

Filed Electronically

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Ms. Diane Rhéaume
Secretary General
Canadian Radio-television and
Telecommunications Commission
1 Promenade du Portage
Les Terrasses de la Chaudière
Central Building
Gatineau, Québec
K1 A 0N2

Dear Ms. Rhéaume:

RE: Public Notice CRTC 2005-2, *Forbearance from regulation of local exchange services*, 28 April 2005 (the PN)

Introduction

1. Pursuant to paragraph 53 of the PN, this is the argument of Vonage Canada Corp. ("Vonage Canada").
2. Vonage Canada appreciates the opportunity to provide its views on the important issue of local forbearance to the Commission. Although Vonage Canada has not actively participated in earlier stages of this proceeding, it has audited the proceeding and record with great interest. As recognized by the Commission in Telecom Decision CRTC 2005-28, *Regulatory Framework for voice communication services using Internet Protocol*, 12 May 2005 (the VoIP Decision), the market for local services is one in which the ILECs continue to exercise substantial market power. Measures taken by the Commission to deregulate this market will have a profound effect on the ability of new entrants, including those employing new technologies such as VoIP, to deliver the benefits of competition to Canadian consumers. Accordingly, it is crucial that the Commission fully understand the implications for competition of the ILECs' proposals in this proceeding.
3. Vonage Canada believes in the power of market forces and in particular, the power of entrants and new technologies to bring innovation, lower prices and greater choice to

Canadians. These benefits, however, will only be realized in a workably or effectively competitive market-place and will be short-lived indeed if the Commission redefines its forbearance criteria in a way that prematurely lifts existing rate regulation and competitive safeguards. Vonage Canada wishes to address four specific issues in these brief submissions. These are:

- a. Market share and the criteria for forbearance – the Commission must ensure that competition is "sticky" and not transitory before the market can be forborne;
 - b. Barriers to entry faced by access-independent VoIP providers – despite the ILECs' touting of VoIP providers' low cost of entry, in order to succeed, VoIP providers must overcome the tremendous customer acquisition costs and economies of scale necessary in order to win, and keep, customers of the ILECs;
 - c. The concept of "transitional measures" being implemented prior to forbearance – these transitional measures risk as much, if not more, harm to competition than rate deregulation if implemented too early; and
 - d. The scope of forbearance – it is important that the Commission maintain all of the ILEC obligations not to discriminate in the provision of access to their network elements, including numbers and facilities necessary to meet 911 and other obligations.
4. Before addressing these substantive issues, however, Vonage Canada wishes to point out that two ILEC proposals clearly are outside the scope of this proceeding and should be rejected by the Commission out of a concern for basic procedural fairness.
 5. In the PN, the Commission makes it clear that the purpose of this proceeding is to further refine the framework for forbearance from the regulation of residential and business local exchange services – not, with the sole exception of the Aliant application, to consider forbearance of these services itself. In Bell Canada's initial comments, however, it has proposed that the Commission forbear from optional local services. This is outside of the scope of this proceeding and should not be considered by the Commission.

6. The PN also invites comments from interested parties regarding the possibility of the relaxation of certain specific competitive safeguards prior to forbearance. In this regard, the Commission requested comments on the elimination of the winback no-contact rule and the relaxation of certain restrictions on the ILECs' local wireline promotions. Yet, Bell has treated this proceeding as an opportunity to advance its deregulatory agenda by pressing for an additional so-called "transitional measure" – the de-averaging of rates within the same rate band. This is clearly out of the scope of the proceeding and likewise would not be appropriate for the Commission to address in its decision. Moreover, the Commission rejected this same proposal as recently as April of this year, in Telecom Decision CRTC 2005-27, *Review of price floor safeguards for retail tariffed services and related issues*, 29 April 2005. In that decision, the Commission observed that permitting an ILEC to discriminate unjustly among subscribers while at the same time targeting competitors entering the market would be counter-productive to the goal of promoting competition. For this reason, too, this out-of-process request should be rejected.

Market Share Matters: Competition must be "Sticky"

7. In the PN, the Commission repeated its oft-quoted ruling in Decision 94-19 that it considers that a market is not sufficiently competitive if a firm possesses substantial market power. The Commission stated:

Market power may be assessed by examining three factors: market shares, demand conditions that affect responses of customers to a change in price for a product or service, and supply conditions that affect the ability of competitors in the market to respond to a change in the price of a product or service. High market share is a necessary but not sufficient condition for market power; other factors must be present to enable a firm with market power to act anti-competitively.

8. The record of the proceeding is predictably flush with debate concerning the role of the ILECs' market share in the Commission's determination of whether an ILEC continues to possess market power, i.e., the threshold for forbearance. With upwards of 96 per cent of the residence market nationally at the end of 2004¹, the ILECs are predictably dismissive of the significance of market share in determining market power. These parties prefer to

¹ See Telecom Public Notice CRTC 2005-11, *Release of certain local market data*, 30 August 2005.

focus instead on other criteria identified by the Commission in Decision 94-19, such as the existence of barriers to entry (Bell claims there are none!), evidence of rivalrous behaviour, and other indications they say show that the market is already workably competitive.

9. Hedging their bets, the ILECs claim a 5% market share loss is sufficient to indicate a loss of market power. Vonage Canada is unaware of any other circumstance in which a former monopolist has succeeded in claiming that it has lost its significant market power after losing a mere 5% of its customer base. In the VoIP Decision released in May of this year, the Commission, relying heavily on market share, emphasized that the ILECs remained dominant with 98% of the local residential market, not including wireless services in the relevant market definition. In light of that ruling, the ILECs' position in this proceeding that they would no longer be dominant once their share of the relevant market, including wireless NAS, fell a further 3% (i.e., to below 95%), is absurd and untenable. Vonage Canada notes that Bell, in particular, is largely re-arguing the Commission's determinations in the VoIP Decision.
10. In Vonage Canada's submission, market share cannot be so easily separated from other criteria for determining an ILEC's market power. For example, when the ILEC retains such a high level of market share, the Commission can take no real comfort from other indicia that might suggest competition is rivalrous, even if that were the case. This is particularly so in the market for local telephone services, where there are not only significant barriers to entry from the perspective of supply conditions but also a history of an entrenched monopoly, ubiquitous network and customer inertia (see discussion below).
11. In these circumstances, the fact that competitors have captured 5% of the market – or even 20% of the market, for that matter – provides no assurance that competition is here to stay. Moreover, at such high levels of market share, ILECs clearly retain both the incentive and the ability to drive competition out of the market to maintain their virtual stranglehold on the market. The incentive is arguably even more powerful in a VoIP environment, where the ILEC may not only lose a customer for local exchange service, but also revenues it might have continued to earn from leasing a local loop to a circuit-

switched CLEC or providing service to a reseller. In this regard, Vonage Canada underscores that section 34(3) of the *Telecommunications Act* requires the Commission *not* make a determination to forbear "if the Commission finds as a question of fact that to refrain would be likely to impair unduly the establishment or continuance of a competitive market ..."

12. In order to conclude that the ILECs no longer wield substantial market power such that competition is sufficient to protect the interests of users, the Commission must be confident that competitors' market share gains are real, non transitory, and sustainable – in other words, that competition is sufficiently "sticky". As the Commission is well aware, despite more than 7 years of efforts, competition based on resold ILEC local loops has been neither "sticky", with multiple entrants having exited, nor effective at making a significant dent in the ILECs' former monopoly. While Vonage believes that customers will continue to be attracted to its feature-rich, innovative IP-based services, it is critical that the Commission resist the ILECs' urging to deregulate their services on the mere promise, or even modest early results, of this competition. Premature forbearance would cause significant damage to the competition just beginning to take root, carry a high risk of the requirement for re-regulation of the market and would send the wrong signals to the marketplace.

A Barrier-free World?

13. In an attempt to eliminate the Commission's consideration of barriers to entry from its forbearance equation, Bell Canada's asserts in its initial comments that there are no barriers to entry remaining in the market for local exchange services. This is not credible.
14. The ILECs love to paint a picture in which they retain no advantage in the world of access-independent VoIP services. Claiming in fact that they are disadvantaged (burdened as they are with their ubiquitous, high capacity networks) these ILECs trumpet the low cost of entry by access-independent VoIP providers. There is some truth to this, of course, as VoIP providers such as Vonage Canada are able to *enter* the market based on a relatively low capital expenditure for network facilities. But this characterization

tells only part of the story. In order to *succeed* in the market, far more is required than a modest investment in racks and routers.

15. The ILECs start not only with a ubiquitous network, but also all of the customers. Vonage and other access-independent VoIP providers start with neither.
16. Like other entrants, access-independent VoIP providers must build their business one customer at a time. In order to do so, they must overcome numerous hurdles. While Vonage Canada is confident that on a level playing field it will be able to clear these hurdles, they nonetheless represent real barriers to entry that cannot simply be wished away when assessing the ILECs' market power.
17. The first of these barriers to entry is customer inertia. The Commission recognized this barrier in the VoIP Decision. In order to succeed as a VoIP provider, Vonage must be able to win away a customer's local business. Local service is *the* primary connection Canadians maintain with each other, with emergency services and indeed with the world. Vonage has to earn the trust of Canadians one at a time, and must do it despite the efforts of the ILECs to exploit their historic monopoly position – witness Bell Canada's advertising campaign celebrating its 125th anniversary, punctuated with slogans such as "Trust isn't something you build in months."
18. The second of these barriers is customer acquisition costs. Although access independent VoIP providers' customer acquisition costs do not match those of entrants who must pay service charges associated with the rental of the local loop, there are nonetheless substantial, sunk costs of building a customer base, including the significant cost of building brand awareness and trust to compete with some of the strongest and best-established brands in the country. VoIP entrants like Vonage Canada cannot take advantage of the same marketing opportunities available to the ILECs and cable companies, of inexpensively emailing or writing to their significant established customer bases, which cover hundreds of thousands, if not millions of customers. The risk and reward profile could not be more divergent between an ILEC, which has a low cost of marketing in order to stem any loss of its entrenched customer base, and an independent VoIP provider, which must spend heavily for the opportunity to provide Canadians with innovative services, choice and lower prices and must then struggle to keep the customer

long enough to demonstrate its service and services, and to thereby avoid expensive churn.

19. The third of these significant barriers is resisting or surviving the churn generated by the ILECs' own conduct in the market. Unconstrained by, or in violation of, regulatory rules, the ILECs have proven their ability to stem market share loss: it is called winback. This strategy permits the ILEC to focus virtually all of its marketing efforts on those customers who (a) are thinking about leaving; (b) have decided to leave; or (c) have in fact left. The churn statistics and other data on the basis of which the Commission has repeatedly restated and modified the winback no-contact rules (the Winback Rules) prove that this is a successful strategy in the hands of an ILEC. This behaviour represents a significant barrier to entry to be overcome by an entrant, regardless of the entry strategy chosen. This is why the ILECs' proposal that the Winback Rules be eliminated as a so-called "transitional measure" on the road towards forbearance is so contrary to the public interest.

20. In addition to the barriers to entry described above, there is an obvious limitation in terms of the addressable market for VoIP services that affects the demand conditions in the market. In order to subscribe for VoIP service, a customer must have, or be willing to purchase, broadband access. Although Canada enjoys comparatively high penetration levels of broadband service, the market is still roughly half the size of the overall market for local exchange services. Furthermore, the market for access-independent VoIP services is being suppressed artificially by the unavailability of, and lack of customer awareness regarding, the opportunity for customers to truly "cut the cord" with their local service provider by cancelling their PES altogether and obtaining DSL Internet access from the ILEC on a stand-alone, "naked DSL", basis. Indeed, to Vonage Canada's knowledge, currently Bell is the only ILEC offering this service, and needless to say, it is not promoting it. Greater access to broadband facilities, and improved information regarding these options, are necessary if Canadians are to reap the maximum benefits of the innovative services, choice and low prices offered by independent VoIP providers.

Not "Transitional" Measures at All

21. In the PN, the Commission invites views on whether there should be a transitional regime that provides ILECs with more regulatory flexibility prior to forbearance. In this regard, the Commission specifically asks under what circumstances should it lessen or remove the existing competitive safeguards for promotions and the no-contact restriction under the winback rules.
22. In Vonage Canada's submission, given the specific nature of the barriers to entry identified in this argument, such as customer inertia, customer acquisition costs and the ILECs' ability to pre-empt competition by targeting customers which are considering leaving, have announced an intention to leave, or have in fact left, the so-called "transitional regime" is likely to impede, rather than accelerate the end-game, which should be that market forces are able to replace regulation in its entirety. In other words, permitting the ILECs to engage in conduct such as targeted win-back contacts and promotions, just when there is finally entry and the promise of greater innovation and choice, is counter-intuitive and potentially counter-productive.
23. With respect to the Winback Rules specifically, Vonage notes that the Commission reaffirmed the necessity of maintaining these rules and extending their application to VoIP services in the VoIP Decision, where it cited the high cost of customer churn and the need for entrants to prove their services to customers.
24. If there is insufficient competition to protect the interests of users, then the market will not benefit from freeing the ILECs to engage in strategies likely to impede the establishment of a viable, competitive market, by winning away customers before they have had a chance to become comfortable with competitors' services.

Scope of Forbearance

25. One of the many strengths of Vonage Canada's business model is that it does not rely on the extensive leasing of network components from the ILECs or any other parties. This does not mean, however, that Vonage Canada and other access-independent VoIP providers do not depend on certain critical inputs from ILECs in order to provide service to Canadian consumers.

26. Most significant among the requirements of VoIP providers are of course access to telephone numbers and access to ILEC 911 trunks and information for the provision of emergency services. Having identified emergency services as a high priority, the Commission itself has indicated a strong inclination to require the unbundling of the relevant facilities of the ILECs, in Telecom Decision CRTC 2005-21, *Emergency service obligations for local VoIP service providers*, 4 April 2005. VoIP providers, including Vonage Canada, continue to work to offer Canadian customers the most reliable, state-of-the-art access to emergency services possible. Any local forbearance regime must preserve critical regulation meant to ensure that all providers can compete on an even playing field, by providing them with access to these true "bottleneck" facilities and services.

Conclusion

27. Vonage Canada believes VoIP services can deliver greater choice, innovation and lower prices to Canadian consumers and thus increase the role that market forces, as opposed to regulation, can play in Canada's communications industry. VoIP services are not a "silver bullet" or panacea to the ILECs' market power, however, and the Commission must be diligent to ensure that its local forbearance framework does not permit premature deregulation of the ILECs' local services that will threaten the gains finally being made by entrants. When the market is ready for forbearance, the Commission should forbear; until then it must retain its regulatory oversight of the ILECs' local services and maintain critical competitive safeguards that prevent the ILECs from pre-empting budding competition in the market.

We appreciate this opportunity to submit our views and wish the Commission good luck in its deliberations.

Yours very truly,


C. William (Bill) Rainey
President
Vonage Canada

c. List of Interested Parties, PN 2005-2

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