

**BEFORE THE CANADIAN RADIO-TELEVISION
AND TELECOMMUNICATIONS COMMISSION**

TELECOM PUBLIC NOTICE CRTC 2005-2,

***FORBEARANCE FROM REGULATION OF LOCAL
EXCHANGE SERVICES***

REPLY ARGUMENT

OF

UTC CANADA

Filed: October 7, 2005

Introduction

1. The United Telecom Council of Canada (“UTC Canada”) is filing this Reply Argument 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 remains of the view that the Commission should adopt a cautious approach to the issue of forbearance in local telephone markets. The regulation of the local telephony market should not be abandoned simply on the hope or the promise of future competition. We believe that the Commission needs to assess the state of competition in local markets on the basis of what exists today, and to forbear from regulating those markets only if and when the incumbent local telephone companies (“ILECs”) no longer possess market power.
3. It has taken more than eight years for even a small level of facilities based competition to begin to develop in the local telephony market. While the prospect of increased competition is on the horizon, local markets continue to be dominated by the ILECs. Given this recent history, caution is warranted in making the leap of faith from what we know the competitive situation to be today to what we may think it might be in the future. If a decision to forbear is made based on projections that do not come to pass within the anticipated timeframe, the ILECs will be able to use their existing market power to eliminate the competitors that do exist and to foreclose further market entry.
4. As the Commission is well aware, this is not the first time that the ILECs have pointed to the imminent threat of new entry into the local market by cable television companies as the rationale for deregulation. The ILECs made similar statements in the proceeding that resulted in the issuance of Telecom Decision CRTC 97-8, *Local Competition* and Telecom Decision CRTC 97-9, *Price Cap Regulations and Related Issues*.
5. The Commission did not accept those wildly optimistic prognostications that were made in the context of the local competition proceedings and should not accept them in this proceeding.
6. The goal of creating a competitive local telephone market has proven to be elusive. More than eight years after the local market was opened to competition, 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.
7. In the latest national data released by the Commission in Telecom Public Notice CRTC 2005-11, competitors had managed to garner only 3.2% of local residential lines by the end of 2004. While competitors’ share of the local business market fared slightly better, after eight years of competing, there is still a long way to go before the market will be subject to a degree of competition that is sufficient to protect the interests of users. In

fact, the competitors' share of the local business market appears to have flattened out in recent years. The number of business lines provided by competitors has risen from 721,000 in 2002 to only 806,000 by the end of 2004. Moreover, if one considers that almost 70% of those competitors' local business lines are, in fact, provided by out of market ILECs, it would appear that the ILECs have been able to compensate for losses in their own local markets by taking market share in other territories. In view of these numbers, the ILECs, as a group, would appear to be gaining strength in the local business line markets, and not losing strength as they have suggested.

8. While UTC Canada acknowledges that there are reasons to be optimistic that sustainable competition will develop in at least some local telephony markets, it should be recognized that many of these recent developments – such as broad-based entry of the cable television companies into the local exchange market and the development of voice over Internet protocol (“VoIP”) services - are still at a nascent stage and have yet to fully emerge as viable alternatives to the ILECs local service.

9. There is a lot at stake if a local market is prematurely opened to competition. If a decision to forbear is made, but sustainable competition fails to develop within a reasonable period of time, the ILECs will be able to use their market power to continue to dominate the local telephony market. This would require the Commission re-regulate the market in order to protect the interests of consumers and other users of local services. No one who participated in this proceeding has suggested that the process of re-regulation could be done seamlessly and without massive disruption to the telecommunications industry.

Market Share Analysis

10. Given the high stakes involved in deciding whether to forbear from regulating the local exchange market and the administrative burden that could be associated with reaching such a determination, we believe that it would serve the industry and the Commission well to establish a bright lines test that would be used to trigger a full-scale market review of an ILEC's market power. UTC Canada has reviewed the market share tests that have been employed by various competition authorities in Canada and in the European Community and we believe that these tests could be used in Canada as prima facie evidence of market power.

11. As we noted in our early submissions and in our appearance at the public hearing, the Competition Bureau's *Merger Enforcement Guidelines* use a 35 percent market share as a threshold to identify mergers that are unlikely to have anticompetitive consequences. Under those Guidelines, a market share of less than 35 percent will not give rise to concerns of market power dominance. Significantly, the European Community uses a similar 40 percent market share as raising a red flag for possible dominance. At the same time, it should be noted that the Canadian Competition Tribunal has established 80 percent market share as the threshold that gives rise to a presumption of dominance that can only be rebutted by showing an absence of barriers to entry.

12. Consistent with the market power mechanisms used by these competition authorities, we have advocated in this proceeding the adoption of a bright lines test for local forbearance that includes the notion of “book-ending” where the Commission would look at the 35 percent threshold and an 80 percent threshold as the metrics for either granting automatic forbearance or rejecting an application for forbearance. Where an ILEC’s market share falls below 80 percent, but is still greater than 35 percent, the Commission would conduct a market power analysis to determine whether the ILEC continues to exercise market power in a specific geographic and/or product market.

13. UTC Canada is aware that our proposal to establish a threshold of 20 percent market loss to trigger a review is at odds with the thresholds proposed in this proceeding by the ILECs. In our view, however, the 5 percent threshold proposed by the ILECs is simply not workable and would not be enough of a loss to signal that an ILEC no longer exercises market dominance. In this respect, we are not aware of any competition authority that uses such a low number as evidence of the absence of market dominance. As we indicated at the hearing in response to a question from Commissioner Pennefather:

I think one has to ask themselves: The 5 percent, what is the error in the calculation? I have got 5 percent market -- I have lost 5 percent of my market plus or minus 2, 3 percent.

I think it is very difficult to intuitively grasp the concept that a 5 percent loss of market share in a market where you previously had 100 can even be construed as a competitive environment.

So I think the number is just wrong.¹

14. UTC Canada also rejects the ILECs’ proposal to include in the market loss calculation those customers that have switched from the ILEC’s local exchange service to the ILEC’s wireless service. Bell Canada, for example, includes losses to wireless in its market share numerator. The prospect of a customer switching from one Bell Canada local service offering to another Bell Canada local service offering certainly cannot be considered evidence of vibrant competition in the marketplace.

15. We also believe that the Commission should be loath to include in the market share calculation those customers that have switched to a reseller of an ILEC’s local service. This is consistent with our view that only facilities-based competition should be seen as a true alternative to the ILECs local service offering. In our view, resale does not amount to actual market loss for the ILECs. We emphasized this point at the public hearing:

¹ UTC Canada Appearance at Public Hearing re Telecom Public Notice CRTC 2005-2, Transcript, September 28, 2005, at paras. 4693 to 4695.

If some of that is resale, is it actually a market loss? If the ILEC is being paid for the circuit on the backend and being topped up, is that a real market loss?

For example, the CDNA tariff, is it a loss of a DS-3? When a carrier sells a DS-3 at CDNA price, gets their money back to bring them back to their whole price from the deferral account, is that actually a lost circuit for them?

Does that count as a lost circuit?²

16. After reviewing the submission filed in this proceeding and listening to other parties at the public hearing, UTC Canada continues to believe that a fair and reasonable approach to the market share issue is to establish a bright line of 80 percent. It is only in those situations where an ILEC's market share in a given market falls below 80 percent (and above the 35% bookend) that the Commission would need to conduct a full analysis of that market to determine whether the ILEC continues to exercise market dominance. We would note that based on the numbers released by the Commission in Telecom Public Notice CRTC 2005-11, the vast majority of markets in Canada are a long way from this threshold. It is only in Charlottetown and Halifax where the competitor, Eastlink, appears to have made significant inroads, and as such Aliant would appear, in those two markets, to be within the bookends (between 35 and 80 percent market share). It would appear, therefore to be reasonable for the Commission to conduct an analysis of Aliant's market power in these two geographic markets.

Market Definitions

17. As the Commission has itself indicated, the first step in assessing competitiveness is to define the relevant market. This relevant market definition will form 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.

18. It should be emphasized at this point that most of the comments filed in this proceeding relating to market definitions have focussed on the residential market. Very little information and evidence has been provided in respect of business market definitions. One of the reasons for this is that the one highly-touted facilities-based competitor to the ILECs is the cable industry. As the Commission is well-aware, the cable companies have focussed their attention (and their facilities) on residential markets. As such, they would appear to have very limited penetration in business areas. Given that business markets have not been prominent in this proceeding, we believe that the Commission should exercise additional caution before setting any conditions for forbearance in those markets.

² Ibid. at paras 4701 to 4703.

i. Product Market

19. With that in mind, 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. In our view there are at least five distinct product markets: single line residential, single line business, multi-line business, National Centrex and high-capacity fibre access.

20. For those customers that have abandoned their local exchange residential service and replaced it with either a Wireless (cellular/PCS) service or a VoIP service, it would appear that these types of products are substitutes for wireline service. There is therefore a distinct single-line residential market for these services.

21. While it could also be argued that single-line business and residential telephone service are substitutes, UTC Canada believes that there are enough differences to categorize these two types of services as distinct product markets. Single line business and residential services are functionally equivalent. However, they are not typically accepted as substitutes because the carriers continue to price them differently and the carriers refuse to allow business users to use residential telephone service. For that reason, it is appropriate to consider single-line business and residential as two markets. This situation may change as the competitive market develops. If it does, and if pricing for business and residential services evolves towards a single rate, then this issue may have to be reassessed.

22. UTC Canada believes that multi-line business services are 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. A single location service provider will not be able to compete for customers that require this type of national coverage.

23. Finally, 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. UTC Canada would also note that it is possible that this market segment could be divided up even further. This is an issue that is being address by UTC Canada in the proceeding initiated under Telecom Public Notice CRTC 2005-8, *Framework for forbearance from regulation of high-speed intra-exchange digital services*.

ii. Geographic Markets

24. With respect to the appropriate geographic market definition, it is UTC Canada's view that the metropolitan area served by an ILEC would be the relevant market for purposes of forbearance. We have reached this conclusion based on practical considerations and the manner in which ILECs market their local service to the public. We made this point during our appearance at the public hearing:

Generally, marketing activities, it is very difficult to limit a marketing activity to a local calling area and that question of how big is a local calling area, SaskTel made the perfect point the other day. I mean, the local calling area can be Regina; a local calling area can stretch from Oakville to Ajax. I mean, very, very different sizes, very different population bases.

So when looking at it we thought it was probably more advantageous to look at what happens in reality with sales and marketing efforts and the way trucks roll and all those sorts of ideas.

Metropolitan areas make more sense to us. For example, if we want to take an ad or if somebody wants to take a split-run ad in the Globe & Mail for Ottawa, they get Ottawa. They get the city of Ottawa and the surrounding geographic area.

We don't have a lot of experience with LIRs so we don't know how an LIR interacts with that area. We had to have a dissertation on what an LIR actually is. But the metropolitan area makes the most sense to us, we think.³

25. In the event that the Commission decides to choose from among one of the three segments that currently exist within the telecommunications industry – local exchange, local calling area or LIR – we believe that the local calling area would be the most appropriate geographic market because it best approximates the metropolitan areas. A local exchange is not appropriate because it is rarely based on distinct geographic characteristics and most users will not know what exchange they are in or what its geographic boundaries are. Users will, however, know, at least in basic terms, the extent of their local calling area.

26. In the event that an ILEC is forborne from regulation in a geographic area that is not fully served by competing suppliers of substitutable services, the Commission will need to impose safeguards in order to prevent the ILECs from engaging in price discrimination within that market and to protect customers with no competitive choice from being overcharged. These “pockets” will require CRTC price protection in the form of a price ceiling..

27. If, on the other hand, 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 ILEC has no ability to raise prices in regulated markets to cover lower prices in competitive markets, and that there is no collusion between suppliers.

³ Ibid. at paras. 4570 to 4573.

Process for Considering Applications for Forbearance and the Bureau's "Structured Rule of Reason Test"

28. As UTC Canada has emphasized throughout this proceeding, it is our view that the Commission should adopt a bright lines test in order to assess an ILEC's eligibility for forbearance. In this respect, we have proposed a "bookends" approach that would result in automatic forbearance when an ILEC's market share drops to below 35% in a given market and continued regulation where the ILEC's market share remains above 80% in a given market. In circumstances where the ILEC's market share is between 35 and 80%, the CRTC will have to have a more detailed examination of the market and the presence or absence of market power.

29. We would expect that an ILEC would apply for forbearance in a given local market, when it believes the criteria for forbearance have been met.

30. At the hearing we were questioned by Commissioner Pennefather about the process for considering a forbearance application and, in particular, we were asked to comment on certain aspects of the Competition Bureau's proposal to establish a "Structured Rule of Reason" test to determine eligibility for forbearance.

31. Subsequent to the public hearing, we have had an opportunity to review the Competition Bureau's submissions and believe that the test proposed by the Bureau has some validity. In fact, some of the conditions set by the Commissioner of Competition for the application of the test are similar to the criteria that UTC Canada has advocated in this proceeding. There are, however, two aspects of the test that we believe require further comment: one relates to the facilities-based competitor element of the test and the other relates to the costing information requirement.

32. The first concern we have relates to the Bureau's requirement for there to be a facilities-based competitor to the ILECs in the relevant market. We have emphasized throughout this proceeding that one of the fundamental criteria for granting forbearance must be the existence of a facilities-based competitor. 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. The development of facilities-based competition is absolutely essential to forbearance.

33. We have also emphasized the need for the Commission to be wary of the potential for a duopoly to develop. As we have indicated previously, UTC Canada does see some signs of a duopoly forming between the ILECs and the cable companies in at least some segments of the residential and business, local telephone high-speed Internet markets. This duopoly would not benefit customers and other users of local services. We emphasized this point at the public hearing:

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 principle networks; one might argue even three, with the recent discussions between Bell and Rogers on their wireless activities used to provide high-speed broadband access to Canadians.

They clearly have a large head start over all other players and their revenues dwarf the rest of the industry. Great care will therefore have to be taken to ensure that they do not collude in an expressed or behavioural manner to either limit competition between themselves or by third parties.⁴

34. With that caveat in mind, we believe that it will be necessary for the Commission to look beyond the simple existence of a facilities-based competitor to the ILECs in order to properly assess whether the ILEC alone, or together with that facilities based-competitor, exercises dominance in a given market. In other words, the mere entry of a facilities-based competitor into a market should not, by itself, satisfy this element of the Bureau's test.

35. The second aspect of the Bureau's "Structured Rule of Reason Test" that raises concerns for UTC Canada members is the prospect that highly confidential costing information relating to our networks would have to be placed on the public record in order for the Commission to compare the variable costs of competing service providers. When asked to comment on this element of the test at the public hearing, UTC Canada indicated that it would be difficult to provide the Commission with this kind of information. Such costing information is confidential and is not typically provided in a public forum. We also expressed concerns about the kinds of variable cost components that would need to be included in this type of filing in order to ensure that the carrier filing the information would not be able to provide the Commission with a distorted view of its underlying costs.

36. Having considered the issue further, we believe that it would be possible to provide costing information to the Commission. That information would, however, have to be submitted to the Commission on a confidential basis and would also have to be provided in a structured manner to ensure that each company's variable cost components would be compared and contrasted in a fair and equitable manner.

37. UTC Canada thanks the CRTC for considering these reply submissions.

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⁴ Ibid. at paras. 4552 to 4554.