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September 15, 2005

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

Dear Ms. Rhéaume:

Re: Telecom Public Notice 2005-2, Forbearance from regulation of local exchange service

This written argument is filed by the Canadian Cable Telecommunications Association (CCTA) pursuant to paragraph 53 of the procedures established in Telecom Public Notice 2005-2, *Forbearance from regulation of local exchange service* (PN 2005-2).

An electronic copy of this submission is provided to the Commission by email.

Sincerely,

Michael Hennessy

Michael Hennessy,
President

Attachment
c.c.: Registered Interested Parties, Telecom Public Notice 2005-2

CCTA·ACTC

TELECOM PUBLIC NOTICE CRTC 2005-2

FORBEARANCE FROM REGULATION OF LOCAL EXCHANGE SERVICES

WRITTEN ARGUMENT OF THE

CANADIAN CABLE TELECOMMUNICATIONS ASSOCIATION

September 15, 2005

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Executive Summary

Introduction

Any framework for forbearance must be grounded in the requirements of subsection 34(3) of the *Telecommunications Act*, which prohibits the CRTC from making a determination to forbear from regulation of a service where it finds that to refrain from regulation would be likely to impair unduly the establishment or continuance of a competitive market for that service.

CCTA maintains that, based on the record of this proceeding, the Commission does not have sufficient evidence before it to allow it to forbear from the regulation of the ILECs' residential local exchange services at this time. Moreover, the Commission should only consider forbearance once it has made the following findings: 1) that at least 30% of the relevant market is not served by the ILEC; and 2) that competitive alternatives exist in the relevant market on a pervasive and sustained basis.

1. Relevant Product Market

Whether services belong in the same relevant product market is determined by their substitutability. Where services are <u>close</u> substitutes, they are considered to be in the same relevant market. CCTA makes the following key submissions in this regard:

- Most parties agree that residential and business local exchange services are in separate markets.
- VoIP services are close substitutes to local exchange services and should be included in the same relevant market. The Commission has already made this determination in Decision 2005-28. A number of incumbent service providers, including Bell Canada, also submitted that local VoIP services such as Bell's Digital Voice Service are in the same product market as local exchange services.
- Mobile wireless and other services are not functional substitutes for local wireline service and should not be included in the same product market as local exchange services.
- Optional local calling services are strong complements to local exchange services and should be treated the same as local exchange services for the purposes of forbearance analysis.

2. Local interconnection regions define the relevant geographic market

Local Interconnection Regions (LIRs) represent the most appropriate level of aggregation of residences for the purpose of defining the relevant geographic markets for local exchanges services and assessing market power:

- The ability of a competitive supplier to respond to an ILEC pricing action suggests a market definition based on one or more LIRs;
- An LIR represents a "community of interests";
- An LIR closely approximates the geographic boundaries that are likely to provide the basis for geographic price discrimination of local service;
- An LIR represents a geographic market that is large enough to prevent targeted pricing; and
- An LIR provides the best means by which to measure market power.

In contrast, defining the relevant geographic market as the exchange has a number of serious shortcomings:

- It ignores the possibility of supply responses from firms operating in contiguous exchanges and results in an overly narrow market definition;
- It is not competitively neutral as it is based on the network architecture of the ILECs and dictated by the ILECs' legacy technology;
- It would allow an ILEC to readily target pricing to the consumers of its competitors within that exchange;
- It ignores an ILEC's ubiquitous and entrenched position across a much broader segment of its operating territory and allows the ILEC to leverage the advantages of its incumbency position to the detriment of competition, thereby preventing competition from expanding; and
- While there are only about 180 LIRs in the operating territories of the major ILECs, there are nearly 2,800 exchanges. It would vastly simplify the application of the forbearance criteria to conduct assessments of market share and competitive conditions on the basis of LIRs rather than individual exchanges.

3. <u>Forbearance Criteria</u>

CCTA proposes a two-part test for forbearance; 1) evidence that at least 30 percent of the households in a relevant market are not served by the ILEC (quantitative criterion); and 2) evidence that competition has been established in the market on a pervasive and sustainable basis (qualitative criterion).

When a service provider holds significant market power, it is generally accepted that regulation remains appropriate. The Commission, has previously found a market to be workably competitive where the incumbent does not hold more than 70 percent market share and denied forbearance where an incumbent holds 80 percent or more. In the local exchange services market, the ILECs initially provide service to virtually every customer. The residential local exchange service market is characterized by greater than 98 percent penetration.

CCTA notes that a market share threshold of no greater than 70 percent of households served by the ILEC represents a less stringent test than employed by many competition authorities and telecom regulators. Under these regimes, market shares in excess of 50 percent are generally expected to support a finding of market power, barring exceptional circumstances.

Some of the parties proposing a five percent market share threshold point to the Commission's rule with respect to rate deregulation in the broadcasting distribution undertaking (BDU) market. In CCTA's submission, this is not an appropriate comparison for the following reasons:

- At the time the Commission implemented the BDU rate deregulation rule, more than 23 percent of households that *could* subscribe to cable television service did not. Overall, cable companies' share of the market of households with television sets was less than 75 percent when the DTH companies entered the market.
- DTH companies from the first day they launched could serve any and every household who might want their service. The competitor had no need to make contact or interconnect with the cable company. By comparison, competitors in the local exchange market are rolling out service community by community, and must interconnect with the incumbents at each step of the way.

- Unlike residential local telephone service, subscription to multi-channel television service is a not an essential service.
- Finally, basic cable rate deregulation removes only one of many asymmetries in regulation between cable BDUs and their competitors in the broadcasting distribution market.

4. <u>Barriers to entry are significant</u>

As many competitors participating in this proceeding have shown, there remain substantial difficulties and delays in gaining access to the facilities necessary to compete. This is particularly true for facilities-based competitors offering full primary line replacement services. These barriers to entry are summarized below:

- Technical barriers including the development of standards for IP to IP interconnection and implementation of 9-1-1 and MRS for IP-based service providers;
- Financial barriers including the costs of infrastructure, equipment, technical and customer support staff, cost of capital and foreign ownership restrictions that affect the cost of capital;
- Regulatory barriers including CLEC obligations; access to support structures and rights of way;
- Behavioural barriers including customer inertia;
- ILEC incentives to engage in anti-competitive behaviour and lack of compliance with competitive safeguards; and
- Barriers to entry due to lengthy construction periods and high sunk costs.

The claim by some parties that the mere presence of a competitor is sufficient ignores the reality that any such entry is the product of extensive resources and time spent in overcoming significant barriers.

5. <u>Risks of premature forbearance outweigh any potential costs of delayed forbearance</u>

Establishing weak criteria for forbearance creates substantial risks that forbearance will be granted prematurely, thereby undermining the objectives of the *Telecommunications Act*. CCTA disagrees with the views of some of the ILECs that the risks of premature forbearance are outweighed by the potential costs associated with delaying forbearance.

The ILECs appear to be suggesting that only with forbearance would the ILECs have sufficient pricing flexibility to deliver the benefits of competition – primarily lower prices. Experience to date refutes this argument.

- First, competitors currently in the market already offer services at prices that are significantly discounted relative to the ILECs, as recognized by the ILECs themselves.
- Second, ILECs have been granted sufficient pricing flexibility to compete in the market absent forbearance. This claim ignores the fact that the existing price cap regime permits the ILECs to lower prices for residential local exchange service customers in response to competition. The flexibility available to the ILECs is further demonstrated by Bell's Digital Voice service, for which the Commission approved a range of rates that remain in confidence.

The risks of premature forbearance are many, the most obvious of which is the risk of a substantial lessening of competition. Where competition ceased to exist in the forborne market, it would be exceedingly difficult to re-establish.

Moreover, potential competitors considering entry in other markets could reasonably expect that premature forbearance would be granted elsewhere as well. As a result, even if there was not complete competitor exit from the prematurely forborne market due to high sunk costs, competition would be substantially less likely to expand to other geographic markets.

6. <u>Forbearance application process</u>

CCTA submits that its proposals regarding procedure associated with a Commission or ILEC-initiated forbearance review properly balance the need for a complete and reliable evidentiary record with the interest of parties in conducting a streamlined and discernible process.

7. <u>Re-regulation procedures</u>

CCTA strongly recommends that the Commission not rely on the ability to revoke forbearance as a means to offset the risk of premature forbearance. It is critical that forbearance not be granted prematurely in the first instance. Re-establishing regulation over a previously forborne market would come too late to avoid the damage this would cause to the development of competitive markets.

CCTA submits the process for revoking forbearance of ILEC local exchange services should mirror the process to justify forbearance. Moreover, the key question in a re-regulation debate should not be whether the incumbent's market share has exceeded pre-forbearance levels, but whether the trends behind the incumbent's market recapture disclose evidence of harm to the continuance of a competitive market.

8. <u>Scope of forbearance</u>

The Commission should retain its authority to exercise the following powers:

- section 24 - to address consumer safeguards and to facilitate achievement of telecom policy objectives;
- sections 25, 29 and 31 of the Act - insofar as they relate to LEC services and agreements provided to, or involving inter-carrier agreements;
- Subsections 27(2), (3) and (4) - so that the Commission can respond to complaints alleging unjust discrimination and undue preference in relation to services provided by LECs both to end-users and to other carriers; and
- Subsections 27(1) and (5) – insofar as they relate to services provided to and for the benefit of telecom service providers.

Forbearance could be granted with respect to sections 25 and 31 and subsections 27(1), (5) and (6) of the Act in relation to ILEC retail telecommunications services provided to end-users, including resellers.

9. <u>Post-forbearance conditions</u>

The most important task for the Commission is to ensure that forbearance is granted only where to do so will not be likely to undermine the establishment or continuance of a competitive market. If this requirement is met, then there should be little need to retain or impose competitive safeguards post-forbearance.

At the same time, circumstances particular to the market may warrant the imposition of post-forbearance conditions on the ILEC. Examples of such conditions include the requirement to provide equitable access to support structures or essential facilities where ILEC control of these is likely to impede the continuance of a competitive market or the expansion of competition within the forborne LIR. Also, as was the case in the toll market, the Commission may determine that ensuring the policy objectives of the Act (most notably those in paragraphs 7(a), (b) and (h)) are addressed, consumer protections in the form of a price ceiling for stand alone local service, combined with an ILEC obligation to serve and retention of quality of service requirements, will be necessary.

10. A transitional regime is neither necessary nor appropriate

There is no policy justification for the removal of competitive safeguards in advance of a finding in support of forbearance. The implementation of a transitional regime would only serve to maintain the ILECs' market power and slow down or prevent the development of sustainable competition. The current regulatory framework has been established to provide the ILECs with sufficient flexibility to meet competition while providing the necessary safeguards to permit competition to develop.

Under the existing safeguards, the ILECs have the flexibility to offer promotions, subject only to limitations that ensure any promotions offered are not anti-competitive or damaging to competition. Moreover, winback rules have been designed in a way that greatly minimizes their impact on the ILECs' ability to communicate with customers.

Enhanced flexibility for ILECs, such as permitting targeted promotions aimed at winning back customers of competitors, would serve only to increase churn and administrative costs for CLECs.

Finally, CCTA submits that it would be inappropriate to make adjustments to the current price regulation framework. The current price cap regime balances the interests of the telephone companies, consumers and competitors. Any proposed changes to the price cap regime would require a full assessment of the nature of the proposed changes and the impact on the interests of the various stakeholders.

Introduction

1. The purpose of this proceeding is to determine the framework, including the criteria, for forbearance from the regulation of residential and business local exchange services. This proceeding is of critical importance because the criteria for forbearance adopted by the Commission will send a signal to entrants and potential entrants as to whether the risks of investing, or continuing to invest are reasonable. The forbearance criteria need to facilitate a sustainable competitive market, as required under the Telecommunications Act.

2. Any framework for forbearance must be grounded in the requirements of subsection 34(3) of the Telecommunications Act, which prohibits the CRTC from making a determination to forbear from regulation of a service where it finds that to refrain from regulation would be likely to impair unduly the establishment or continuance of a competitive market for that service.

3. CCTA is of the view that its proposed framework for forbearance, including the relevant product and geographic market and two-part test, ensure that the requirements of the Telecommunications Act will be fulfilled. CCTA submits that the Commission should only consider forbearance once it has made a finding that both parts of the test have been met: (1) that at least 30 percent of the relevant market is not served by the ILEC; and (2) that competitive alternatives exist in the relevant market on a pervasive and sustained basis. CCTA further submits that premature forbearance based on too low a market share threshold or a very narrow geographic market, such as an exchange, could result in anti-competitive pricing that deters, or prevents, competitive expansion or entry. This finding is further supported by the report prepared by Drs. David Gillen and Thomas W. Ross, on behalf of CCTA, which noted that predatory pricing is less costly and more effective if it can be targeted narrowly at exactly the point where it does the entrant the maximum harm.

4. Further, it is critical that the Commission take note of the significant costs, of and barriers to, facilities-based entry in the market. Unlike the provision of subscription television services where satellite had ubiquitous coverage and no interconnection requirements, cable companies have to invest and overcome barriers in every geographic market they seek to enter.

5. Based on this framework, and the information filed in this proceeding, CCTA submits that there are insufficient grounds on which the Commission could make a finding in favour of forbearance in the local exchange services market at this time. CCTA remains of the view that, at this stage of development in the local exchange market, there is substantial risk that granting forbearance prematurely would undermine the likelihood of achieving effective and sustainable competition across Canada.

1. Relevant Product Market

6. As CCTA indicated in its 22 June 2005 submission, whether services belong in the same relevant product market is determined by their substitutability.[1] Where services are <u>close</u> substitutes, they are considered to be in the same relevant market. Accordingly, CCTA submitted that: (a) residential and business local exchange services are in separate markets; (b) VoIP services are close substitutes to local exchange services and should be included in the same relevant market; (c) mobile wireless and other services are in separate

[1] CCTA Submission, 22 June 2005, para.19.

markets; and (d) optional calling features should be treated the same as local exchange services for forbearance purposes. Based on CCTA's initial submission and interrogatory responses, as well as an assessment of the submissions of other parties on the issue of the relevant product market for local exchange services, CCTA has identified a number of issues that require further comment.

Residential / business local exchange services

7. In its initial submission, CCTA stated that local exchange services offered to residential customers are in a distinct market that does not include the provision of local exchange service to business customers.[2] CCTA notes that most parties commenting on this issue were in agreement with the product market distinction between residential and business local services. MTS Allstream, however, claimed that the two services are perfect substitutes from the customer's perspective and in terms of supply.[3]

8. Contrary to MTS Allstream's assertion, residential customers do not view business local exchange services as substitutes for their residential local exchange service. As CCTA indicated in CCTA(CRTC)20Jul05-207 b), while a consumer who would normally select residential local exchange service may have the option of subscribing instead to a business local exchange service, this is unlikely to occur given the differences in pricing models that would make such a choice uneconomical to the residential consumer. Furthermore, in the case of multi-line business services, these services are designed to meet more complex requirements than necessary to service the needs of an individual residential customer.

9. With regards to supply substitutability, a number of service providers identified significant differences that impact the supply substitutability of the two services. EastLink noted that residential and business services may in some cases have a different cost structure, with certain business services requiring the use of different facilities.[4] Québécor Media indicated that its subsidiaries provide business local exchange services almost exclusively over its own fibre optic builds, while residential local exchange services are provided over a hybrid fibre/coaxial (HFC) infrastructure.[5] In addition, Bell noted that while business and residential primary exchange service (PES) use the same underlying facilities, differences in traffic profile would require additional costs to provision business PES since these services require more traffic-driven resources than residential PES.[6] Bell further noted that additional switching and/or multiplexing equipment costs, as well as software costs, would be incurred to provide either Centrex or digital trunk services over residential PES facilities.

10. Finally, CCTA disagrees with MTS Allstream's claim that the practical consequence would be forbearance for both residence and business since it would no longer be possible for the Commission to ascertain whether tariffed rates were consistently charged for the service that remained regulated. As noted by Bell et al., there is no difference from an enforcement view between the current situation where both residential and business services are tariffed and differential rates apply and the situation where one of the services is forborne and the other remains subject to rate regulation.[7] TELUS further noted that there were a number of

[2] CCTA Submission, 22 June 2005, para.28 – 30.
[3] MTS Allstream Submission, 22 June 2005, para 46.
[4] EastLink(Aliant)20Jul05-116 a).
[5] QMI(Bureau)20Jul05-1 g).
[6] Bell(CRTC)20Jul05-213 a) and b).
[7] The Companies(CCTA)20Jul05-17.

examples in forborne markets such as long distance and Internet services where there are restrictions on use of the service.[8]

VoIP Services

11. In its initial submission, CCTA noted that the Commission has already found as a fact in Decision 2005-28 that traditional circuit-switched local exchanges services and local VoIP services are close substitutes.[9] CCTA notes that a number of incumbent service providers, including Bell Canada,[10] also submitted that local VoIP services such as Bell's Digital Voice Service are in the same product market as local exchange services.[11] The similarities are further demonstrated by Bell's description of its service:

> The new Bell Digital Voice allows consumers to benefit from a telephone service with advanced capabilities such as voicemail to email, additional numbers, enhanced call forwarding and online account management. **Consumers can keep their current phone number and use all existing phone jacks and handsets in their home. The service does not require a technician visit or the installation of additional equipment at the customer's premise, such as a modem, router or battery back-up. All that's required to activate the service is a simple phone call.**[12] (emphasis added)

12. CCTA submits that for the purposes of defining the relevant product market in applying the forbearance framework, VoIP services should be considered part of the local exchange services market.

Mobile Wireless Services

13. In the proceeding, a number of parties, including Bell et al. and TELUS have claimed that mobile wireless services should be considered as part of the same product market as local exchange services. A similar position was put forward by Bell et al. in the context of PN 2004-2 VoIP proceeding. In Decision 2005-28, the Commission rejected this position, noting that wireless had been treated as a separate market for regulatory purposes for two decades since its introduction. The Commission further noted that its 2004 report on the status of competition in Canadian telecommunications markets indicated that as of 2003 less than 2% of Canadian households had wireless service only.[13]

14. While Bell has presented information that wireless traffic has displaced wireline traffic, CCTA submits that this information is not relevant in a determination of the substitutability of mobile wireless service for local exchange service. Based on accepted conceptual approaches to market definition, the relevant question is not whether wireless is a substitute for some subscribers; rather the relevant question is whether a sufficient number of subscribers would disconnect their local exchange wireline service and replace it with a wireless service in the event of a significant and non-transitory price increase. CCTA submits that a review of the

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[8] TELUS(CCTA)20Jul05-14.
[9] CCTA Submission, 22 June 2005, paras. 26 – 27.
[10] Bell Submission, 22 June 2005, paras. 63 -66 and Appendix E, see also Bell(CRTC)20Jul05-208 and Bell(Xit)20Jul05-2.
[11] See also TELUS Submission, 22 June 2005, paras. 37 and 46.
[12] Bell Canada press release, September 8, 2005.
[13] Telecom Decision CRTC 2005-28, paras. 127 – 128.

available information indicates that wireless services will not discipline price increases in the wireline market; therefore, the two services cannot be defined as close substitutes.

15. As CCTA indicated in its initial submission[14] and in its response to CCTA(CRTC)20Jul05-202, it does not consider mobile wireless services a functional substitute for local wireline service. CCTA noted the following differences in service characteristics:

    - Local wireline service is associated with fixed locations, which may serve one or more users, while mobile wireless services are typically associated with an individual user and are independent of location;
    - Mobile wireless services are priced on a usage sensitive basis for both local and long distance calling, including the payment for incoming calls; by contrast, local wireline services include unlimited local calling for a flat monthly fee and no charge for incoming long distance calls; and
    - Due to the nature of the service and the underlying technology, the perceived quality of mobile wireless services tends to be lower than wireline service.

16. CCTA further submits that the current restrictions on the ability of wireline customers to port their wireline numbers to a mobile wireless service provider further limit the substitutability of the mobile wireless service. These restrictions will remain in effect for another two years.

17. In further support of its position that the two services are not close substitutes and will not likely become substitutes in the near future, CCTA noted that virtually all wireline customers have retained their primary wireline service when subscribing to a mobile wireless service:

    > While Canada has over 15 million wireless subscribers, the percentage of households subscribing to a wireline service is still nearly ubiquitous at 96.3%. Only 302,000 households or 2.4% of Canadian households rely solely on their wireless service as their only phone connection. Clearly most consumers do not consider the two services to be substitutes.[15]

18. CCTA further illustrated this point by reference to the packaging of services by some service providers, noting that Primus Canada offers a bundle including both wireline and wireless services and Rogers offers a discount when customers purchase both Rogers Home Phone wireline service and Rogers wireless service. If wireless and wireline services were substitutes for each other, these types of bundled service offerings would not make any sense, nor would they be purchased by consumers as the consumer would be paying twice for services that provide the same functionality.

19. The Competition Bureau also indicated that there were functional differences between the two services, noting that the cost to consumers and the cost of long distance is typically greater with mobile wireless service. The Competition Bureau also stated that consumers perceive voice quality and reliability to be lower with mobile wireless service.[16]

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[14] CCTA Submission, 22 June 2005, para. 27.
[15] CCTA(CRTC)20Jul05-202 d). CCTA notes that the incidence of wireless only households was more recently reported at 2.7%, not a significant increase over the previous year.
[16] Bureau(CRTC)20Jul05-202 a).

20. Finally, if the Commission were to determine at some point in time that mobile wireless services were substitutes for wireline service, CCTA submits that it would be necessary to consider the affiliate relationship ILECs have with wireless service providers. In particular, it should recognize that a switch by a customer from an ILEC wireline service to an ILEC wireless service does not have any impact on the market power of the ILEC since the customer has not changed service providers and is still receiving a service that would have been found to be in the same product market.[17] The Competition Bureau also proposed a similar treatment of ILEC wireless services in the event the Commission determined that mobile wireless service is in the same product market as wireline service.[18]

Other Services

21. In CCTA(CRTC)20Jul05-202 f), the Commission requested views on the extent to which other communications services such as instant messaging (IM), voice mail and email may limit the ILEC's market power in the wireline market. In response, CCTA indicated that none of these services have any impact on the ILEC's market power in the wireline market. Customers do not consider the products as close substitutes and will not drop the ILEC wireline service and replace it with either IM, voice mail or email service. These services are complementary communications services.[19] CCTA notes that the Competition Bureau also offered a similar view, determining that the services do not appear to be particularly close substitutes and are unlikely to curtail market power.[20]

Optional Local Services

22. CCTA submits that optional local calling services are strong complements to local exchange services and forbearance for these services should only occur when the forbearance criteria are met for local exchange services.

23. As CCTA noted in its initial submission, consumers must select the same service provider for both the exchange service and the optional calling features, as there is no existing market offer that allows the consumer to mix and match providers.[21] Furthermore, there is an increasing trend to offer residential consumers bundles that include the purchase of an exchange service with a set of optional calling features. CCTA further noted that the Commission has recognized that the degree of competition in local exchange services is virtually the same because the services are so closely linked.

24. In its submission, Bell claims that market incentives are sufficient to discipline the pricing of these services. CCTA submits that this claim is unfounded and that the Commission's determinations in Decision 2002-34 clearly indicate that the ILECs have considerable pricing power regarding these services. In Decision 2002-34, the Commission concluded:

> [t]here was no evidence to suggest that competitors had made any inroads into the market for residential optional local services. On the contrary, the ILECs were able to

[17] CCTA(CRTC)20Jul05-202 e).
[18] Bureau(CRTC)20Jul05-202 e).
[19] See also CCTA(CRTC)20Jul05-203.
[20] Bureau(CRTC)20Jul05-202 f).
[21] CCTA Submission, 22 June 2005, para. 32.

increase revenues from these services through rate increases without experiencing a significant reduction in demand.[22]

25. The Commission further indicated that it did not anticipate competition would be sufficient to discipline the ILECs' residential local exchange and residential optional local service rates during the second price cap period. The Commission addressed this situation by establishing service baskets including residential optional services to cap the allowed level of price increases.

26. CCTA submits that the level of competition is not sufficient to discipline the ILEC's residential local exchange and residential optional services as determined by an assessment of the ILEC's market power.

2. Local interconnection regions define the relevant geographic market

27. In PN 2005-2, the Commission asked parties to provide their views with respect to the appropriate geographic market for the purposes of forbearance. The analytical approach to determining the competitive effects of a merger can provide some assistance in developing the framework for an analysis of forbearance and the relevant geographic market. The basic competition principles that support merger analysis are the same principles upon which the framework for forbearance should be based, however, the objectives are considerably different. A merger analysis assesses whether a merger would substantially lessen or prevent competition. The objective of defining the market is to identify those markets where the merged entity could enjoy market power as a result of the merger. In a forbearance proceeding, CCTA submits that the overall objective should be to determine whether regulatory safeguards can be removed within well-defined markets where the ILECs had possessed market power without risking the sustainability of competition within those markets or the potential for the development of competition in non-forborne markets.

28. Consistent with the objective for a forbearance analysis, CCTA submits that the local interconnection regions (LIRs) developed by the Commission in Decision 2004-46 represent the most appropriate level of aggregation of residences for the purpose of defining the relevant geographic markets for local exchange services and assessing market power.

29. In its submission of June 22, 2005, CCTA summarized the key characteristics of LIRs that support selecting them as the relevant geographic market for the purpose of forbearance:

   i) the ability of a competitive supplier to respond to an ILEC pricing action suggests a market definition based on one or more LIRs;
   ii) An LIR represents a "community of interests";
   iii) An LIR closely approximates the geographic boundaries that are likely to provide the basis for geographic price discrimination of local service;
   iv) An LIR represents a geographic market that is large enough to prevent targeted pricing; and
   v) An LIR provides the best means by which to measure market power.

30. In CCTA's submission, there are three important distinctions between a merger analysis and a forbearance proceeding:

[22] Telecom Decision CRTC 2002-34, para. 59.

i) unlike in a merger analysis, post-forbearance, there is the continuing presence of a firm with significant market power in surrounding geographic markets;
ii) ensuring the sustainability of entrants and the potential for further entry and expansion are extremely important objectives in a forbearance proceeding; and
iii) the two analyses lead to different remedial action.

31. Although these differences are relevant to every aspect of this proceeding, they are most significant to defining the relevant geographic market. The following provides a brief discussion of these important distinctions.

32. When analysing a merger, a competition authority analyses whether a substantial prevention or lessening of competition results from a merger that creates, maintains or enhances the ability of the merged entity to exercise market power. The overall objective of market definition is to identify sets of buyers that could face increased market power as a result of the merger. It is appropriate in merger analysis to define the relevant market in terms of the smallest group of products and the smallest geographic area because this effectively restricts the analysis to markets where there is a firm or group of firms with market power.

33. By contrast, in this proceeding, the ILECs already possess significant market power across Canada, the exercise of which is constrained by appropriate regulation. After forbearance in certain geographic markets, ILECs will retain market power in the vast majority of non-forborne geographic markets (including markets that are contiguous to the forborne markets) as well as several complementary product markets. If the Commission adopted an approach that defined the smallest geographic area across which the ILECs theoretically no longer possess market power, the outcome would not reflect the fact that ILECs retain market power in adjacent markets. Unlike in merger analysis, in this proceeding, the ability of the incumbent to leverage market power from contiguous geographic markets and to deter and prevent entry and expansion to non-forborne markets is a significant concern.

34. In merger analysis, entry is examined primarily as a mitigating factor. By contrast, entry and expansion are fundamental to the development of competitive local telephony markets. CCTA submits that forbearance should not take place in any market if its effect is to prevent entry and expansion into non-forborne markets or to cause exit by entrants in forborne markets. The sustainability of the CLEC entrants must be assessed in terms of whether they have achieved sufficient economies of scale and scope to suggest that they will remain viable in the forborne market and will have the ability and incentive to enter non-forborne markets.

35. In a merger analysis, barriers to entry are critical in the examination of the impact of the merger; however, it is not necessary to ensure that entry occurs. Because fostering entry and expansion by existing or new firms is not one of the goals of an enforcement agency when deciding whether or not to challenge a merger, it is not necessary to examine entry and supply responses at each stage of the analysis.

36. By contrast, CCTA submits that entry and expansion are the most important considerations in this proceeding. Competition in the provision of local telephony will not develop across Canada without entry. For these reasons, entry considerations and supply responses should be taken into consideration at each stage of the analysis, including when defining the relevant geographic markets.

37. One final difference is in respect of remedy. If a competition authority determines that there is a substantial lessening of competition in a given market, there are a number of avenues available to obtain remedies on either a contested or consent basis. These include dissolution of the merger or divestiture of assets.[23] The remedy will be sufficient if it addresses the substantial lessening or prevention of competition and prevents a firm from exercising market power. After the remedy is imposed, no concerns should exist about the ability of the merged entity to exercise market power.

38. As described above, after initial forbearance, ILECs will continue to exercise market power in the vast majority of non-forborne markets sufficient to limit further entry or expansion. For this reason, careful consideration should be given to whether forbearance in narrowly-defined markets is appropriate. CCTA submits that, in this proceeding, forbearance from regulation is not the remedy; rather, regulation by the Commission is the remedial action necessitated by the absence of competition. In a forbearance proceeding, the question is not whether remedial action is necessary in certain markets – the question is whether there are certain markets where remedial action is no longer necessary. For this reason, the geographic market is more than simply a tool used toward a determination of market power. Geographic market definition is the single most important question as it provides the basis for the Commission's analysis and it defines the territories across which safeguards against the exercise of market power will be removed.

Supply responses

39. The relationship that LIRs have to the ability of a CLEC to compete across a given geographic area provides a strong basis on which to establish the relevant geographic market for the local forbearance framework. LIRs represent more than simply a technical arrangement by which LECs interconnect. The LIRs are a fundamental component of the Commission's regime for competition in the local exchange services market. By its very nature, the local interconnection region describes the geographic scope over which a CLEC can compete in the local exchange services market. The LIR defines the set of public-switched telephone connections to and from which a CLEC can originate and terminate voice calls from a single point anywhere in a given LIR.

40. Prior to the establishment of LIRs, interconnection had to be arranged in each exchange in which a CLEC wished to compete. This made it difficult for a CLEC to enter and offer competing services consistently across a community. To offer local exchange service across the greater Toronto metropolitan area, for example, a CLEC would have had to establish 35 individual points of interconnection with separate network connections between its facilities and the ILEC's for each exchange. Creating the LIRs improved network efficiencies for all LECs involved and reduced the network resources required for CLECs to compete.

41. CCTA considered the basic conceptual model for market definition – the hypothetical monopolist test – and concluded that strict application of this approach would result in the treatment of individual residences as the relevant geographic market. Because individual residences cannot substitute between geographic supply points, the number of available choices is limited to the number of firms that provide service to a residence. Every party in this proceeding appears to share the view that it is not possible or appropriate to treat the individual residence or, alternatively, two pairs of callers, as the relevant geographic market.

[23] Bureau(CCTA)20July05-1 PN 2005-2.

Because of the inoperability of the hypothetical monopolist test based on demand substitution in local telephony markets, the starting point for CCTA's determination of the relevant geographic market is a consideration of supply responses. This approach is reasonable, as acknowledged by Bell in this proceeding.[24] The important question is the extent to which individual residences should be aggregated. To answer this question, CCTA submits that the Commission should adopt the relevant market that provides the most appropriate basis for calculating market share and examining other factors toward an understanding of the degree to which the incumbents possess market power.

42. In considering market power, the CCTA has arrived at the LIR as the relevant market after aggregating residences based on the conclusion that, in most regions, a sole profit-maximizing seller would be able to profitably impose and sustain a price increase across an LIR without encountering a timely, disciplining supply response from competitors in neighbouring LIRs. A hypothetical monopolist of an exchange, group of exchanges or other aggregation of residences within an LIR would not be able to profitably impose such a price increase in the presence of another sizeable competitor with interconnection within the LIR. This competitor's supply response would discipline attempted price increases.

43. It has been suggested that CLECs must still roll out service by individual exchange even after the establishment of LIRs. CLECs that rely on leased unbundled loops have some additional requirements, such as co-location, that are deployed on an exchange basis. Cable CLECs that have established a point of interconnection in an LIR, however, do not require any facilities from the ILEC at the exchange level.

Community of interests

44. With respect to "community of interests", CCTA notes that the Commission's determination respecting LIRs was focused on aligning the boundaries of LIRs to reflect a community of interest.[25] The Commission cited a number of benefits of relying on existing provincially defined administrative regions as the basis for LIRs. In its view, this would allow for the creation of boundaries that are competitively neutral, well-specified, readily identifiable and associated with economic, social and political interests.

45. Drs. Gillen and Ross also took the view that the relevant geographic market would encompass contiguous population centres such as a city or census metropolitan area where there is social and commercial connectivity.[26] They further expressed the view that LIRs may be a very practical way to define geographic markets that satisfy the conditions they considered important.[27]

46. The Consumer Groups also support the view that community of interest has an important role to play in determining the relevant geographic market, "since consumers with a shared community of interest expect to be treated in a similar manner."[28]

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[24] In the response to Bell(Bureau)20Jul05-32 PN 2005-2, it stated: "In commercial reality, the forces of ready supply-side substitution mean that competitive constraint makes itself felt at a wider level than each premise considered alone. It is very significant that in practice no competition agency views a customer premises as a separate market, which indicates they at least tacitly accept supply-side substitutability."
[25] Decision 2004-46, para. 72.
[26] Drs. Gillen and Ross Report, Attachment to CCTA's Submission of June 22, 2005, at para. 130.
[27] CCTA(Bureau)20Jul05-24 PN 2005-2.
[28] Consumer Groups Submission of June 22, 2005, at para. 43.

Geographic Price Discrimination and the Prevention of Targeted Pricing

47. One reason for defining the geographic market larger than the residence is the fact that firms are unlikely to charge different prices to neighbouring residences. Similarly, such price discrimination among exchanges (unless motivated by anti-competitive interests) is equally unlikely. If an entrant achieves sufficient scale in an LIR, supply responses will defeat attempts at price discrimination within that LIR.

48. At paragraph 2.32 of his submission, Professor McFetridge explains the reasons why it is difficult to profitably sustain geographic price discrimination on the basis of narrowly-defined geographic markets:

> [I]t may be too costly to differentiate marketing and promotional efforts and possibly billing within a relatively small geographic area. One cost of this differentiation maybe the loss of goodwill if it is known that some customers in the same community are being offered price packages that are not offered generally

49. CCTA also submits that price discrimination of local exchange service typically occurs on the basis of large territories such as the province. Geographic price discrimination is not, by definition, anti-competitive in all circumstances. However, with deregulation and the creation of narrowly-defined forborne markets, anti-competitive geographic price discrimination in the form of targeted pricing becomes much easier to justify to consumers.

50. One of the greatest risks of premature forbearance is the likelihood of exit by recent entrants. In a forborne market, ILECs will have the ability to deter competitive entry and eliminate new entrants by engaging in predatory pricing. Under certain economic conditions, targeted pricing of individual customers can be efficiency enhancing and can benefit consumers in a competitive market; however, targeted pricing of groups of consumers (based on geographic location) should be prohibited if its purpose and effect is to eliminate new entrants or to deter expansion to non-forborne markets. Absorbing a short-term revenue loss in a narrowly-defined forborne market is a rational strategy if the ILECs preserve their dominant market position in contiguous geographic markets and complementary product markets.

Geographic market should not be based on the exchange, local calling area or serving area of a full facilities based CLEC

51. CCTA submits that the exchange as the relevant geographic market has a number of shortcomings, as described in greater detail in CCTA's submission of June 22, 2005.

    - the exchange ignores the possibility of supply responses from firms operating in contiguous exchanges and results in an overly narrow market definition; (para. 44)
    - the exchange is not competitively neutral as it is based on the network architecture of the ILECs and dictated by the ILECs' legacy technology; (para 49)
    - forbearance on the basis of an exchange would provide a basis for ILECs to engage in targeted pricing to consumers of competitors within that exchange; (para 56) and
    - forbearance on the basis of an exchange would ignore an ILEC's ubiquitous and entrenched position across a much broader segment of its operating territory; it would also allow an ILEC to leverage the advantages of its incumbency position to

> the detriment of competition, thereby preventing competition from expanding. (para 60)

52. The Consumer Groups rejected the exchange as the basis for the geographic market.

> From a consumer perspective, the network boundaries of a local exchange are both mysterious and arbitrary. They provide little, if any justification, for differences in regulatory treatment. In particular, the fact that one side of a street may be served by one ILEC local exchange and the other side of the street by a different exchange is unlikely to carry much weight with neighbours who find their terms and conditions of local telephone service to be significantly different as a result of different regulatory regimes applied to the two different exchanges.[29]

53. The use of LIRs as the geographic market also has benefits in terms of administering the local forbearance regime. The number of exchanges is more than ten times greater than the number of LIRs. While there are only about 180 LIRs in the operating territories of the major ILECs, there are nearly 2,800 exchanges. It would vastly simplify the application of the forbearance criteria to conduct assessments of market share and competitive conditions on the basis of LIRs rather than individual exchanges.

54. Local calling areas do not represent a practical model for defining relevant geographic markets. Local calling areas do tend to reflect a community of interest as demonstrated by calling patterns, however, their design does not lend themselves to identifying distinct geographic areas. This is due to a high incidence of overlapping local calling areas within communities, as demonstrated by the example described in the preamble to an interrogatory posed by the Commission.[30]

55. As a result, it may not be possible to rely on local calling areas to define a distinct geographic territory as the relevant geographic market for which forbearance should be considered. CCTA notes that, when presented with the example, the Consumer Groups suggested that they would support LIRs if the local calling areas were found to be unworkable. In stating their support for LIRs, the Consumer Groups noted that "LIRs are competitively neutral, are well specified, readily identifiable and are associated with economic, social and political interests."

56. TELUS proposed to define as the relevant geographic market the area served by a full facilities-based CLEC. This approach would make it extremely difficult to administer the forbearance criteria on an ongoing basis. The proposed geographic market would not be static but continuously changing with time as individual competitors sought to expand their market coverage and build a sustainable base of customers. Moreover, the relevant geographic market of one CLEC could encompass common areas among two or more CLECs. TELUS suggested that where common areas emerge, market share would still be measured individually for each CLEC's serving territory. The implications are that one CLEC's serving territory could meet the criteria for forbearance while the criteria would not be met in the other CLEC's territory. Even so, the ILEC would be granted forbearance in part of the latter CLEC's serving territory. It is not clear whether future assessments of market share in the latter CLEC's serving territory would include or exclude the forborne portion.

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[29] Consumer Groups Submission of June 22, 2005, at para. 43.
[30] Consumer Groups(CRTC)20Jul05-210 PN 2005-2.

57. It is also not clear how the forbearance criteria proposed by TELUS would be applied on an ongoing basis given that a full facilities-based CLEC is likely to continue to expand from an initial serving area. Even if forbearance had already been granted to its initial serving area, it may be necessary to evaluate separately each new increment of serving area. It is worth noting in this regard that TELUS proposed monthly monitoring of the forbearance criteria.

3. Forbearance Criteria

58. CCTA has proposed a two-part test for forbearance; the first part based on observing at least a 30 percent share of the relevant market not served by the ILEC (quantitative criterion); and the second part based on indicators that competition had been established on a pervasive and sustainable basis (qualitative criterion). Where a market satisfies the first part of the test, it is taken as evidence that competition has emerged to a sufficient degree to warrant a more extensive investigation into whether other conditions are present to satisfy the qualitative part of the test. Under this approach, the additional resources required to conduct the analysis for the second part are focused on those markets that are more likely to warrant forbearance.

59. The two-part test also respects the framework established by the Commission in Decision 94-19. In Decision 94-19, the Commission recognized that market share is a significant factor in measuring market power, "consistent with the criteria outlined in the widely accepted Merger Enforcement Guidelines".[31] At the same time, the Commission identified a number of factors related to demand and supply conditions as indicators of whether to forbear. In CCTA's submission, the two parts of its proposed test accomplish the same goals as set out in Decision 94-19. The market share threshold of the first part provides a necessary but not sufficient indicator of whether to forbear. The second part relies on a more in-depth assessment of competition based on demand and supply conditions in the market.

60. The second part of the test would evaluate the sustainability of competition by measures such as the number and type of competitors operating in the ILEC territory, evidence of rivalrous behaviour and the resolution of regulatory barriers to entry. Consideration should be given to how recently competition had begun and whether competitors are facilities-based (i.e., CLECs), resellers, VoIP service providers or other. With respect to regulatory barriers to entry, as discussed elsewhere in this Argument, there are a number of challenges that competitors continue to face in obtaining access to the necessary facilities to interconnect and compete in the local exchange services market. Until these challenges have been addressed it would be premature to grant forbearance.

61. CCTA has considered the application of its criteria to the circumstances of the residential local exchange market in Aliant's operating territory. In CCTA's submission, the first part of the two-part test is not satisfied for the relevant geographic markets of either Nova Scotia or Prince Edward Island. This is supported by information on market shares provided in Telecom Public Notice CRTC 2005-11 as well as by information filed on the record of this

[31] Decision 94-19, at page 67.

proceeding.[32] In addition to this information, the Commission has also concluded in Telecom Decision CRTC 2005-53 (Decision 2005-53) that the state of competition in Aliant's operating territory remains limited.

> [t]he Commission notes that such competition in the residential local exchange services market, as it exists, is only within a portion of Aliant Telecom's operating territory, and even within that portion of the territory where competition exists Aliant Telecom still retains a substantial majority of the customers.[33]

62. Having failed to satisfy the first part of the two-part test, CCTA submits that it is not necessary to proceed with the second part. In any event, the second part of the test would not be satisfied as there is insufficient evidence of the pervasiveness and sustainability of competition in the relevant markets. Moreover, the barriers to entry remain significant, as discussed in this submission and demonstrated by the evidence filed by EastLink in this proceeding.

Market share threshold

63. Some parties have made proposals to forbear that rely solely on a measure of market share. These proposals depend on conceding to claims that demand and supply conditions should be presumed to have evolved to a workably competitive state. These claims suggest that the mere presence of another competitor should be accepted as sufficient evidence that there are no barriers to customers switching their demand to a competitor's service and that suppliers face no barriers to competing to serve those customers. In effect, these proposals rely simply on the potential for pervasive and sustainable competition to emerge rather than evidence that it has happened. CCTA submits that the record of competitive entry and survival in the local exchange market during the first eight years argues for less reliance on potentialities and much more on actualities in determining whether to forbear.

64. In the local exchange services market, the ILECs start off providing service to virtually every customer. The residential local exchange service market is characterized by greater than 98 percent penetration. Almost every household has local exchange service and that service has been supplied by one of the ILECs exclusively. The success of entrants in this market depends entirely on convincing each customer to switch from one of the ILECs to their service. The market power of the ILECs in the provision of local exchange services is significant.

65. When a service provider holds significant market power, it is generally accepted that regulation remains appropriate. CCTA has taken into consideration past determinations by the Commission as well as the approach by competition authorities in Canada and internationally in putting forward its proposed threshold of 30 percent of the market not

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[32] In the response to Aliant(CRTC)20Jul05-808 Revised, Aliant provided its estimates of the share of the residential local exchange market served by competitors. As indicated in Attachment 2 of that response, the entrants' share of lines is 16.5 percent in Nova Scotia and 12.2 percent in Prince Edward Island. CCTA did not advocate using individual LIRs as the relevant geographic market for Nova Scotia, however, estimates filed in Attachment 4 of that interrogatory response indicate that the market share of local customers in individual LIRs do not exceed 21.4 percent. While these estimates are based on the share of lines and local customers rather than households as proposed by CCTA, any minor differences in the shares due to the differences in approach would not alter the fact that the first part of the test is not satisfied.

[33] Telecom Decision CRTC 2005-53, para. 80.

served by the ILEC. In the case of the Commission, it has previously found a market to be workably competitive where the incumbent does not hold more than 70 percent market share and denied forbearance where an incumbent holds 80 percent or more.[34]

66. CCTA provided further details respecting international approaches in its response to CCTA(Bureau)20Jul05-19. As indicated in that response, market shares in excess of 50 percent are considered strong indicators of market dominance and only in exceptional circumstances would there likely be a finding otherwise. CCTA also cited evidence from EU countries and the United States respecting findings in favour of deregulation of an incumbent telecommunications service provider in circumstances where its market share had been less than 60 percent. Finally, CCTA and other parties have noted the Competition Bureau's reference to market share when conducting its analysis. In its Enforcement Guidelines on the Abuse of Dominance Provisions Merger, the Competition Bureau states:

> In summary, the Bureau's general approach with regard to market share is as follows:
>
> - A market share of less than 35 percent will generally not give rise to concerns of market power or dominance.
> - A market share of 35 percent or more will generally prompt further examination.
> - In the case of a group of firms alleged to be jointly dominant, a combined market share of 60 percent or more will generally prompt further examination.[35]

67. CCTA submits that a market share threshold of no greater than 70 percent of the relevant market served by the ILEC represents a less stringent test than employed by many competition authorities and telecom regulators. Under these regimes, market shares in excess of 50 percent are generally expected to support a finding of market power, barring exceptional circumstances. CCTA considers that requiring an ILEC to serve no more than 70 percent of the addressable market represents a reasonable first stage in an assessment of its market power. As with other authorities, including the Competition Bureau, it remains important to conduct a more detailed assessment of the competitiveness of the relevant market where 30 percent of the market is not served.

Five percent is the wrong threshold

68. Some parties have proposed that it is appropriate to forbear as soon as an entrant has five percent market share, or when five percent of the market is not served by the ILEC's local wireline service. These proposals imply that an ILEC serving 95 percent of the market does not have significant market power.

69. CCTA submits that adopting a five percent threshold would result in premature forbearance. Under any objective assessment, an entrant would not have achieved the economies of scale and scope required for sustainable competition at a five percent threshold.

70. The evidence from Canada and internationally provide no basis for reaching the extraordinary conclusion that an incumbent with 95 percent of the market is not in a position to exercise significant market power. While most competition authorities point to an

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[34] See the Attachment to the response to CCTA(TELUS)20Jul05-3 PN 2005-2 for a summary of the relevant determinations by the Commission to forbear and not forbear from regulation.
[35] Shaw(TELUS)20Jul05-1, quoted from page 15 of the Competition Bureau's Enforcement Guidelines on the Abuse of Dominance Provisions, available at http://strategis.ic.gc.ca/pics/ct/aod.pdf.

assessment of other factors, the circumstances in the market would have to be quite unusual for these factors to outweigh the overwhelming position of power and concentration that rest with the incumbent.

71. Few markets share the characteristics found in the residential local exchange market. In that market, every potential customer is already receiving service from a single supplier who in almost every instance is the incumbent monopolist. The service is an essential item in every household, as evidenced by penetration rates in excess of 98 percent. Service reliability and quality are expected to be very high, with service available at all times in case of an emergency. The fixed cost of the infrastructure required to supply the service is substantial and sunk. For the incumbent, decades of rate of return regulation combined with serving all customers have allowed it to recover the investments necessary to build a high-quality and efficient network. Because of long-standing public policy goals, rates for residential local exchange service have been kept below or close to cost, leaving razor-thin margins for any entrant. Taken together, these characteristics lend strength to the market power of the incumbent. A loss of only five percent of its share of the market would barely make a dent in an incumbent's market power. Yet, those supporting such a low threshold claim that the mere presence of another competitor demonstrates that the incumbent's advantages have been overcome.

72. Some of the parties proposing a five percent market share threshold point to the Commission's rule with respect to rate deregulation in the broadcasting distribution undertaking (BDU) market. These parties have sought to adopt one aspect of a test from a different market that is regulated under entirely separate legislation with its own objectives and has little in common with the local exchange service market. In CCTA's submission, this is not an apples to apples comparison.

73. The Commission determined in Broadcasting Public Notice CRTC 1997-150 that cable BDUs could apply to have their basic cable rates deregulated under two conditions, the second of which relates to the five percent measure. The second condition requires confirmation that the cable BDU was no longer providing its basic service to five percent or more of the total of premises that it served on an earlier date since another BDU's service was available to these premises.[36]

74. As indicated in the response to CCTA(Yak)20Jul05-2, the five percent figure is not a measure of market share. The numerator relates to a number of addresses at which the cable BDU previously but no longer provides service. The denominator relates to the total number of addresses at which the cable BDU provided service. It does not indicate the share of the market held by one or more entrants, nor does it measure the share of the market held by the cable BDU. There are a number of reasons why this test for basic cable rate deregulation is not relevant or appropriate for the local exchange service market.

75. The denominator in the test for basic cable rate deregulation does not reflect a complete measure of the market to be served or being served. While virtually every household has one or more television sets, not every household subscribes to cable television service or a similar subscription service from a direct to home (DTH) satellite service provider or other competitor. At the time the Commission implemented the BDU rate deregulation rule, more

[36] BDU Regulations at section 47 and Broadcasting Circular CRTC 427.

than 23 percent of households that could subscribe to cable television service did not.[37] Overall, cable companies' share of the market of households with television sets was less than 75 percent when the DTH companies entered the market. When the first cable system was rate deregulated in the Fall of 2001, DTH companies had already built up a customer base of more than 1.5 million multi-channel video subscribers.

76. Under the Commission's cable BDU test, households that take service from a competitor are not measured nor are those households that could take service from either provider. Moreover, only households that ceased to take service from the cable BDU are taken into account in the numerator. Given that there is a large base of households that did not have any multi-channel TV service, a competitor can gain far more than simply those customers that had switched from cable, thus providing a competitor with more than a five percent share of the addressable market. These fundamental differences in the measurements involved demonstrate why a threshold of five percent used for cable rate deregulation is not applicable in the local exchange service market.

77. The proposal to import the five percent figure from the cable BDU rate deregulation test is inappropriate for other reasons that are related more to differences in market circumstances. As indicated above, DTH companies from the first day they launched could serve any and every household who might want their service. The competitor had no need to make contact or interconnect with the cable company. By comparison, competitors in the local exchange market are rolling out service community by community, and must interconnect with the incumbents at each step of the way. This remains a barrier to entry and expansion that must be overcome by each entrant.

78. Another significant difference is the fact that subscription to multi-channel television service is not an essential service. While virtually every household has local exchange service, 15 percent of Canadian households with television sets do not subscribe to any multi-channel television service. These households do not need to be won over or persuaded to make an active decision to disconnect from the incumbent. Because virtually every household in Canada already has telephone service from an ILEC, the success of the local exchange competitor is entirely dependent on winning customers away from the ILEC. The high degree of customer inertia and entrenched position of the incumbent represent further barriers that must be overcome.

79. Finally, basic cable rate deregulation removes only one of many asymmetries in regulation between cable BDUs and their competitors in the broadcasting distribution market. A number of other regulations remain in place that constrain the ability of cable BDUs to differentiate their services and provide a competitive response.

80. CCTA submits that another reason to reject such a low threshold and simple test for forbearance of local exchange services is the risk that the conditions that satisfied the forbearance criteria in the first instance will cease to exist. Under the proposals of those favouring the five percent threshold, forbearance could be automatically granted in an exchange after only a few hundred or perhaps a couple of thousand customers had

[37] CRTC Broadcast Distribution Statistical and Financial Summaries 1996 – 2000. The results reported for 1997 indicate that there were 7.94 million basic cable subscribers and 10.37 million households wired, meaning 76% of those able to be served by a cable company subscribed. Based on total households within the licensed serving area, 74% of households subscribed.

switched to a competitor.[38] It is not inconceivable that, following ILEC forbearance in an exchange, a competitor could lose a portion of its few hundred customers. The Commission would face pressure to re-regulate the market in each exchange where this occurred.

Market share measurement methodology

81. CCTA submits that the methodology for calculating market shares should be chosen so as to provide the best means to assess market power. Incumbents possess market power when they serve a very large number and percentage of households in their serving territory. For this reason, market share should be measured for the residential local exchange market based on the proportion of the total number of households within a geographic market (LIR or aggregation of LIRs) that are served and not served by the ILEC. CCTA's proposed measure relies only on data on households served by ILECs and total household counts by LIR. This information should be readily available to the ILEC, including information on the number of households in each LIR.[39] Basing market share on total households reasonably reflects the addressable market since ILECs are able to serve all or virtually all households in their operating territory.[40]

82. CCTA cautions against adopting a methodology that results in a distorted measure of market power. Any measure that is based on the mere presence of another competitor fails to take into account the market power retained by the ILEC across the geographic market as well as in contiguous markets. CCTA notes in this regard that the Competition Bureau states that "[w]hen calculating market shares, the Bureau uses the best indicators of sellers' future competitive significance."[41] CCTA submits that the best means by which to measure a local telephony firm's present or future competitive position is by calculating the percentage of households served.

83. CCTA's proposed measure does not require competing service providers to report data on households served or the number of lines provided. While such information could be collected in order to augment that observed from ILECs, this may introduce inaccuracies. Collecting accurate information from competitors respecting the number of lines they serve disaggregated by the relevant geographic market may be difficult.

84. Measuring market share based on total lines served rather than households represents a second-best approach. This measure would include counts of second lines, even though these are discretionary and, therefore, do not reflect the position of power that the ILEC has in serving that household. It may also not reflect the primary purpose of the service since households may subscribe to a VoIP line simply to take advantage of low-priced long distance calling.

[38] To demonstrate the volume of subscribers, consider a census metropolitan area (CMA) which has a minimum population of 100,000. This would roughly equate to 40,000 households, 5 percent of which would be 2,000. Assuming there is more than one exchange per CMA, the number of households that would be represented by a 5 percent share could be much lower.
[39] In the response to The Companies(Yak)20Jul05-10, it states that the number of wireless only connections at the exchange level could be estimated using information on the number of households in the local exchange. The method to determine the number of households in an exchange could be applied on a more aggregated basis for the number of households in each LIR.
[40] See the responses to Bell(CRTC)20Jul05-905; SaskTel(CRTC)20Jul05-906 and TELUS(CRTC)20Jul05-905.
[41] Merger Enforcement Guidelines, para. 4.6.

85. CCTA's proposed measure of market share should be reported annually using the Commission's existing data collection system as part of its ongoing monitoring activities. Some parties have proposed more frequent data collection, including quarterly and monthly. CCTA submits that the more frequently data is collected, the greater will be the regulatory burden on service providers and that burden will be disproportionately borne by new entrants.

86. CCTA is of the view that the Commission should analyse data on market share for each relevant service and geographic market based on the most recently available annual figures. Where the reported market share is approaching the market share threshold for a relevant market, the Commission could decide to require more recent data. Depending on the trends in market share observed, it may be appropriate to initiate quarterly tracking of the market share in a specific relevant market. It should be possible to focus the collection and analysis of market share data so as to make best use of the resources of service providers and the Commission. CCTA does not consider it necessary or practical to require collection of data for all relevant service and geographic markets on a more frequent basis than annually where there is no evidence that the threshold could be exceeded.

87. CCTA submits that using a very low market share threshold, such as the five percent proposed by some parties, would significantly increase the number of markets for which data would have to be collected and analysed. Combining this threshold with a very narrow geographic market (e.g., almost 2,800 exchanges) would add further to the administrative burden associated with implementing the forbearance framework.

88. The regulatory burden will also increase exponentially in relation to the level of geographic disaggregation. In particular, requiring new entrants to track information by individual ILEC exchange would require them to develop new mapping systems capable of relating each of their serving areas to the exchange boundaries of the ILECs. While LIRs are based on ILEC exchanges, the greater degree of aggregation reduces the effort required to associate serving areas with a relevant geographic market.

4. Barriers to entry are significant

89. Some parties have argued that barriers to entry are low, citing evidence of competitors which have launched services in some markets. The claim that the mere presence of a competitor is sufficient ignores the reality that any such entry is the product of extensive resources and time spent in overcoming significant barriers. As many competitors participating in this proceeding have shown, there remain substantial difficulties and delays in gaining access to the facilities necessary to compete. This is particularly true for facilities-based competitors offering full primary line replacement services.[42]

90. Some of the barriers to entry have been described in general terms at paragraphs 114 to 122 of its initial submission and in the responses to CCTA(CRTC)20Jul05-206 and CCTA(Bureau)20Jul05-11. These are summarized below:

- Technical barriers, including the development of standards for IP to IP interconnection and implementation of 9-1-1 and MRS for IP-based service providers;

[42] While access independent VoIP providers may face fewer barriers, it is not clear that consumers will view these services in the near term as primary line replacements.

- Financial barriers, including the costs of infrastructure, equipment, technical and customer support staff, cost of capital and foreign ownership restrictions that affect the cost of capital;
- Regulatory barriers, including CLEC obligations; access to support structures and rights of way;
- Behavioural barriers, including customer inertia;
- ILEC incentives to engage in anti-competitive behaviour and lack of compliance with competitive safeguards; and
- Barriers to entry due to lengthy construction periods and high sunk costs.

91. EastLink's experience with barriers to entry was described in its submission of June 22, 2005:

> In order to provide telephone service, EastLink has had to upgrade its cable network at significant costs. In addition, EastLink has incurred costs associated with access to Aliant and Nova Scotia Power support structures and make-ready charges for those structures, along with dependence on Aliant for responding to requests in a timely fashion. Access agreements with the municipality had to be put in place, and all back office work associated with billing systems, provisioning services to consumers, interconnection with Aliant and inter-exchange service providers were also required. EastLink also invested capital and resources in order to implement processes for customer transfers, directory assistance, 911 service, etc.[43]

92. Providing 9-1-1 services is also a challenge for competitors. As CCTA described in its response to CCTA(Bureau)20Jul05-8, establishing the service requires working with individual municipalities whose representatives may be difficult to contact and reluctant to work with another local exchange carrier.

93. Shaw also provided a succinct description of the effort required to establish interconnection and other procedures with an ILEC, based on its experiences.

> In order to offer local telephone service in Saskatchewan Shaw must negotiate a variety of agreements and request provisioning of services and facilities with SaskTel. Without SaskTel's cooperation on these matters Shaw could not offer local exchange service in Saskatchewan in a timely manner. Shaw, for example, must complete a variety of agreements with SaskTel including basic PSTN interconnection through a Master Agreement for Local Interconnection, the leasing and interconnection of various trunk groups must be arranged through SaskTel, SaskTel must also process LSR requests prior to the porting of telephone numbers, and SaskTel must approve certain types of equipment utilized by Shaw for local services.[44]

94. In its supplemental response to Shaw(SaskTel)20Jul05-3, Shaw stated that the initial interconnection process can take a minimum of 10 months and may take as long as 18 months. CCTA notes that this is typical of the experiences of other cable companies.[45] In addition, the CLEC must adapt its processes to the ILEC such that each time a competitor approaches a different ILEC it may have to put in place new procedures to support interconnection.

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[43] EastLink Submission of June 22, 2005, at para. 76.
[44] Shaw(SaskTel)20Jul05-1 PN 2005-2.
[45] See CCTA's Submission of June 22, 2005 at para. 107.

95. With respect to access to support structures, CCTA notes the experience of Shaw as described in its response to Shaw(CRTC)20Jul05-506:

> Much of the support structure that Shaw relies on for the provision of its services, including local exchange services, are owned and controlled by the ILEC's. Restricting access, delaying access, demanding exorbitant payments and imposing costly and difficult conditions for the use of support structures are means available to the ILECs to prevent or forestall competitive entry.

96. A number of other concerns were identified in response to Shaw(Bureau)20Jul05-24, including the fact that Shaw is experiencing delays in number porting of as much as 90 days in the case of TELUS.

97. Another important consideration is the costs incurred by cable companies in order to support telephony. These costs are over and above the $7.5 billion invested over the past five years to support digital cable and high-speed internet services. At least $300 million is being spent by Cogeco, Rogers and Shaw to deploy telephony services. This represents a significant investment relative to these companies' available financial resources. The ILECs generated nearly $2.7 billion in free cash flow in 2004, which is more than five times the amount generated by the three cable companies.[46] Further details on the specific costs incurred by cable companies were filed in confidence in the responses to Cogeco(CRTC)20Jul05-213, EastLink(CRTC)20Jul05-213, Rogers(CRTC)20Jul05-213, and Shaw(CRTC)20Jul05-213.

98. In CCTA's submission, the cable companies are undertaking substantial investments to compete in the local exchange market. The cable companies are not seeking a guarantee that their investments will be protected. However, these investments have been made on the expectation that competitive safeguards would remain in place as long as the market had not become competitive on an effective and sustainable basis.

99. Customer inertia is another characteristic in the local exchange market that impedes the ability of new entrants to attract customers to their services. As the Commission itself has recognized, customers in this market are very reluctant to change local service providers. This is further demonstrated by the behaviour of customers facing a choice of competitors offering services that are close substitutes where one service provider offers a lower price. In normal competitive markets, one would expect most, if not all, customers to choose the lower priced service. The reality in the residential local exchange market is that very few customers actually choose the lower priced service. In the case of Nova Scotia and Prince Edward Island, four out of five customers continue to choose Aliant's higher priced service over EastLink's. Survey results from the Yankee Group provided by Bell also indicate a strong propensity to stay with the incumbent.[47] These results indicate that, if the cable company offered telephony service at the same price only one percent of consumers indicated they would be very likely to switch. Even with discounts ranging from 10 to 25 percent, less than one-third would be very likely to switch.

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[46] This comparison is based on information in the 2004 annual reports of the cable companies and ILECs (excluding SaskTel). An estimate of Rogers free cash flow is from the investment analyst report filed in Attachment 6 of the response to Bell(CRTC)20Jul05-907 PN 2005-2.
[47] Bell(Bureau)20Jul05-19 PN 2005-2.

100. Customers are accustomed to receiving a reliable, low-priced service from the ILECs. While there exists in any market a small percentage of customers who are prepared to try a new service or service provider, the majority of customers are unlikely to seek out alternatives, particularly when their level of satisfaction with their current supplier is high. Entrants need to overcome these barriers in consumer behaviour in order to gain a stable customer base.

5. Risks of premature forbearance outweigh any potential costs of delayed forbearance

101. Weak criteria for forbearance create substantial risks that forbearance will be granted prematurely. CCTA submits that the objectives of the Telecommunications Act would be best met by minimizing the risk of such an error. CCTA disagrees with the views of some of the ILECs that the risks of premature forbearance are outweighed by the potential costs associated with delaying forbearance.

102. The ILECs seem to suggest that only with forbearance would the ILECs have sufficient pricing flexibility to provide consumers with the benefits of competition – primarily lower prices. Experience to date refutes this argument.

103. Competitors do not put offers in the market that are anything less than the most compelling offers that they can provide to ensure customers switch to, and stay with the competitors' services. The competitors currently in the market already offer services at prices that are significantly discounted relative to the ILECs, as recognized by the ILECs themselves.[48] There is no credible evidence that competitors are not interested in attracting and keeping as many customers as possible. Only by growing their customer base can entrants hope to recover their substantial fixed costs, thereby enabling them to operate on an efficient and sustainable basis. The customers that switch to the competitors' services will see lower prices, more choice and other benefits.

104. Further, the ILECs have been granted sufficient pricing flexibility to compete in the market absent forbearance. The existing price cap regime permits the ILECs to lower prices for residential local exchange service customers in response to competition.[49] As Bell stated in an interrogatory response, it "determined that the optimal strategy was not to reduce prices, even though the Company had the flexibility to do so within the constraints" of the price cap regime.[50] The existing price cap regime permits the ILECs to finance such rate reductions through drawdowns from the deferral account. The ILECs do not have to forgo additional revenues in order to provide customers with the benefit of lower prices as the funds in the deferral account have already been deducted from the ILECs' revenues. The flexibility available to the ILECs is further demonstrated by Bell's Digital Voice service, for which the Commission approved a range of rates that remain in confidence. Moreover, the current effective rate offers a bundle of tariffed and non-tariffed services at rates that provide savings comparable to other competitors.

[48] See the responses to The Companies(CCTA)20Jul05-30 PN 2005-2 which states that cable competitors offer "significant discounts" and TELUS(CRTC)20Jul05-402 PN 2005-2 which states that the pricing of competitors' services "ranges from moderate to deep discounts" relative to the ILECs.
[49] Decision 2002-34, para. 412.
[50] Bell(Bureau)20Jul05-29 PN 2005-2.

105. The ILECs point to restrictions on further rate de-averaging as preventing them from lowering prices on a targeted basis. Their issue, therefore, is not with the flexibility they already have to lower prices for large groups of customers who may have competitive choices. This would provide the benefits of lower prices to many customers, including customers who might not switch to a competitor's service. Rather, the ILECs seek greater flexibility to offer highly targeted price reductions to specific customers who have chosen, or are about to choose, another service provider. The benefits of any ILEC competitive response would be very narrowly distributed and likely short-lived. There is little likelihood that such benefits would last after the ILECs had won back their customers.

106. Granting the ILECs forbearance sooner than might occur under firm and effective criteria would not result in greater benefits of competition. Competitors in the local market are already providing those benefits to any customer they can convince to take their service. The ILECs' promise of delivering greater benefits if only the Commission would rush through forbearance orders is nothing more than a promise to defeat competitors by targeting their hard won customers. The ILECs have claimed that low barriers allow competitors to easily enter, and if necessary, re-enter the market. This may be the case in some markets, however, exiting the local exchange market would have a very damaging effect on a competitor's reputation given the essential nature of the service. Residential consumers cannot be expected to accept the risk of switching to an unreliable service provider for 'lifeline' local exchange service.

107. The risks of premature forbearance are many; the most obvious of which is the risk of a substantial lessening of competition. This not only impacts competitors but also exposes consumers to the risk of price increases where competition is insufficient to discipline an ILEC's market power. Where competition ceases to exist in the forborne market, it would be exceedingly difficult to re-establish. CCTA described the following risks of premature forbearance in its response to CCTA(CRTC)20Jul05-201:

> …there would be no regulations to preclude the ILECs from using their market power to undermine competition in the forborne market segment. The ILECs would be able to engage in targeted pricing, winback and promotional activity with the result that sustainable competition would not take hold in the prematurely forborne market. In addition, the ILECs would be able to leverage this market power to defeat competitive threats from entrants across all segments of the local market. Competitors and potential competitors would take note of the fact that the ILECs were granted forbearance prematurely as an indication that similar outcomes would likely occur in non-forborne markets. As a result, competitors considering entering the forborne and non-forborne market segments would be deterred from entering or expanding their operations and competitors in the forborne market would be prevented from using this market as a platform for entry in non-competitive markets.

108. CCTA disagrees with the claim that granting premature forbearance on a limited geographic basis would limit the impact of such a mistake. Potential competitors considering entry in other markets could reasonably expect that premature forbearance would be granted elsewhere as well. As a result, even if there was not complete competitor exit from the prematurely forborne market due to high sunk costs, competition would be substantially less likely to expand to other geographic markets. Entry in the local exchange service market is already a very risky endeavor requiring large investments and scale to compete on an efficient and sustainable basis. The additional risk that forbearance could be granted prematurely could well be the tipping factor that convinces a

potential entrant and its financial backers to take their money elsewhere. Any limited competition that remained in select pockets of the country would be more tenuous and easily defeated. Consumers in markets where competitors decided not to enter would be denied the benefits of competition while consumers in prematurely forborne markets could face price increases.

109. The ability of the ILECs to engage in anti-competitive behaviour where premature forbearance has been granted was described in CCTA's submission and the report prepared by Drs. Gillen and Ross and summarized in the response to CCTA(Bureau)20Jul05-12. In particular, CCTA notes the following:

> Predation is less costly and more effective if it can be targeted narrowly at exactly the point where it does the entrant the maximum harm. Predation is more expensive for the predator when the low prices must be offered across a broad market. Overly narrow geographic market definition leading to forbearance would allow a predator to lower prices just where the entrant has appeared and secured some market. Thus a predatory response that may not have been profitable had the lower prices applied across a larger market area, is profitable when so limited.[51]

110. Aliant further demonstrated that targeted price reductions are less costly when it provided an illustration of why it would not lower prices more broadly. In Aliant's submission of June 22, 2005, it performed a calculation that, according to assumptions filed in confidence, suggested the company would lose more in revenues by lowering rates for all customers than it would gain from winning back customers lost to EastLink.[52]

111. The Commission could re-regulate in the prematurely forborne market as a remedy but only on a going forward basis. The damage to competition and customer choice, as well as to the financial resources and reputation of competitors, would be irreparable. The Commission's initial submission to the Telecommunications Policy Review Panel highlighted the risks of responding to anti-competitive behaviour after the fact.

> The second point is that under an *ex post* review approach, the damage can be done to the competitive market by the time the complaint is made, responded to and ruled upon. [para. 124]

112. Finally, the risks of premature forbearance will remain high as long as there are significant barriers to entry and expansion. As discussed elsewhere, the fact that barriers to entry are not low is demonstrated by the numerous difficulties that competitors continue to face in obtaining access to facilities necessary to provide local exchange service.

6. Forbearance Application Process

113. CCTA described at paragraphs 175 to 187 of its initial submission its proposed process for granting forbearance applications, based on its two part test. The process for an application can be initiated as part of the Commission's periodic review of the quantitative measures of market share in the relevant service and geographic markets. Alternatively, a process could be initiated by an ILEC application filed pursuant to Part VII of the Telecommunications Rules of Procedure, demonstrating that the market share threshold

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[51] Drs. Gillen and Ross Report, Attachment to CCTA's Submission of June 22, 2005, at para. 149.
[52] Aliant's Submission, page 17, footnote 3.

has been reached. The latter option provides an opportunity to initiate a review in a period between the reporting of results from the annual data collection process.

114. CCTA is also of the view that the second part of the test should provide for a comment and reply process. This process is necessary to evaluate whether the achievement of the threshold is accompanied by other market conditions sufficient to ensure that forbearance will not impair the establishment or continuance of a competitive market. The Commission should issue a public notice, with a 30-day comment and 10-day reply comment period. The public notice should contain the Commission's results of market share at the level of an LIR or aggregation of LIRs within the ILEC operating territory and supplemented by specific information regarding the pervasiveness and sustainability of competition.

115. In the case of an ILEC-initiated review, the Part VII application would need to present evidence that the first part of the test respecting market share has been satisfied. Parties would then have the normal 30-day period to comment on the application, including any challenges to the evidence of the ILEC. The ILEC would file a reply 10 days later. The Commission would review the submissions and decide whether to initiate the process for the second part of the test. This process would be the same as with a Commission-initiated review, beginning with a public notice and subsequent 30-day comment and 10-day reply comment period. This process should allow for a timely determination on whether to grant a forbearance application filed by an ILEC.

116. CCTA submits that its proposals regarding procedure associated with a Commission or ILEC-initiated forbearance review properly balance the need for a complete and reliable evidentiary record with the interest of parties in conducting a streamlined and discernible process.

7. Re-regulation procedures

117. At paragraph 31 of PN 2005-2, the Commission invited parties to comment on, among other things, triggers for revoking forbearance of ILEC local services. CCTA submits that in an ideal scenario, one where the competitive market was firmly established prior to forbearance, re-regulation would not be required. However, it is impossible to predict whether extraordinary circumstances might arise that alter these market conditions. The Commission should, therefore, be prepared to undertake a review along the lines contemplated in section 34(3) of the Act to determine whether continued forbearance threatens the continuance of a competitive market for local exchange services in that territory.

118. CCTA submits the process for revoking forbearance of ILEC local exchange services should mirror the process to justify forbearance. Moreover, the key question in a re-regulation debate should not be whether the incumbent's market share has exceeded pre-forbearance levels, but whether the trends behind the incumbent's market recapture disclose evidence of harm to the continuance of a competitive market (i.e., the result that follows from applying section 34(3) of the Act). Such an approach minimizes the risk and associated impact on stakeholders of alternating between forbearance and re-regulation every time some number of customers shifts from the ILEC to a competitor and then back to the ILEC.

119. CCTA considers that reversion to 20 percent share (from the 30 per cent at forbearance) of the market not served by the ILEC would serve as an indication of a trend that threatens sustained competitive presence. CCTA submits that initiation of a review regarding possible re-regulation should follow the same process as that applicable to initiation of a forbearance review. Where information from annual reporting or a competitor application provides evidence of a reversion to 20 percent or less share of the market not served by the ILEC for a given LIR or aggregation of LIRs within an ILEC's operating territory, the Commission should undertake a section 34(3) review to determine whether continued forbearance threatens the continuance of a competitive market for local exchange services in that territory.

120. Implicit in this assumption is the idea that evidence disclosing a significant and growing amount of customer recapture supports a reasonable inference of harm to the competitive market and provides cause for concern about the sustainability of competition. The "credible evidence of harm to competitors or the competitive market"[53] associated with the CCTA proposal allows the Commission to expend its resources in contemplation of re-regulation in a timely and appropriate way.

121. CCTA strongly recommends that the Commission not rely on the ability to revoke forbearance as a means to offset the risk of premature forbearance. It is critical that forbearance not be granted prematurely in the first instance. Re-establishing regulation over a previously forborne market would come too late to avoid the damage this would cause to the development of competitive markets.

122. CCTA submits that Commission should disregard alternative proposals calling for automatic triggers or complex processes for re-regulation. Contemplated use of automatic triggers, such as those proposed by PIAC and others, anticipates the possibility of premature forbearance and a desire to have sufficient authority to right the wrong quickly. However, it would be neither efficient nor effective to revoke forbearance of an ILEC's local exchange services on this basis alone.[54] Only where trends demonstrate aggressive and successful customer re-capture by ILECs to the point where the share of the market served by the ILEC increases substantially is Commission intervention warranted.

123. A competitive market will be fluid and changes are bound to occur. As such, it is not an effective and efficient use of Commission and industry resources to react to or plan for each change. Likewise, giving substantial weight to the presence or absence of customer complaints, as suggested by the ILECs, requires the Commission to concentrate on a single detail and risk ignoring the bigger picture. Commission decisions regarding the granting or revoking of forbearance relate less to the experience of one or more individual customers than to the impact of its decision on all customers within the affected geographic market. The Telecommunications Act is very clear in this regard, speaking of benefits to Canadians (paragraph 7(b)) and interests of users (section 34) in the aggregate. For this reason, CCTA submits that it is preferable for the Commission to adopt a re-regulation process that responds principally to clear trends (i.e., of ILEC customer recapture) and overt ILEC actions (e.g., such as the acquisition by an ILEC of a competitor) that represent undeniable threats to the continuance of a competitive market.

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[53] See CCTA(CRTC)20Jul05-501 PN 2005-2.
[54] See CCTA(CRTC)20Jul05-502 PN 2005-2.

8. Scope of forbearance

124. At paragraph 29 of PN 2005-2, the Commission invited comments on which of its powers and duties should be forborne, to what extent and with what conditions, in respect of ILEC local exchange services. As CCTA indicated in its initial submission, the starting point for the scope of forbearance for ILECs would be that applicable to other non-dominant carriers, namely CLECs.[55] CCTA is of the view, therefore, that the Commission should limit the degree of forbearance to no more than that provided in respect of CLEC local exchange services.

125. Based on the above principle, the Commission should retain its authority to exercise the following powers:

- section 24 - to address consumer safeguards and to facilitate achievement of telecom policy objectives;
- sections 25, 29 and 31 of the Act - insofar as they relate to LEC services and agreements provided to, or involving inter-carrier agreements;
- Subsections 27(2), (3) and (4) - so that the Commission can respond to complaints alleging unjust discrimination and undue preference in relation to services provided by LECs both to end-users and to other carriers; and
- Subsections 27(1) and (5) – insofar as they relate to services provided to and for the benefit of telecom service providers.

126. Forbearance could be granted with respect to sections 25 and 31 and subsections 27(1), (5) and (6) of the Act in relation to ILEC retail telecommunications services provided to end-users, including resellers.

9. Post-forbearance conditions

127. In addition to seeking comments on post-forbearance conditions for revoking forbearance, the Commission also invited comments at paragraph 31 of PN 2005-2 respecting other conditions or safeguards should be put in place. In CCTA's submission, the most important task for the Commission is to ensure that forbearance is granted only where to do so will not be likely to undermine the establishment or continuance of a competitive market. If this requirement is met, then there should be little need to retain or impose competitive safeguards post-forbearance.

128. CCTA submits that it would be very risky to rely on post-forbearance conditions as a stand-in for an assurance that a market had become competitive on an effective and sustainable basis. Moreover, the implementation and enforcement of such safeguards in a post-forbearance environment would likely increase the number of disputes between ILECs and competitors.

129. Nonetheless, it is important to consider whether conditions particular to the market warrant the imposition of post-forbearance conditions on the ILEC. Examples of conditions cited in CCTA(CRTC)20Jul05-302 include where inequitable access to support structures, or ILEC control over essential facilities are likely to impede the continuance of a competitive

[55] CCTA's Submission of June 22, 2005, at paras. 149, 160 and 161. See also the responses to CCTA(CRTC)20Jul05-403 and 404.

market or the expansion of competition with the forborne LIR.[56] Also, as was the case in the toll market, the Commission may determine that ensuring the policy objectives (most notably those in paragraphs 7(a), (b) and (h)) of the Act are addressed, consumer protections in the form of price ceiling for stand alone local service, combined with an ILEC obligation to serve and retention of quality of service requirements, will be necessary.[57]

10. A transitional regime is neither necessary nor appropriate

130. At paragraph 33 of PN 2005-2, the Commission invited parties to submit their views on whether there should be a transitional regime that provides ILECs with more regulatory flexibility prior to forbearance. The Commission also requested comments on whether and under what circumstances the Commission should consider specific relief during a transitional period. CCTA addressed these issues in its initial submission at paragraphs 194-228, as well as in interrogatories.[58] The following comments addressing the general issue of a transitional regime apply equally to the examples of specific relief identified in PN 2005-2.

131. CCTA submits that in order to address the question of whether a transitional regime that lessens competitive safeguards is appropriate, the Commission must address the relevance of the safeguards to the objective of effective and sustainable competition in local exchange services. CCTA submits that based on such a review, it is clear on the evidence before the Commission that there is no policy justification for the removal of these safeguards in advance of a finding in support of forbearance. The implementation of a transitional regime would only serve to maintain the ILECs' market power and slow down the development of sustainable competition, further lengthening the timeframe until forbearance is warranted.

132. Having reviewed the submissions and interrogatory responses of parties favouring a transitional regime, CCTA submits that there is no evidence or argument that outweighs the concern that such a regime would unnecessarily and perhaps irrevocably impede the pursuit of sustainable competition in the local exchange market.

The safeguards are a regulatory response to anti-competitive behaviour

133. To protect against anti-competitive practices by the ILECs, the Commission implemented a number of competitive safeguards. These safeguards and restrictions have been reviewed and modified by the Commission over time in recognition that local competition has not developed at the pace initially anticipated with the release of Decision 97-8.

134. As the Commission noted in its submission to the Telecom Policy Review Panel, many of the regulations that currently govern ILEC delivery of local exchange service (most notably, those associated with the winback rules) were a measured response to repeated instances of anti-competitive ILEC activity that threatened to undermine emerging competition.

> Not unexpectedly, the ILECs also resisted loss of any market share with all of the tools at their disposal, including "win-back" campaigns targeted at individual customers who

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[56] See also CCTA(CRTC)20Jul05-405.
[57] See also CCTA(CRTC)20Jul05-401, 403, and 406.
[58] See CCTA(CRTC)-703, CCTA(CRTC)-701, and CCTA(MTS Allstream)-301.

decided to switch carriers, as well as various promotions and targeted price reductions designed to recapture any lost customers. While new entrants had to penetrate a market already one hundred percent served by the ILECs, the ILECs could target their marketing efforts in respect of individual customers that chose to leave them, thereby often reversing a customer's decision to switch by offering them a new deal. This conduct, which was impeding the development of a competitive market, prompted the Commission to implement a number of regulatory safeguards designed to restrict the ILECs' retaliatory marketing efforts until competitors managed to get a foothold in the market. Floor prices were also established to prevent the ILECs from dropping rates below cost to undermine new entry.[59]

135. More recently, at paragraph 78 of Decision 2005-53, the Commission reiterated that competitive safeguards such as winback restrictions have been established "in order to promote sustainable facilities-based competition, enforced that rule in the face of violations, and extended the time period during which the rule applies based on evidence that three months was not sufficiently long."

136. As CCTA indicated in its submission of June 22, 2005, it would be inappropriate to implement a transitional regime prior to the granting of forbearance in the local exchange services market. In CCTA's view, the pursuit of sustainable competition in the local exchange market would unnecessarily and perhaps irrevocably be impeded by the introduction of transitional measures of the type contemplated by PN 2005-2.

137. As the Commission has recently acknowledged, the ILECs enjoy numerous advantages including brand recognition, customer reach and retention of customer information stemming from decades of incumbency.[60] Granting the ILECs relief from competitive safeguards prior to forbearance would serve only to further entrench these incumbency advantages.

Existing framework provides adequate flexibility

138. CCTA submits that the current regulatory framework has been established to provide the ILECs with sufficient flexibility to meet competition while providing the necessary safeguards that permit competition to develop. As the Commission noted at paragraph 80 of Decision 2005-53, "Aliant Telecom has not exhausted the possible avenues for mitigating the impact of competition from EastLink, such as reductions in the price for its residential service or the use of promotions as now permitted pursuant to Decision 2005-25." The fact that the ILECs have not availed themselves fully of such flexibility further demonstrates that the introduction of a transitional regime is not warranted.

139. Under the existing safeguards, the ILECs have the flexibility to offer promotions, subject only to limitations that ensure any promotions offered are not anti-competitive or damaging to competition. Moreover, winback rules have been designed in a way that greatly minimize their impact on the ILECs' ability to communicate with customers.

[59] CRTC TPR Submission dated August 15, 2005 at para 75.
[60] Decision 2005-27, paras. 145 and 146.

140. The CCTA submits that enhanced flexibility for ILECs, such as permitting targeted promotions aimed at winning back customers of competitors, serve only to increase churn and administrative costs for all competitors. The relative impact of these increased costs, of course, is much more significant for CLECs.

141. The Commission's conclusions regarding the negative impacts associated with promotions targeted at customers of competitors, issued mere months ago, remain valid:

> [t]he Commission considers that ILEC promotions that target the customers of competitors in order to win them back would threaten the expansion, and possibly survival, of competition in the provision of local wireline services. For example, the ubiquitous nature of the ILECs' operations enables them to offer lower promotional prices in areas where competitors have introduced local services, with major consequences for competitors and little risk to themselves.[61]

<u>*No further flexibility required prior to forbearance*</u>

142. There is no requirement to implement a transitional regime to provide ILECs with additional regulatory flexibility prior to forbearance. Indeed, CCTA submits that retaining competitive safeguards, including the no-contact restriction, may be appropriate after forbearance has been granted where there remain concerns regarding the ILEC's dominant market position.

143. Some parties have suggested that if a gradual lessening of safeguards resulted in a deterioration of the state of competition, remedial Commission action might be possible. CCTA submits that the Commission's multi-year experience in developing the safeguards should be sufficient to permit it to dismiss such suggestions. First, notwithstanding the presence of safeguards, as evidenced by the Commission's release of 2004 market share statistics, the state of local competition remains nascent, fragile and highly susceptible to harm occasioned by the ILECs' proven attempts to "[resist the] loss of any market share with all of the tools at their disposal". Second, as the Commission has repeatedly found,[62] and indeed recently communicated to the Federal Government's Telecom Policy Review Panel, intervention after the fact is a poor substitute for a safeguard when the propensity to transgress the rules has been demonstrated and the harm is irreparable:

> First, many of the regulatory safeguards that are currently in place have arisen as a result of complaints regarding conduct of a dominant carrier that was found to constitute a breach of subsection 27(2) of the *Act.* These safeguards have often been modified over time in response to further infractions. The second point is that under an *ex post* review approach, the damage can be done to the competitive market by the time the complaint is made, responded to and ruled upon.[63]

144. Implementation of a transitional regime assists, at most, those few customers for whom a competitive local service is available, and then – as history has shown - only during the time that promotional offering remains available. The Commission has previously

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[61] Decision 2005-25, para. 62.
[62] See, for example, Telecom Decision CRTC 2002-76 at para 148: …an after the fact complaint process cannot provide an adequate remedy for certain types of harm which may result from either isolated or multiple acts of non-compliance (e.g. loss of business, loss of reputation, loss of financial viability).
[63] CRTC TPR Submission dated August 15, 2005 at para 124.

considered the possibility that maintenance of winback rules, and by extension, related regulatory safeguards, may limit a former ILEC customer's ability to benefit from ILEC offers, and still held firm to the view that safeguards were necessary.

> As regards the argument that former ILEC customers may be harmed because they will not benefit from winback communications for the extended period by the ILEC, the Commission considers that this potential harm would be outweighed by the overall benefit to all customers of an increased competitive market. Further, the Commission is of the view that the potential benefits to the CLECs of extending the no-contact period outweighs any negative impact that this measure could have on the ILECs.[64]

145. As the Commission found in this ruling, the broader benefits of fostering effective and sustainable competition over the longer run outweigh perceived value to a small set of customers that could be obtained from transitory and targeted promotions.

No rate de-averaging within band

146. CCTA submits that it would be inappropriate to make adjustments to the current price regulation framework. The current price cap regime balances the interests of the telephone companies, consumers and competitors. Any proposed changes to the price cap regime would require a full assessment of the nature of the proposed changes and the impact on the interests of the various stakeholders.

147. The removal of the prohibition on de-averaging of local exchange rates would remove an important safeguard against targeted price reductions. As indicated in CCTA(CRTC)-503 the Commission recently re-confirmed its policy on further rate de-averaging in Decision 2005-27, para. 300 finding that this policy provides a valuable additional safeguard to protect against targeted price reductions. The importance of preventing targeted pricing in markets that are not workably competitive was discussed elsewhere.

11. Conclusion

148. CCTA submits that the Commission should only consider forbearance once it has made a finding that the two-part test proposed by CCTA has been met: (1) that at least 30 percent of the relevant market is not served by the ILEC; and (2) that competitive alternatives exist in the relevant market on a pervasive and sustained basis. CCTA further submits that premature forbearance based on too low a market share threshold or a very narrow geographic market, such as an exchange, could result in anti-competitive pricing that deters, or prevents, competitive expansion or entry.

149. In CCTA's submission, the evidence available at this time supports a finding that forbearance from the regulation of residential local exchange services would unduly impair the sustainability of nascent competition in prematurely forborne markets as well as the establishment of competition in non-forborne markets. Accordingly, it would be contrary to section 34(3) of the Telecommunications Act for the Commission to forbear from the regulation of residential local exchange services.

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[64] Decision 2004-4 at para 125.