

July 10, 2006

Via email: procedure@crtc.gc.ca

Ms. Diane Rhéaume
Secretary General
Canadian Radio-television and
Telecommunications Commission
Ottawa, ON K1A 0N2

Dear Ms. Rhéaume:

Re: Telecom Public Notice CRTC 2006-5; *Review of price cap framework*

1. Cogeco Cable Canada Inc., Rogers Communications Inc. and Shaw Communications Inc., (collectively, the Competitors) are pleased to submit Evidence pursuant to paragraph 33 of Telecom Public Notice CRTC 2006-5 (PN 2006-5), *Review of price cap framework*. This Evidence addresses the specific issues that the Commission has identified in paragraph 22 of PN 2006-5 as being the subject matter of the proceeding.

1. Objectives of the regime

2. The Commission designed the price cap regime in Telecom Decision 2002-34 to achieve the following objectives:
 - 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;

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- 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.
3. The Competitors submit that these objectives remain appropriate today for a price cap regime. The pursuit of these objectives has provided an environment in which meaningful competitive entry into the local residential market has begun. As competition takes hold and develops over the next few years, the conditions for forbearance will be met allowing the price cap regime to be removed in these forborne markets at that time.

2. Basket structure and assignment of services, except for Competitor Services

4. The current price cap 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.
5. The Competitors submit that the current basket structure and the assignment of services to the baskets remain appropriate today.

3. Constraints for basket(s) of services (e.g., I-X)

6. The individual basket constraints rely on an inflation factor (I), a productivity factor (X) and an exogenous factor (Z), as appropriate.

7. In Decision 2002-34, the Commission applied a basket constraint equal to inflation less the productivity factor to the basket of residential services in non-HCSAs. The Commission did not impose a basket constraint on the basket of residential services in HCSAs as such a constraint would have forced down local exchange rates in HCSAs which were already set below cost.
8. In order to ensure that rates were just and reasonable, the Commission implemented a deferral account mechanism to mitigate the adverse effects on local competition for residential services in non-HCSAs that might have resulted from mandated rate reductions. With a deferral account mechanism, an amount equal to the revenue reduction required by the residential non-HCSA 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. For the reasons noted in Section 7 below, the Competitors submit that the deferral account mechanism should not apply for the next price cap regime.
9. In the business market, the Commission did not consider it necessary to subject business services to productivity offset in the last Price Cap regime, given the extent to which market forces were present and the extent to which business rates were reduced in the initial price cap regime.
10. The Competitors submit that the same reasoning that applied to the business market beginning in 2002 should apply to the residential market beginning in May 2007. Overall ILEC residential rates decreased effective June 1st, 2006 under the current price cap regime. With respect to market forces, these are not yet sufficiently strong to discipline the ILECs. They continue to have significant market power. Therefore, a price cap remains appropriate. At the same time market forces should be present in increasing strength in the residential market by May 2007, so that a productivity offset will not be necessary. Therefore,

average rates for the residential and business local exchange baskets should not be permitted to increase by more than the rate of inflation.

11. With respect to 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 ILECs would continue to achieve productivity and efficiency gains in respect of these services. Accordingly, these services were made subject to the productivity offset. Following the same reasoning as applies to the residential and business baskets, the Competitors submit that a price cap set at the rate of inflation, without a productivity offset, would be appropriate.
12. The Commission established two categories of Competitor Services. Category I Competitor Services are those services found to be in the nature of an essential service. These services comprise interconnection and ancillary services required by Canadian carriers and resellers interconnecting to the ILECs' networks. Since there were few, if any, competitive alternatives for services assigned to Category I Competitor Services and having regard to the expectation that ILECs would experience productivity and efficiency gains in respect of these services, the Commission considered that rates for Category I Competitor Services should reflect productivity gains on an ongoing basis. The Competitors submit that this treatment remains appropriate.
13. Category II Competitor Services are Competitor Services that are not in the nature of an essential service. The Commission considered it appropriate not to apply a productivity offset to the rates for these services and capped these services at the existing 2002 rate level. The Competitors submit that this treatment remains appropriate.

14. The rates for 9-1-1 service and Message Relay Service were frozen. Also, public and semi-public pay telephones were placed in a separate category and their rates were frozen. All tariffed services not assigned to one of the previous baskets or service groups were classified as uncapped services and are not subject to any upward pricing constraints. The Competitors submit that this treatment remains appropriate.

4. Constraints for individual services or rate elements (e.g., the percentage increase per year allowable for basic residential services), except for Competitor Services

15. With regard to the sub-baskets for residential services in HCSAs and non-HCSAs established in Decision 2002-34, the Commission applied 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.

16. The specific rate element constraints applied in Decision 2002-34 were 10% for the Business Service and Other Capped Services baskets. The Competitors submit that this treatment remains appropriate.

17. The rules for residential service were somewhat more complicated with a 5% specific rate element constraint applied to the Basic Residential Services sub-basket in both non-HCSAs and HCSAs. The Competitors submit that this treatment remains appropriate.

18. The Competitors note that these constraints provide considerable flexibility for ILECs as a rate band is defined as a separate rate element.¹

¹ Telecom Decision CRTC 97-9, para. 130.

19. Residential optional services for both non-HCSAs and HCSAs were constrained to maximum annual increases of \$1 per feature, except service bundles. The Competitors submit that this treatment remains appropriate.

5. Rate deaveraging within a band

20. In Decision 2004-34, the Commission determined that further rate deaveraging within a rate band should not be permitted.² Since that decision, the Commission has permitted Bell Canada to further rate deaverage within a rate band on a provincial basis for its Bell Digital Voice service; the same band in Ontario and Quebec can have different prices for Bell's Bell Digital Voice service.³

21. As noted in Decision 2005-62, the Competitors recognize that other ILECs currently offer telecommunications services at rates which reflect provincial boundaries and do not object to similar treatment for Bell Canada. In the context of this proceeding, the Competitors confirm that their view also applies to traditional circuit-switched local exchange services; that is, the same band in Ontario and Quebec should be permitted to have different prices for primary exchange service.

22. The Competitors submit that further rate deaveraging within a band within a province should not be permitted at this time. On a broad rate band basis, not all locations in a band face competition. Allowing rate deaveraging will permit the ILECs to reduce rates where they face competition and maintain them at higher levels where they do not face competition while still complying with the overall price cap constraints. This is anti-competitive because competitors only face the lower prices. Competitors do not benefit from higher prices as they do not yet operate in the non-competitive locations.

² Telecom Decision CRTC 2002-34, paras. 419 and 428.

³ Telecom Decision CRTC 2005-62.

23. The ILECs enjoy this situation not by virtue of superior performance but rather by virtue of having operated as a monopoly for 125 years serving all telephony customers. Competitors do not have a base of inelastic telephone service customers that can be leveraged to offer discount prices to the remainder of the market.
24. The Competitors submit that during the transition to competition, the CRTC may wish to consider adopting an approach that would grant additional rate deaveraging flexibility prior to full rate forbearance. The Competitors submit that a different rate could be applied in a Local Forbearance Region (LFR) as defined in Telecom Decision 2005-15 once the ILECs market share fell to 80% in the LFR. The same rate would be charged to all customers within the LFR. This additional rating flexibility would be consistent with the approach that Commission took with regard to the local winback rule in Telecom Decision 2006-15.⁴
25. Once competitors have captured 25% of the market, or conversely the ILECs serve “only” 75% of the market, market forces will have developed to the point where the ILECs will have to make lower prices more generally available to the broad market. In other words, they will have lost their significant market power. At this time, prices will differ on the basis of differential costs and product characteristics and the ILECs should be free to rate deaverage as they wish within an LFR.

6. Components of the price cap formula (e.g., I, X, and Z)

26. The Competitors support the use of the chain weighted Gross Domestic Product – Price Index (GDP-PI) published by Statistics Canada as the inflation measure.

⁴ Telecom Decision CRTC 2006-15, paras. 487 and 488.

27. In Decision 2002-34, the Commission set the productivity offset at 3.5%. The Competitors are not in a position to recommend an alternative measure to the 3.5% productivity offset as they have no insight into the ILECs' productivity performance over the past 5 years. In previous price cap proceedings, interested parties enjoyed the benefit in preparing their Comments of having seen interrogatory responses from the ILECs on productivity performance.

28. The Competitors do note in this regard, that BCE reported in its First Quarter 2006 Results presentation that it is on target to achieve \$700-900M in total savings in 2006 from its productivity activities.⁵

29. Exogenous factor adjustments remain appropriate based on the criteria and determinations reached by the Commission in Decision 2002-34.

7. The continuing need for a deferral account for the residential non-HCSA basket

30. The Competitors do not see the value of continuing the deferral account apparatus. Further accumulation in a deferral account will lead to continued regulatory process in regard to the dispersal of the account. Moreover, while "the Commission implemented the deferral mechanism to mitigate the adverse effects on local competition for residential services in non-HCSAs that might have resulted from mandated rate reductions," mandated rate reductions have been imposed in 2006, a scant 11 months after Rogers, for example, entered the local market. The deferral account mechanism served to delay rate reductions but only until cable companies entered the market. In many respects this situation was the realization of the cable industry's worst fears. Specifically that they would enter a market based on a set of projected prices and then immediately confront a lower level of prices. The Competitors submit that the regulatory

⁵ BCE Q1 2006 Results Overview Slides, page 16.

process can be streamlined at this time by elimination of further accumulation in the deferral account.

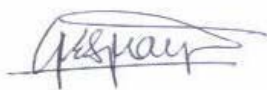
31. After resolution of the outstanding issues in regard to CDNA billings, the final deferral account balances can be struck and the mechanism dismantled. The deferral account will be in equilibrium and no further accumulation should occur.

32. Competitor service rates will remain subject to movements according to the I-X Price Cap mechanism.

8. Length of the next price cap regime, including whether the regime should be of a fixed duration

33. The duration of the next price cap regime should be five years from May 2007 through April 2012. During this period, a number of services in specific geographical locations will, of course, be forborne from rate regulation.

Yours very truly,



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