficiency gains in respect of these services. Accordingly, the Commission found it appropriate to subject these services to a productivity offset.
15. With respect to the market for Competitor Services, the Commission established two categories of Competitor Services in Decision 2002-34 for the other large ILECs. Category I Competitor Services were those services deemed to be in the nature of an essential service. Competitor Services not classified as Category I were assigned to Category II Competitor Services. The Companies offer a number of services comparable to the services classified as Competitor Services in Decision 2002-34.
16. Since there were few, if any, competitive alternatives for Companies' services that were comparable to services classified as Category I Competitor Services under Decision 2002-34 and having regard to the expectation that Companies would experience productivity and efficiency gains in respect of these services, the Commission concluded in Decision 2002-43 that rates for those of the Companies' services that would be classified as Category I Competitor Services should reflect productivity gains on an ongoing basis.

17. In Decision 2002-34, the Commission determined that it would not be appropriate to apply a productivity offset to the rates for Category II Competitor Services. The rates for these services were either mandated or market-based and were based on considerations in addition to or other than Phase II costs. Accordingly, in Decision 2002-43, the Commission also considered that the rates for services that would be classified as Category II Competitor Services for Télébec and TCQ should not be subject to a productivity offset.
18. With respect to the remaining services and their treatment under this regime, services such as 9-1-1 service and Message Relay Service were subject to frozen rate treatment. Public and semi-public pay telephones were placed in a separate category and their rates were frozen. All tariffed services not in one of the previous baskets or service groups were classified as uncapped services and are not subject to any upward pricing constraints.

Other components of the regime

19. With respect to quality of service, the Commission was not persuaded in Decision 2002-43 that competitive pressures in either the retail or competitor services markets would be sufficient to ensure that the Companies could meet approved service quality standards. The Commission noted that, even where limited local competition has taken hold in the operating territories of the other large ILECs, service quality has been below standard. In the Commission's view, under the price regulation regime for the Companies, the drive to improve earnings at the expense of quality of service would not be adequately offset by competitive pressures. In the Commission's view, it was appropriate to adopt the same approach with respect to quality of service for the Companies as was adopted for the other large ILECs in Decision 2002-34.
20. Accordingly, in Decision 2002-43, the Commission introduced, on an interim basis, quality of service mechanisms which provided for rate adjustments to customers and competitors if the Companies failed to meet the Commission mandated quality of service indicators. These mechanisms were the same as the plans established in Decision 2002-34 for the other large ILECs. These mechanisms were finalized in *Retail quality of service rate adjustment plan and related issues*, Telecom Decision CRTC 2005-17, 24 March 2005 and *Finalization of quality of service rate rebate plan for competitors*, Telecom Decision CRTC 2005-20, 31 March 2005.
21. In Decision 2002-43 and subsequent decisions, the Commission approved the Service Improvement Plans for the Companies. These plans would extend service to unserved customers and upgrade service to underserved customers, and ensure that the Commission's basic service objective (BSO) would continue to be achieved in their territory. The BSO comprises individual line local service with Touch-Tone dialling, provided by a digital switch with capability to connect via low-speed data transmission to the Internet at local rates; enhanced calling features, including access to emergency services, Voice Message Relay service, and privacy protection features (included in call management services); access to operator and directory assistance services; access to the long distance network; and a copy of a current local telephone directory.
22. In keeping with the ongoing effort to streamline and improve the efficiency of regulation, the reporting requirements of the Companies were revised to eliminate the filing of Phase III/Split Rate Base reports, as well as intercorporate transaction reports. The Commission considered that the concept of a Utility Segment no longer had relevance. This was due,

in part, to the introduction of a Phase II-based determination of the subsidy requirement starting in 2002 and the structure of the current regime. The Commission's annual monitoring process would be used to gauge the financial state of the Companies in order to ensure that the objectives of the price cap regime are being met.

Extending the current price regulation regime

23. The Commission determined that the price regulation regime for the Companies would be in place for a period of four years, commencing 1 August 2002. The Commission noted that a review of the price regulation regime for the Companies should be completed prior to the end of the four-year period.
24. As explained above, the current price regulation framework was based, in large part, on the general environment under which Télébec and TCQ operate, the prospects for the development of local competition in their serving territories and their ability to achieve productivity and efficiency gains in respect of certain services. The Commission considers that the factors and circumstances present at the time of the establishment of the current price regulation regime have not changed significantly and still exist at this time.
25. While competitive entry into the residential local services market through various initiatives, such as voice communications services using Internet Protocol (IP), may well increase the level of competition for residential local services in the future, the timing and magnitude of this impact are not clear at this time. In *Regulatory framework for voice communication services using Internet Protocol*, Telecom Decision CRTC 2005-28, 12 May 2005, the Commission set out the regulatory framework for voice communication services using IP. The Commission will need to assess the impacts of that Decision on the state of competition in the residential local services market and, consequently, any changes that may be required to the price regulation regime.
26. In addition, in *Forbearance from regulation of local exchange services*, Telecom Public Notice CRTC 2005-2, 28 April 2005, the Commission initiated a proceeding to consider the framework for forbearance from the regulation of residential and business local exchange services. The determinations in that Decision may impact the existing price regulation regime.
27. As outlined above, the current price regulation regime is comprised of many interrelated initiatives which collectively are designed to achieve the objectives set out in Decision 2002-43. The Commission considers that the current regime is achieving the objectives set out in Decision 2002-43 and, as such, current circumstances within the industry do not warrant a review at this time.
28. In light of the above, the Commission is of the opinion that an extension of the regime without any changes would be appropriate at this time. The Commission considers that a two-year extension is appropriate given the current circumstances. Accordingly, the Commission invites comments on its proposal to extend the existing price regulation regime for the Companies for a period of two years.

29. In *Proceeding to consider extending the price regulation regime*, Telecom Public Notice CRTC 2005-3, issued today, the Commission initiated a separate proceeding to seek comments on extending the current price regulation regime for the other large ILECs.

Procedure

30. Télébec and TCQ are made parties to this proceeding.
31. Other interested parties wishing to participate in this proceeding are required to notify the Commission of their intention to do so by **16 June 2005** (the registration date) and to provide their contact information. They should do so by contacting the Secretary General by mail at CRTC, Ottawa, Ontario, K1A 0N2, by fax at (819) 994-0218 or by email at procedure@crtc.gc.ca. They are to indicate in the notice their e-mail address where available. If such parties do not have access to the Internet, they are to indicate in their notice whether they wish to receive disk versions of hard copy filings.
32. The Commission will issue, as soon as possible after the registration date, a complete list of interested parties and their mailing addresses (including their e-mail addresses, if available), identifying those parties who wish to receive disk versions.
33. All parties may file comments with the Commission on any matter within the scope of this proceeding by **27 June 2005**, serving a copy on all parties by that date.
34. All parties may file replies to any comments made pursuant to paragraph 33 by **11 July 2005**, serving a copy on all parties by that date.
35. The Commission will not formally acknowledge comments. It will, however, fully consider all comments and they will form part of the public record of the proceeding.
36. Where a document is to be filed or served by a specific date, the document must be actually received, not merely sent, by that date.
37. Parties can file their submissions electronically or on paper. Submissions longer than five pages should include a summary.
38. Each paragraph of your submission should be numbered.
39. Where the submission is filed by electronic means, the line *****End of document***** should be entered following the last paragraph, as an indication that the document has not been damaged during electronic transmission.
40. Please note that only those submissions electronically filed will be available on the Commission's web site and only in the official language and format in which they are submitted.
41. The Commission encourages interested parties to monitor the public examination file (and/or the Commission's web site) for additional information that they may find useful when preparing their submissions.

Important

42. All information submitted, including your email address, name and any other personal information as provided, will be posted on the Commission's web site. Documents received in electronic format will be posted on the Commission's web site exactly as you send them, and in the official language and format in which they are received. Documents not received electronically will be available in .pdf format.

Location of CRTC offices

43. Submissions may be examined or will be made available promptly upon request at the Commission offices during normal business hours:

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Secretary General

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