BEFORE THE CANADIAN RADIO-TELEVISION AND TELECOMMUNICATIONS COMMISSION

TELECOM PUBLIC NOTICE CRTC 2005-2,

FORBEARANCE FROM REGULATION OF LOCAL EXCHANGE SERVICES

ARGUMENT

OF

UTC CANADA

Filed: September 15, 2005

1. INTRODUCTION

1. This argument is filed by the United Telecom Council of Canada ("UTC Canada") in accordance with the procedures established by the Canadian Radio-television and Telecommunications Commission ("CRTC") in Telecom Public Notice CRTC 2005-2, *Forbearance from regulation of local exchange services*.

2. UTC Canada is an industry association focused on addressing telecommunications issues for utilities and energy companies in Canada and the providers of telecommunications infrastructure or information technology services that are affiliated with those companies. The association was formed to address common regulatory issues facing its members and to provide a forum for cooperation on technical and marketing issues. The members of UTC Canada include facilities-based telecommunications carriers that are registered with the CRTC as non-dominant carriers.

3. As discussed in its June 22, 2005 comments, UTC Canada is urging a cautious response to the issue of forbearance in local telephone markets. As the CRTC is keenly aware, the development of viable alternatives to the incumbent local telephone companies' ("ILECs") local exchange services have been slow to develop since this segment of the market was opened to competition in 1997. The slow pace of development has proven to be in direct contradiction of the ILECs' predictions in the public proceeding leading up to the issuance of Telecom Decisions CRTC 97-8, *Local Competition* and 97-9, P*rice Cap Regulation and Related Issues*.

4. In those proceedings, the ILECs had argued against the need for marketing restraints despite their long-standing monopoly in the provision of local exchange services up until that point in time. They pointed to the imminent threat of new entry into the local market by the cable television companies and predicted a rapid loss of market share.

5. Fortunately the CRTC viewed these projections as overly optimistic, and foresaw that high entry barriers to the local market would likely result in a slower rollout of

competitive services in this market than in other segments of the telecommunication market, such as the long distance market, where the requirement to duplicate local distribution facilities was negated to some extent by the imposition of tandem access arrangements on the ILECs. Inter-exchange facilities could be duplicated with less capital investment than local exchange facilities.

6. Experience over the past eight years bears testament to the fact that the CRTC was right and the ILECs were wrong. Indeed, if anything, the road towards a competitive local telephone market has been even bumpier and more difficult than the Commission foresaw. Eight years later, we are in a position where very little progress has been made in reducing the ILECs' dominance in the provision of local residential services and only very modest gains have been made in the provision of local exchange services to business customers. In the latest national data released by the CRTC, competitors had managed to garner only 2% of local residential lines and 1.9% of local residential revenues by the end of 2003. While competitors' share of the local business market faired somewhat better at 8.6% of local business lines and 7.9% of revenues, the latter figure for revenue share actually declined between the end of 2002 and the end of 2003.

7. Rather than reduce or eliminate the marketing safeguards placed on the ILECs back in 1997, as the ILECs had urged, the Commission has actually had to strengthen them several times in the face of the ILECs' market power. The Commission has also seen fit to introduce new Competitor services, such as Competitor Digital Network Access ("CDNA") service, in order to offset advantages enjoyed by the ILECs as the dominant supplier of digital access services in local markets.

8. In the last few years we have also witnessed some instances of the ILECs' pricing below cost in areas where they face competition in order to maintain or improve their dominant position in the market. Evidence of this type of abuse was discovered by the Commission in the context of Bell Canada's evasion of regulatory safeguards in its customer-specific contracts and was discussed by the Commission in Telecom CRTC 2004-20, *Optional Fibre Service Arrangements*. As a result of this behaviour, the vast

majority of CLECs that launched service in the aftermath of the CRTC's 1997 decisions have been subjected to a war of attrition. This has resulted in the loss of significant shareholder investment in these companies, many of which went out of business. The effects are still being felt today as witnessed by increased consolidation in the industry.

9. In the past two years, we have witnessed renewed calls by the ILECs for elimination of the marketing safeguards and pricing restraints placed on them by the CRTC. As was the case in 1997, the anticipated broad-based entry of the cable television companies forms the basis of calls for regulatory forbearance but, this time, there are other developments which the ILECs also rely on as justifying deregulation. These other factors include: the development of voice over Internet protocol ("VoIP") services; the development and successful deployment of high-speed Internet access services by the cable television companies capable of delivering VoIP services; the high penetration of mobile wireless services; and the advent of new facilities-based carriers, including some of the members of UTC Canada, that are deploying local fibre facilities in combination with Wi-Fi and other access technologies.

10. While UTC Canada acknowledges that these developments all hold the potential promise of broader-based competition in at least some local markets, many of these developments are still at very early stages of development. For example, entry into the local telephone market by Canada's largest cable TV company, Rogers Cable, has only recently occurred – eight years after the market was opened. As regards the substitutability of mobile wireless services for local telephony services, according to the CRTC, only about 2% of wireless phone users actually use cellular or PCS service as a substitute for local wireline service. In addition, while UTC Canada's members have extensive fibre facilities on some routes within the ILECs' local exchanges, none of them cover the ILECs' local footprints, and all of them will have to look to other technologies to provide broad-based local telephony services. Even VoIP, which is touted as the major catalyst for change, has yet to prove its ability to replace local telephone service on a broad basis.

11. In this environment, caution by the CRTC is still warranted. While subsection 34(2) of the *Telecommunications Act* does permit the CRTC to look beyond the state of the local market as it exists today, to determine whether competition "will be subject to competition sufficient to protect the interests of users", the CRTC is also prohibited from forbearing from regulation by subsection 34(3) where it finds that "to refrain would be likely to impair unduly the establishment or continuance of a competitive market."

12. There is a lot at stake if a local market is prematurely opened to competition. It has taken eight years to get to the stage where we find ourselves today, with a toe-hold of competition in a local market still dominated by the ILECs, and with the prospect of increased competition still on the horizon. Based on recent history, caution is warranted in making the leap of faith from what we know the competitive situation to be, to what we think it might be in the future. Timing is everything. If a decision to forbear is made based on projections that do not come to pass within the anticipated time frame, the ILECs may be able to use their existing market power to eliminate the competitors that do exist and to foreclose further market entry.

13. In these circumstances, given what it has taken to get this far down the road, it appears to be very risky to gamble on competition suddenly taking off, rather than waiting another year or two to see whether it in fact materializes.

2. COMMENTS ON THE CRTC'S QUESTIONS IN PN 2005-2

3.1 What is/are the appropriate relevant market(s) for forbearance from the regulation of local exchange services, taking into consideration both services and geographic areas?

27. UTC Canada agrees with the Commission's approach to geographic and service markets, as stated in its decision on *Review of Regulatory Framework*:

> The Commission notes that the first step in assessing competitiveness is generally the definition of the relevant market. Indeed, once defined, the relevant market forms the basis for the entire forbearance exercise, as well as any subsequent analysis examining alleged anti-competitive behaviour. The relevant market is essentially the smallest group of products and geographic area in which a firm

> with market power can profitably impose a sustainable price increase. Thus, in determining whether to refrain, and the extent to which it should refrain, the Commission considers it necessary to first identify a well-defined product market that takes into account the substitutes and other market features of the service in question. The Commission finds support for this approach in the language of section 34, which refers to "a service or a class of services".[1]

Product Market

28. UTC Canada believes that the correct approach is to establish service markets comprised of substitutable services based on functionality, quality, price and availability to consumers.[2]

29. Turning first to basic single line local exchange service, most of the evidence has focussed on whether wireless (cellular/PCS) services and VoIP services are substitutes for wireline service.

30. With respect to VoIP services, as defined by the CRTC, UTC Canada expressed the view in PN 2004-2 that VoIP was a substitute for primary exchange service (PES):

> While UTC Canada acknowledges that PES and VoIP have some different features, this does not alter the fact that the core service is essentially the same. Users of PES and VoIP services can communicate orally in real time with the universe of local exchange subscribers using NANP telephone addresses for incoming and outgoing calls and can access other networks that are interconnected with the PSTN such as wireless or long distance networks. While the additional features of VoIP and PES may differ, this basic communications function is equivalent.[3]

31. Since the CRTC has mandated the provision of such public service features as 9-1-1 and MRS by VoIP service providers, VoIP services also serve as substitutes for these important ancillary services.

32. As regards ancillary call management features, VoIP service providers appear to be offering most of the same features as PES, as well as some additional features such as

[1] Telecom Decision CRTC 94-19, at page 66.
[2] UTC(CRTC)20July05-207(a) PN 2005-2.
[3] Reply Argument of UTC Canada, PN 2004-2, at para. 7.

nomadic telephone access and a choice of NPAs.

33. UTC Canada does not view the lack of an embedded power source in access independent VoIP services as an impediment. Many cordless phones suffer from the same deficiency – but are still widely used.

34. As regards the substitutability of mobile wireless services for local telephony services, the CRTC has indicated that only 2% of wireless phone users actually use cellular or PCS as a substitute for wireline service. The reasons offered by UTC Canada for this low number include the fact that wireless service is perceived to be priced higher than flat-rated local wireline service and there are concerns about transmission quality and network reliability.[4]

35. This two percent of wireless users should be included in calculating local market shares. However, given this low number and the fact that the ILECs enjoy a large share of the wireless market as well, wireless will not act as much of a restraint on the ILECs' market power.

36. As regards the issue of whether business and residential telephone service are substitutes, UTC Canada believes that this depends on the service in question, as well as the way in which it is priced and marketed. While single line business and residential services are functionally equivalent, they will not be accepted as substitutes if the carriers continue to price them differently and if the carriers refuse to allow business users to use residential telephone service.

37. UTC Canada believes that multi-line business services are generally in a different market from single line service due to their different functionality. National Centrex is also in a separate market for national services that offer single stop shopping and multi-location discounts.[5] A single location service provider will not be able to compete for

[4] UTC(CRTC)20July05-202(a) PN 2005-2.
[5] UTC(CRTC)20July05-209 PN 2005-2.

customers that require this type of national coverage.

38. The capacity of local access facilities also differentiates telecommunications service markets. DS-0, DS-1, DS-3 and fibre access are all in separate markets due to their lack of substitutability on functional and/or economic terms.

Geographic Market

39. In theory, the relevant geographic market for local telephone service is the area where the individual customer lives. That customer will only have a competitive alternative if more than one supplier serves him or her, or could serve him or her with a substitute service within a reasonable period of time.

40. Whether one can extrapolate from individual locations, where competitive alternatives are available, to broader areas such as local exchanges, local calling areas or local interconnection regions, depends on whether the customers located in those areas can be served with a substitute service or services (in terms of functionality, quality and price) within a reasonable amount of time after placing an order. If there are holes in the competitor's coverage or ability to extend its coverage on comparable terms, then the area chosen is not a good proxy.[6]

41. If forbearance is granted in geographic areas that are not fully served by competing suppliers of substitute services, then safeguards may be required to stop price discrimination within that market and to protect customers with no competitive choice from being overcharged.

42. If the geographic market is fully covered by more than one facilities-based carrier, this will not be of concern. However, the regulator will still have to ensure that the incumbent has no ability to raise prices in regulated markets to cover lower prices in competitive markets, and that there is no collusion between suppliers.

[6] UTC(CRTC)20July05-210(a) to (c) PN 2005-2.

43. The evidentiary record of this proceeding does not provide an answer to the question of whether an exchange, a local calling area or a local interconnection region (LIR) is the appropriate geographic market. However, as pointed out by UTC Canada in its response to UTC(CRTC)20July05-210(d) PN 2005-2, the ability of a new entrant to initiate service within an area that is smaller than a local calling area, may be limited by marketing considerations. In larger urban areas, a local exchange is rarely based on distinct geographic characteristics and most users will not know what exchange they are in or what its geographic boundaries are. All they will know, in rough terms, is the extent of their local calling area. Trying to target a new service offering to an exchange may therefore be extremely difficult:

> Either the local exchange or the LIR could in theory be appropriate geographic markets if they were fully served by competing carriers. In general, UTC Canada believes that a new entrant will have difficulty entering a local market unless it can market its services to the local calling area. Even if it can effectively serve a single exchange within a local calling area, it will have great difficulty targeting its marketing to that single exchange. To do so will promote confusion in the market and could lead to a marketing failure.
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> Some exceptions to this general proposition may exist where the new entrant is targeting a niche market and does not have to resort to mass media to sell its services. In those circumstances, it may be sufficient to be able to provide service to the individual customer in question (e.g. a large business customer) as long as termination of local calls is offered throughout the same local calling area as the ILEC serves.[7]

44. UTC Canada's members do not have first-hand experience with LIRs – so they are not in a position to comment on whether they would be a more appropriate geographic market from the point of view of CLEC entry into a market. However, UTC Canada believes that these types of practical considerations should also come into play in defining an appropriate geographic market.

[7] UTC(CRTC)20July05-210(d) PN 2005-2.

3.2 What are the appropriate criteria to be applied to determine whether the relevant market(s) is/are sufficiently competitive for forbearance?

30. Notwithstanding the low market shares captured by new entrants in local markets, the ILECs have introduced a considerable amount of evidence in an attempt to convince the Commission that structural changes have either already occurred or are on the immediate horizon in Canadian local markets. They have pointed to the high penetration of wireless (cellular/PCS) services in Canada, the announcements by cable TV companies of their intention to enter the local exchange market, the introduction of voice over Internet Protocol (VoIP) services by Primus, Vonage and others, and increased competition in the provision of local broadband services by companies that include the members of UTC Canada.

31. While there is obviously a lot of change underway in the local telecommunications market, it is important to distinguish what "is" from what "might be." The fact is that none of the evidence presented to date in recent proceedings has established that these developments have resulted in the loss of significant market share:

- While wireless penetration rates continue to rise, the fact is that very few Canadians (less than 2% according to the CRTC) have abandoned their wireline telephone service as their primary local service.
- While Canada's largest cable television company, Rogers Cable, has long indicated its intention to enter the local exchange market, it only very recently entered the market.
- While VoIP holds out the promise of increased competition in the provision of local exchange services, VoIP services are still in their infancy in Canada. We have yet to see any concrete evidence of the extent to which VoIP is causing consumers or business customers to abandon the ILECs as their provider of choice for local telephone service. The statistics available with respect to penetration by Shaw and Vidéotron are

encouraging – but they only indicate that [1 or 2%] of Canadians have switched to their alternative services thus far.

- While UTC Canada's members and other carriers have begun to provide broadband facilities in some Canadian markets, these companies have generally not begun to offer local exchange services. Furthermore, the provision of fibre-based facilities by UTC Canada's members is route-specific. Within a local calling area, these companies cover only certain limited routes. They do not even begin to offer the ubiquity of coverage that the ILECs' networks enjoy.

32. In these circumstances, it should be very apparent that while the future holds the promise of increased competition in the provision of local exchange services, the achievement of this policy objective is still in the future and there is no precise timetable for getting there.

33. From a regulatory perspective, this is an important fact. In UTC Canada's view, the Commission should regulate Canadian telecommunications carriers in the context of the market structure that exists today – not on the basis of what might ultimately be. We can only make informed guesses at what might be, while we can assess the current state of competition.

34. In the view of UTC Canada, the *Telecommunications Act* provides the Commission with the necessary tools to adapt to changes in market structure as they occur. The forbearance power, in particular, is framed in a way that allows the Commission to lighten or remove regulation when competitive forces grow to an extent capable of tempering the ILECs' market power. We have already seen the Commission exercise this power on a service-by-service or route-by-route basis, in several more competitive segments of the market. The Commission is also required by section 7 of the Act to pursue the objective of fostering increased reliance on market forces. So the Commission has ample flexibility and power to lighten the regulatory burden on the

ILECs, when the market structure justifies such action.

35. However, these steps can only be taken when the market is sufficiently competitive to protect the interests of users. The Commission is expressly prohibited by section 34(3) from forbearing when it finds that to refrain from regulation would be likely to impair unduly the establishment or continuance of a competitive market for the services or class of services under consideration.

36. In these circumstances, it is very important that the Commission gather evidence on all of the factors that are limiting new entrants' market share before drawing any conclusions as to the ability of competitive market forces to do a better job of constraining abuse of the ILECs' market power, than the existing regulatory safeguards.

37. The Competition Bureau has indicated the types of factors and tests that the Commission must apply in order to do a full-blown economic analysis of the state of competition.

38. The CRTC's data from its 2004 Report to the governor in Council on the state of competition demonstrates that competitive gains are very uneven across the different regions of Canada and in rural versus urban areas. For example, in some provinces, such as Newfoundland and Saskatchewan, there is virtually no competition, whereas in some urban centres, and particularly in Toronto, competitors' share of both the local residential and business markets is significantly higher than the national average.

39. For these reasons, it may be difficult to develop a simple set of principles to identify market power, in a specific market. However, UTC Canada has discussed the use of a possible short-cut, or "bright lines" test, that might provide guidance in clear-cut cases below.

Development of a "bright lines" Test

40. The test for forbearance in section 34 of the *Telecommunications Act* requires the Commission to assess whether competition in a given market is sufficient to protect the interests of users. This generally requires a fairly complex review of a number of the factors discussed in previous CRTC decisions on forbearance. If one wishes to avoid this analysis and use a rule of thumb or a "bright lines" test, one should pick a test that errs on the side of prudence. This is because the implications of forbearing prematurely are potentially so damaging (the elimination of competition and re-monopolization of the market).

41. While economists appear to shy away from relying on market share data in assessing market power, and while the Competition Bureau does not appear to advocate using it as a "bright lines" test for forbearance, UTC Canada believes that it is nonetheless a good indicator of whether a market is competitive. It provides cogent evidence of actual competitive entry into a market, of the substitutability of the competitor's services for the incumbent's services, and of the ability of new entrants to gain a foothold in the market. In short, it provides evidence of the degree to which competitors have succeeded in entering a market.

42. It is also noteworthy that, despite claims to the contrary, market shares are often used by competition authorities as *prima facie* evidence of market power. This is true in Canada, where the Competition Bureau's *Merger Enforcement Guidelines* use a 35% market share to identify mergers that are unlikely to have anti-competitive consequences:

> 4.12 The Bureau has established thresholds to identify mergers that are unlikely to have anti-competitive consequences from those that require a more detailed analysis. In particular:
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> - the Commissioner generally will not challenge a merger on the basis of a concern related to unilateral exercise of market power when the post-merger market share of the merged entity would be less than 35 per cent.

- the Commissioner generally will not challenge a merger on the basis of a concern related to a coordinated exercise of market power when:
  - the post-merger market share accounted for by the four largest firms in the market (known as the four-firm concentration ratio or CR4) would be less than 65 per cent; or
  - the post-merger market share of the merged entity would be less than 10 per cent. [8]

43. In its *Enforcement Guidelines* on the *Abuse of Dominance Provisions*, the Competition Bureau again states that a 35% test is appropriate:

> The Bureau considers that a market share of less than 35 percent will normally not give rise to concerns that a firm has engaged, or is engaging in, a practice of anti-competitive acts that is preventing or lessening competition substantially in a market. If a firm has a 35 percent or higher market share, the Bureau will normally continue its investigation.
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> ...
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> In summary, the Bureau's general approach with regard to market share is as follows:
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> - 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.[9]

The Competition Tribunal has gone further in stating that an 80% market share gives rise to a presumption of dominance that can only be rebutted by showing an absence of barriers to entry:

> As the market shares of the dominant firm(s) rise, the jurisprudence articulates a relationship between market shares and the standard of proof that will be used in assessing barriers to entry. The Tribunal notes this in both *Nielsen* and *Tele-Direct*. In *Tele-Direct*, where market shares were 80 percent or higher, the

[8] *Merger Enforcement Guidelines*, s. 4.12.
[9] Robert S. Nozick, *Competition Act*, 2005 Annotated Edition, at p. 600.

> Tribunal stated that it would require evidence of "extenuating circumstances, in general, ease of entry" to overcome a prima facie determination of control.[10]

44. The EC similarly uses a 40% market share as raising a red flag for possible dominance:

> An operator will be presumed to be dominant if it enjoys a market share of over 40%, as compared to the current 25%. While market share is one factor taken into account when assessing the existence of a dominant position, other relevant factors which will be taken into account by the Commission and the European Courts, are:
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> - overall size of the undertaking
> - control of "essential facility" type infrastructures
> - technological advantages
> - absence of countervailing buying power
> - economies of scale and scope
> - vertical integration
> - highly developed distribution and sales network
> - absence of potential competition[11]

45. If market shares of this magnitude are used as a red flag to justify a detailed review of market power, it would appear logical to use them inversely to demonstrate on a *prima facie* basis that a detailed review of market power is not justified. It is therefore consistent with Canadian and EC Competition law to use market share evidence as a bright lines test on this basis. Pursuant to the Canadian and European practice, a market share of less than 35% (40% in the EC) would justify forbearance on a bright lines basis. A market share higher than 35% (40% in the EC) would require a full blown competition analysis along the lines described in the *Merger Enforcement Guidelines*.

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[10] Ibid, at p. 601.

[11] Michael H. Ryan, *The New EU Regulatory Framework for Electronic Communications*, 2002.

Forbearance Based on Wholesale Rate Regulation

46. UTC Canada believes that the benefits of consumer choice, price competition and innovative services will come from facilities-based competition – not resale of wholesale services using a common technology platform and a common cost base. Setting the perfect rate for wholesale service is fraught with difficulties and could result in endless regulation by the CRTC and disputes between resellers and ILECs. In UTC Canada's view, it is a better course to be patient, to wait for facilities-based competition to develop, and then to forbear from rate regulation when the ILECs no longer possess significant market power.[12]

47. UTC Canada does not believe that regulation of wholesale rates justifies deregulation at the retail level absent real facilities-based competition at the retail level. There are several reasons why UTC Canada does not believe that wholesale rate regulation is adequate.

48. First, the nature of competition at the retail level is suspect if the services are all being delivered over the same network. True price competition will not be possible and service innovation will be limited by use of a common technology platform.

49. Secondly, the extent of competition will depend on the price established for the wholesale service. This is very difficult to get right and it will inevitably be subject to challenge by either the carrier or the service providers, or both. The Commission will be called upon to adjust the price depending on the competitive outcome it produces. This will place the Commission in a very awkward position of deciding competitive outcomes instead of allowing market forces to work.

50. Thirdly, in the long term, a wholesale rate approach does not stimulate facilities-based competition – so regulators are stuck with this pseudo form of competition on an

[12] UTC(Xit)20July05-10 PN 2005-2.

on-going basis.

51. Fourthly, this model assumes that competitors will enter the market if the incumbent carrier raises its retail rates too high. In fact this type of entry may not occur for a number of reasons. One reason is that in the absence of retail price regulation, the incumbent can raise or lower prices in response to competitive entry or rumours of competitive entry. New entrants are unlikely to take this chance of entering the market and facing rate reductions, if they are reliant on the incumbent for network services and don't enjoy a real cost advantage over the ILECs. New entrants are unlikely to enjoy a cost advantage in a wholesale environment. In fact, the opposite is most likely true given the fact that the wholesale rates paid are based on the incumbent's costs – not the new entrant's, and the incumbent is likely to enjoy economies on the service side of its business derived from the integrated nature of its network services. In addition, even if regulated wholesale rates exist, new entrants are unlikely to offer service in many areas characterized by lower population densities. These customers are likely to remain captive by the ILECs regardless of the retail price level.

52. Finally, UTC Canada believes that wholesale regulation can actually impede facilities-based competition since investors may be hesitant to invest in new networks where wholesale access is available at cost-based rates.

53. In Telecom Decision CRTC 2002-34, *Regulatory Framework for the Second Price Cap Period*, the CRTC decided to require the ILECs to offer CLECs a special wholesale price on digital network access services used by their competitors (CDNA Services) in the local exchange market. This step was taken in order to improve the ability of CLECs to compete on an equitable basis with the ILECs in the local exchange market. The CRTC required the ILECs to re-price these services based on the incremental cost of providing them plus a lower mark-up than is ordinarily permitted. This special wholesale price was made available to competing carriers and resellers – and did not affect the ILECS' retail rates to other customers. Although the CRTC initially ordered a 40% price reduction for CDNA services on an interim basis, once the costing

exercise was completed, these rates dropped by up to 80%. Moreover, the ILECs were not required to forgo this revenue. In order to offset any financial harm to the ILECs, the CRTC decided to allow them to recoup this lost revenue from a new revenue deferral account. The deferral account was comprised of revenues that the ILECs were permitted to generate by keeping retail rates for basic phone service at a higher level than would otherwise have been permitted under the CRTC's price cap regime. In other words, the CRTC permitted the ILECs to fund the lower priced CDNA service to CLECs through higher priced services to businesses and consumers of local telephone service. The ILECs remained whole, while CLECs got a break, in hopes of stimulating local competition.

54. Unfortunately, UTC Canada's members got left out in the cold.

55. Since UTC Canada's members provide services that compete with the ILECs' CDNA services, at least in areas where the Utelcos have network facilities, and since competing carriers comprise an important part of Utelcos' customer base, the artificially low rates for CDNA service imposed on the ILECs has severely cut into the Utelcos' revenue base. However, unlike the ILECs', UTC Canada's members have not had their revenue losses made up from the ILECs' deferral fund.

56. In essence, UTC Canada's members have been sacrificed to give CLECs parity in the local exchange market. This type of wholesale regime therefore runs contrary to the CRTC's policy of encouraging facilities-based competition.

***Ex Ante* v. *Ex Post* Regulation**

57. In UTC Canada's view, *ex ante* regulation is justified as long as a carrier possesses SMP in a given market. Once SMP is lost, and a market is forborne, complaint driven *ex post* regulation is justified in respect of the powers the CRTC has retained.

58. History has repeatedly demonstrated that the ILECs will take advantage of their market power whenever they can to enhance their market position. If one examines the history of competition in the telecommunications sector from Challenge Communications in 1978 to the more recent use of Bell Nexxia to evade regulatory restraints and engage in below cost pricing, one can see this proposition confirmed time and again. In fact, most of the regulatory safeguards currently in place were only devised after the fact when abuses of SMP were investigated by the CRTC.

59. Given the incentive and opportunity the ILECs have to enhance their market positions through abuse of SMP, the ILECs have not shown any propensity to resist the natural economic urge to exploit their advantage.

60. In many cases, the damage has been done by the time the abuse is stopped. To suggest that the resultant safeguards should not be approved and applied on an on-going basis would simply encourage more infractions. Until the underlying SMP no longer exists, *ex ante* economic regulation is required.

61. Once SMP no longer exists, *ex post* regulation is justified in respect of certain forms of conduct, such as discriminatory access to service providers. The CRTC has on occasion taken this approach when it has forborne a service from rate regulation – but retained its power under section 27(2) to regulate access on a complaint-driven basis. In UTC Canada's view, this is the correct approach.

3.3 What Commission powers and duties should be forborne?

62. UTC Canada notes that in this proceeding the CRTC is considering whether to forbear from regulation of the ILECs' retail and business local services. In UTC Canada's view, it is extremely important that the Commission retains full jurisdiction to consider all issues related to interconnection with the ILECs and the provision of Competitor Services by the ILECs.

63. The CRTC and the Government of Canada have encouraged the development of a "network of networks" in Canada with both interconnection and interoperability between competing networks. In order to preserve and foster this environment, the CRTC must retain jurisdiction over these issues including its dispute resolution functions.

64. In UTC Canada's view, it is equally important for the CRTC to continue to regulate Competitor Services. Until such time as competitors have the ability to compete with the ILECs on all routes, and in all parts of a local market on a facilities basis, they will need the ability to round out their networks with Competitor Services. The Commission will also need to consider the impact on existing non-facilities-based carriers of eliminating Competitor Services. To do so could have the effect of eliminating the small foothold gained by these carriers to data.

65. The CRTC will also undoubtedly also wish to retain jurisdiction over certain other aspects of local telephone service, even if it ultimately decides to forbear. This should include 9-1-1 emergency services and other public service features of local service that the CRTC will likely want to preserve as a uniform feature of local telephone service. (Message Relay services, local telephone directories, access by law enforcement agencies etc.)

66. This will require retention of powers under section 24 and 29 of the Act, as well as section 27(2). As regards section 29, the Commission will need to decide whether carriers should continue to receive the benefit of CRTC-sanctioned limitation of liability clauses, or the burden of CRTC imposed wording of such limitations, in a competitive market.

67. Once a carrier is found not to be dominant in a given market, the presumption should be that regulation is not required, unless there is a sound public policy reason for it. In the case of limitations of liability, this may depend on whether the CRTC is also imposing other obligations on carriers, such as 9-1-1 service obligations, which might affect the extent of the carriers' liability to the public. An attempt should be made to

match the protection afforded by the Commission to the increased exposure to liability that its regulatory requirements create.

68. UTC Canada is also concerned with the incentives for the ILECs and cable television companies to engage in anti-competitive conduct, vis á vis third party service providers, if they find themselves in a duopoly position in local markets. While the cable companies and the ILECs may have the incentive to compete with each other, they may also have the incentive to limit the ability of other service providers to capture market share. Their ability to engage in this type of conduct will be enhanced by their control of the two principal networks used to provide high-speed broadband access to Canadians.

69. Part of the benefit of VoIP services is their ability to ride over third party broadband access networks. In Canada, this feature has already spawned early entry into the market by Primus and Vonage. If the ability of the third party VoIP service providers to compete in the retail market is going to be preserved, the Commission will need to retain the power to regulate both access and quality of access to underlying broadband networks by competing suppliers.

3.4 What post-forbearance criteria and conditions should apply and why?

70. UTC Canada does not generally like the prospect of re-regulation hanging over a supposedly competitive market. It tends to create uncertainty in the market and could lead to the rearguing of forbearance decisions on an on-going basis.

71. The need for re-regulation arises when the Commission is wrong about the strength of competition in the market, or guesses wrong about the likelihood of competition developing to the extent necessary to replace regulation as a restraint on the ILECs' market power.

72. As discussed above, UTC Canada does not favour this type of prediction regarding the future strength of competition being made. There is too much riding on it.

It is often said that nothing is more difficult to predict than the future. This goes doubly for predicting technology trends or consumers' responses to it.

73. For this reason, UTC Canada prefers a cautious approach to forbearance, which avoids the very large pitfalls of predicting the future state of competition, and does not require re-regulation if things go wrong.

74. The prospect of having to re-regulate a market or market segment will lead to significant confusion in the market. While UTC Canada doubts that consumers will be prejudiced by re-regulation of the ILECs since such a move will likely be taken to suppress price increases, re-regulation will send confusing signals to the marketplace. That is why patience is required not to rush into forbearance prematurely.[13]

75. Given that it has taken eight years for competition to gain a very modest foothold in the local telephone market, and given the fact that it took numerous regulatory interventions to get to this point, it would appear imprudent to suddenly forbear from regulation absent some compelling evidence of change in market structure actually taking hold.

76. UTC Canada believes that it is important to establish a time period during which a market share threshold should be maintained before forbearance is granted. This gives the Commission time to assess whether customers are just trying out the new service – or are finding that it is a viable substitute to the ILEC's service. It also gives the market time to assess the ILEC's competitive response to new entry and to determine whether an aggressive response recaptures market share. It also gives an opportunity to gauge the ability of the new entrant to withstand a competitive response. UTC Canada believes that a one year period would be appropriate.[14]

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[13] UTC(CRTC)20July05-502 PN 2005-2.
[14] UTC(CRTC)20July05-601 PN 2005-2.

77. For these reasons, forbearance should not occur in a market until the CRTC is satisfied that market forces are strong enough to prevent the ILECs from abusing their market power. Once this stage is reached, the *Competition Act* will apply. If the CRTC finds at a later date that market forces have weakened to a state where the ILECs again possess significant market power and are abusing that power, the CRTC should re-regulate the ILECs' rates.[15]

78. In the event that competition does not prove to be sustainable in a forborne market, the test for re-regulation should be the same test that is applied when the Commission first considers forbearance – i.e. whether ILECs have market power and whether competition is sufficient to protect consumers and other users of local services (as required under section 34 of the Act). Evidence of consumer complaints and evidence of price increases over the level established for the same service in other more competitive regions, would provide prima facie evidence of the need to re-examine forbearance.[16]

3.5 What is the appropriate process for future applications for forbearance from the regulation of local exchange services?

79. As discussed above, UTC Canada believes that using the bright lines test established in the Canadian *Merger Enforcement Guidelines*, an ILEC should be eligible for forbearance when its market share drops to below 35% in a given market. Forbearance in these circumstances should be automatic.

80. In all other circumstances, the CRTC will have to have a more detailed examination of the market and the presence or absence of market power.

81. UTC Canada does not see why the Commission would want to use a different bright lines test than the Competition Bureau, whose job it is to perform these types of

[15] UTC(Xit)20July05-11 PN 2005-2.
[16] UTC(CRTC)20July05-501 PN 2005-2.

competitive analysis on a day-to-day basis.

82. UTC Canada would ordinarily expect an ILEC to apply for forbearance in a given local market, when it believes the criteria for forbearance have been met. In other circumstances, if the CRTC determines from the market share data in its possession that the proposed bright lines test has been satisfied, then the CRTC should, on its own motion, grant forbearance.

83. UTC Canada notes that the CRTC already collects data on the status of competition in the market. The list of data collected may have to be modified to accommodate the bright lines test.

84. For the business and single line markets, NAL is likely a good indicator of market share. For some business services that have value built into more than just network access, a combination of NAL equivalents and gross revenues might be more appropriate. UTC Canada also believes that with respect to NALs, leased local loops used by carriers or resellers to provide local service should be separately tracked to determine the extent of facilities-based competition.[17]

85. UTC Canada notes that the CRTC already collects some of this type of data on an annual basis for its reports to the Governor in Council. In UTC Canada's view, an annual collection is adequate. Significant changes in market share are not likely to occur rapidly. This is largely because of the century-old hold that the ILECs have had over these markets and the time it takes to build new networks and gain new customers. For those reasons, and given that there will be a need to ensure that the regulatory burden imposed on competitive service providers is minimal, an annual filing requirement would be appropriate. However, timeliness of reporting the data and making it public is more important. At the moment, there is an 11 month delay in releasing it.

[17] UTC(CRTC)20July05-901 PN 2005-2.

86. The CRTC is already reporting this data on an aggregated basis. It could be disaggregated at a relevant market level (e.g. exchange, LIR or Local Calling Area) and reported as ILEC's and competitors percentage share. The ILECs already have a good idea of this number and, if the competitors' share was reported in the aggregate, it should not hurt individual competitors in the market.[18]

3.6 Should there be a transitional regime that provides ILECs with more regulatory flexibility prior to forbearance?

87. As discussed above, UTC Canada does not believe that forbearance should occur until such time as the Commission is assured that competition will protect consumers and businesses from the ILECs' market power, better than price regulation and marketing safeguards. By the same token, prior to competitive market forces taking over this role, there is no rationale for loosening regulatory safeguards

88. The CRTC has only recently concluded a number of proceedings that are pertinent to this issue:

- On April 25, 2005, in Telecom Decision CRTC 2005-6, *Introduction of a streamlined process for retail filings*, the CRTC streamlined the regulatory process for the ILECs' tariff approval process;

- On April 27, 2005, in Telecom Decision CRTC 2005-25, *Promotions of local wireline services*, the CRTC reviewed the appropriateness of the ILECs' promotions and win-back rules and made revisions to them; and

- On April 29, 2005, in Telecom Decision CRTC 2005-27, *Review of price floor safeguards for retail tariffed services and related issues*, the CRTC reviewed and modified the downward price restrictions on the ILECs' services.

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[18] UTC(CRTC)20July05-90(b)and(d) PN 2005-2.

89. All of these decisions were released less than five months ago. Absent a significant change in circumstances, there would not appear to be any need for revisiting these decisions at this juncture.

90. Notwithstanding the CRTC's attempts to temper the ILECs' market power through the imposition of regulatory safeguards such as price caps and cost-based floor prices, the experience of UTC Canada's members has been that these rules are often ignored by the ILECs.

91. Bell Canada's ability to evade General Tariff requirements for "customer-specific" arrangements (CSAs) is particularly troubling since in some cases the underlying service components being provided were functionally equivalent to services found in the ILECs' General Tariff. The ILECs have been given far too much leeway to designate a service as "customer-specific" simply because the customer is requesting Bell Canada to put several service elements into a package deal or is asking for connections to multiple locations, when all elements of the package can be found somewhere in Bell Canada's tariffs.

92. UTC Canada's concerns about the ILECs' ability to price below cost has been buttressed by the CRTC's own findings in Telecom Decision CRTC 2004-20, *Optical Fibre Service Arrangements*, and Telecom Orders CRTC 2004-142 and 143.

93. While past history is not necessarily a guide to the future, it does provide some evidence of the ILECs' conduct in situations where they face competition but remain dominant. Left unregulated, the evidence suggests that market power will be exploited to limit competitive entry. If anything, the CRTC needs expanded powers to enforce its rules and fine ILECs for infringing them.

3.7 Aliant Telecom's forbearance application

94. Although the CRTC's latest report to the Governor in Council shows that the Nova Scotia local exchange market is possibly the most competitive in Canada (with approximately 10% of the market in aggregate served by Eastlink and other competitors at the end of 2004), this is a far cry from the magnitude of market share that would give rise to a *prima facie* presumption in favour of forbearance. In fact, Aliant's market share is well in excess of the 80% level that the Competition Tribunal says gives rise to a *prima facie* presumption of dominance. Based on those statistics, forbearance would not appear to be warranted on a *prima facie* basis.

95. UTC Canada lacks the data necessary to gauge the degree of competition that exists in individual local exchanges or local calling areas in Aliant's territory, due to the fact that this information has been filed in confidence. We are therefore not in a position to gauge whether this competitive situation has changed since 2004, or whether the facts justify forbearance in specific local markets.

96. UTC Canada thanks the CRTC for considering these submissions.

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