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Working Group on the Interaction between Trade and Competition Policy

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COMMUNICATION FROM CANADA

The following communication, dated 14 June 2000, has been received from the Permanent Mission of Canada with the request that it be circulated to Members.

The Significance of Competition Policy Advocacy

In response to the "Note by the Chairman" of 31 March 2000, the Canadian government agrees that it is important for the Working Group on the Interaction between Trade and Competition Policy (WGTCP) to focus on concrete examples which help clarify both the costs and benefits of implementing competition policies, notably for developing countries. In our view, such an approach is a constructive application of the WGTCP's mandate which should contribute both to its work on cooperation and communication as well as to its trade objectives.

In this light, the Canadian delegation is submitting to the WGTCP's meeting of 15-16 June 2000 the attached paper on "Competition Policy Advocacy and Regulatory Reform in the Canadian Telecommunications Industry". The intent of this paper is to respond to the Chair's suggestion with respect to contributing to the creation and maintenance of a culture of competition by sharing with the Members of the WGTCP the fruits of our practical experience with respect to competition policy advocacy, using the example of the work carried out in our telecommunications sector. At the same time, the paper makes clear that competition policy advocacy has an important role to play in market reform, deregulation and privatization processes and hence market access, thus contributing to the WTO's ultimate goal of increasing international trade.

At first glance, the advocacy role of a competition authority might seem somewhat of a luxury, especially for a fledgling regime which faces numerous competing priorities in implementing competition disciplines. However, as should become apparent from our paper, competition policy advocacy has the potential for a much broader impact upon general economic development. This point becomes more obvious when considering the impact of regulation on economic development. While regulation of course has an important and legitimate function in government policy, it must be recognized that it has its costs, both direct ones such as those linked to administration or compliance, but also the indirect costs attributable to distortions in the marketplace. Competition policy advocacy serves to highlight and clarify these costs to regulators, thereby encouraging a fuller evaluation of both the costs and benefits of regulation. Similarly, once the decision has been made to de-regulate or privatize a sector, competition policy advocacy can contribute to managing the difficult transition phase from full regulation to open

competition. Finally, competition policy advocacy can also be used to inform policy development more generally.

Such activities naturally come at a cost to a competition authority, which must divert resources from its direct enforcement of competition priorities to the more indirect goal of encouraging a competition culture more generally. Nonetheless, it has been the experience of the Canadian Competition Bureau that such an investment bears fruit in the long term by reducing the challenges to competition which it might otherwise face, for example from de-regulation which results in market foreclosure by a dominant privatized entity. This, in turn, has important implications for economic development. Indeed, it is Canada's conclusion that the advocacy role of a competition authority is absolutely essential and should thus be adequately resourced and grounded in statutory authority.

The Canadian delegation trusts that this example will prove instructive to the WGTCP, and remains prepared to respond to any specific inquiries concerning our experience with competition policy advocacy which Working Group Members may have.

Competition Policy Advocacy and Regulatory Reform in the Canadian Telecommunications Industry

I. INTRODUCTION

Over the past decade one of the most notable changes in Canada is the changing competitive landscape in the telecommunications industry. The rapid pace of technological change in how we communicate (e.g., wireless telephones), the advances in engineering such as digital, signal compression and sophisticated new switching equipment are lowering the cost of providing services and opening the gates to new competition.

This paper sets out the Canadian experience regarding the evolution in thinking and approach to regulation in the telecommunications sector. Interventions by the Commissioner of Competition ("the Commissioner"; previously the Director of Investigation and Research ("the Director")), and the decisions of the Canadian Radio-television and Telecommunications Commission ("CRTC") have played a pivotal role in this regulatory reform process, and in turn, dramatically changed the competitive structure of the Canadian telecommunications industry.

The paper is organized as follows: (1) advocacy provisions of Canada's *Competition Act* (the "Act"); (2) a description of the regulated conduct defence and the statutory provisions of the *Telecommunications Act* dealing with forbearance; (3) the relationship between regulation and competition; (4) regulatory interventions of the Competition Bureau in the telecommunications sector; and (5) the Bureau's policy development activities related to telecommunications. The concluding section will offer some lessons learned by the Bureau in its advocacy work in the telecommunications sector.

II. THE ADVOCACY PROVISIONS OF THE *COMPETITION ACT*[1]

The Competition Bureau has a long history of advocating pro-competitive solutions before regulatory bodies and commissions. Sections 125 and 126 of the *Competition Act* provide the

[1] THE *COMPETITION ACT* CAN BE ACCESSED AT HTTP://STRATEGIS.IC.GC.CA/SSG/CT01250E.HTML

Commissioner with independent authority to advocate competition before federal, and upon agreement, provincial regulatory agencies that make decisions that affect competition in particular markets. Section 125 of the Act enables the Commissioner to make representations in respect of competition before any federal board, commission or other tribunal where such representations are relevant to the matters under consideration and the factors that can be taken into consideration by the board, commission or other tribunal in making its decision. Section 126 allows the Commissioner to make representations to provincial boards, commissions or tribunals, with the consent of the relevant body. Annex A (see attached) provides detail on the interventions made by the Competition Bureau over the past quarter century.

III. THE RELATIONSHIP BETWEEN COMPETITION AND ECONOMIC REGULATION

In many circumstances, market forces may produce outcomes that are neither economically efficient nor satisfy certain social policy objectives. In these situations a call is often made for some form of regulation to correct the problem. However, it must be recognized that regulation itself has costs: these include both direct costs such as administration and compliance costs as well as indirect costs such as those caused by the distortions that regulation may produce in the marketplace. It is the existence of these costs that invalidates the assertion that market failure alone is sufficient to justify the introduction of regulation. It must also be shown that regulation, with all of its own inherent costs, can improve upon the market outcome. Of course, whether regulation can do this or not often depends on the type of regulation that is being considered.

Experience in the telecommunications sector has shown that rate of return regulation [2] was not effective in promoting economic efficiency because of the disincentives it created for firms to reduce cost and innovate. These distortions were particularly damaging in a dynamic sense because at best they slowed the rate of innovation and the introduction of new technologies, and at worst, they prevented new technologies or innovations from emerging. Consequently, consumers may have been late in receiving the benefits of products whose introduction were delayed from the market and denied the benefits of products that never appeared. It is largely due to these problems that Canada has moved to a system of price cap regulation in recent years.

In addition to the past experience of using rate of return regulation to promote economic efficiency, the costs of using regulation in general to promote social policy goals, such as affordable

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[2] **COST OF SERVICE REGULATION (COS) COMPENSATES THE FIRM FOR COSTS INCURRED PLUS A REASONABLE RATE OF RETURN ON ITS INVESTMENT. THE APPROACH UNDER COS REGULATION IS TO STRIKE A BALANCE BETWEEN THE INTERESTS OF FIRMS AND CONSUMERS BY SETTING PRICES EQUAL TO AVERAGE COST. IMPLEMENTATION PROBLEMS IN DETERMINING COSTS CAN RESULT WHEN SERVICE REQUIRES THE FIRM TO MAKE INVESTMENTS IN DURABLE ASSETS, SUCH AS PLANT AND EQUIPMENT. THE ROOT OF THIS PROBLEM IS THE NEED TO DETERMINE CAPITAL COSTS. THE EMPHASIS ON THE RETURN TO INVESTORS MEANS THAT AN IMPORTANT ASPECT OF COS REGULATION WILL BE AN ALLOWANCE FOR - AND CONTROL OF - THE RATE OF RETURN. EMBEDDED IN COS REGULATION WILL BE REGULATION OF THE FIRM'S RATE OF RETURN. RATE OF RETURN REGULATION ALLOWS FOR A CEILING ON THE RETURN TO INVESTMENT FOR A REGULATED FIRM IN THE PROVISION OF A SERVICE. RATE OF RETURN IS USUALLY DEFINED AS NET PROFIT AFTER DEPRECIATION AS A PERCENTAGE OF AVERAGE CAPITAL EMPLOYED IN A BUSINESS. THE RATE OF RETURN MAY BE CALCULATED USING PROFIT BEFORE OR AFTER TAX, AND THERE ARE A NUMBER OF OTHER VARIATIONS OF THE CONCEPT. PROFIT MAY BE DEFINED AS NET OF TAX BUT NOT OF DEPRECIATION AND INTEREST; I.E., PROFITS AVAILABLE FOR EQUITY SHAREHOLDERS OR AS OPERATING PROFIT, I.E., TO EXCLUDE INVESTMENT INCOME AND CAPITAL GAINS. COS REGULATION HAS BEEN CRITICIZED FOR PROVIDING INADEQUATE INCENTIVE FOR COST EFFICIENCY, THE INTRODUCTION OF NEW PRODUCTS AND SERVICES AND AN ONEROUS REGULATORY BURDEN. FOR A FULLER ELABORATION OF THIS ISSUE, PLEASE SEE JEFFREY CHURCH AND ROGER WARE, *INDUSTRIAL ORGANIZATION: A STRATEGIC APPROACH*, TORONTO: MCGRAW-HILL, 2000, P. 829-887.**

universal telephone service, have recently become ever more apparent. The pursuance of this and other like-minded objectives has resulted in the misalignment of relative prices for various services which in turn has imposed costs in terms of pricing inflexibility and delays in the introduction of new products and services. Moreover, arguably these social policy objectives have largely been achieved, yet it has proven very difficult to realign prices to reflect underlying costs which is crucial for setting the proper environment for effective future competition.

From time to time, due to advances in technology and economic thinking, it comes to be recognized that certain regulated services can be and should be competitively supplied. At these critical junctures policymakers face the difficult issue of how to manage the transition phase from full regulation to open competition. Often, the incumbent is perceived as having many advantages over new entrants stemming from its past experience, financial resources and control over network elements, access to which is essential for the survival of competitors. While it is often necessary to implement some regulatory measures in order to "level the playing field", regulators need to be aware that this type of asymmetrical regulation has potential costs. Namely, it may unduly deny incumbent firms the pricing flexibility they need in order to respond to the competitive pressures they now face in the market.

The process of deregulation is very important in an industry like telecommunications which is characterized by rapid technological change and where the boundaries between telecommunications, computing and television distribution are disappearing. In this environment, the costs to the overall economy become even greater when the regulatory scheme is out of step with technological advancements.

The debate with respect to the relationship between competition authorities and the regulator in the telecommunications sector is intensified by convergence. Broadcasting and telecommunications worlds are penetrating each others markets because of the major impact of digital technology and the increasingly wide array of new products and services it brings. This means that as convergence evolves, competition authorities and the regulators are increasingly forced to navigate their way through highly complex issues in order to come to grips with the issue "if competition, then how much and how soon". Ultimately, how competition authorities and regulators work out compromises with each other will determine the shape of the telecommunications sector and thereby the extent to which users will benefit from a modern telecommunications system, and by extension, therefore, the consequent impact on economic growth and adaptability of the economy.

IV. REGULATED CONDUCT DEFENCE (RCD)[3]

In a number of competition regimes, firms which engage in practices which may be considered anti-competitive have sought protection in the courts by advancing a legal "regulated conduct" doctrine. The regulated conduct defence (RCD) applies when a specific activity is authorized or carried out in keeping with valid regulation; such activity is deemed to be in the public interest and cannot be found to be in violation of the *Competition Act*. This defence applies as long as the regulator has exercised its authority and has not been frustrated in its operations by the conduct or activity in question.[4]

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[3] THE FOLLOWING IS BASED ON ROBERT D. ANDERSON, ABRAHAM HOLLANDER AND JOSEPH MONTEIRO, "REGULATORY REFORM AND THE EXPANDING ROLE OF COMPETITION POLICY IN THE CANADIAN ECONOMY, 1986-1996", *REVIEW OF INDUSTRIAL ORGANIZATION*, VOLUME 12, NOS.1-2, APRIL 1998, PP. 177-204; GERALD ROBERTSON, W. T. STANBURY, GERNOT KOFLER AND JOSEPH MONTEIRO", COMPETITION POLICY, TRADE LIBERALIZATION AND AGRICULTURE", A PAPER PREPARED FOR THE THIRD AGRICULTURAL AND FOOD POLICY SYSTEMS INFORMATION WORKSHOP, TUCSON, ARIZONA, 1997; AND ALAN GUNDERSON, JOSEPH MONTEIRO AND GERALD C. ROBERTSON, "COMPETITION BUREAU ADVOCACY IN THE CANADIAN TELECOMS SECTOR", *GLOBAL COMPETITION REVIEW*, JUNE/JULY 1999, P 20-268.

[4] THE MERE FACT THAT GOVERNMENT REGULATION EXISTS IN A GIVEN SECTOR DOES NOT IN ITSELF PRECLUDE THE APPLICATION OF THE *COMPETITION ACT*. FURTHERMORE, WHETHER OR NOT SUCH A DEFENCE

MAY BE APPLICABLE DEPENDS UPON A CAREFUL EXAMINATION OF THE NATURE OF REGULATION AND THE FACTS OF THE PARTICULAR CASE UNDER REVIEW. THE COMMISSIONER OF COMPETITION HAS IDENTIFIED FOUR ELEMENTS NECESSARY FOR THE DEFENCE TO BE CONSIDERED: THE RELEVANT PROVINCIAL BOARD OR FEDERAL LEGISLATION MUST BE VALIDLY ENACTED; THE ACTIVITIES MUST BOTH FALL WITHIN THE SCOPE OF THE RELEVANT LEGISLATION, BUT ALSO BE SPECIFICALLY AUTHORIZED; THE AUTHORITY OF THE REGULATORY BODY MUST HAVE BEEN EXERCISED; AND FINALLY, THE ACTIVITY OR CONDUCT IN QUESTION CANNOT HAVE FRUSTRATED THE EXERCISE OF AUTHORITY BY THE REGULATORY BODY. THE RCD WAS PRIMARILY DEVELOPED IN THE CONTEXT OF THE CRIMINAL LAW PROVISIONS. THE APPLICABILITY IN THE CONTEXT OF THE NON-CRIMINAL PROVISIONS OF THE *ACT* IS LESS CLEAR. IT HAS BEEN SUGGESTED THAT THE CIVIL PROVISIONS MAY BE CONCURRENTLY APPLICABLE TO PARTICULAR CONDUCT, ALONG WITH RELEVANT REGULATORY STATUTES.

Forbearance[5]

A related concept to the RCD is regulatory forbearance, which is of significance to the work of the Competition Bureau in the telecommunications sector. Regulatory forbearance may be generally defined as a practice of reducing or possibly eliminating rules or practices imposed on an industry. In this particular circumstance, the regulator explicitly withdraws from regulation of a specific activity, normally pursuant to specific legislative provisions that permits it to do so, and based on a determination on the regulator's part that such action serves best the purposes of the relevant legislation.[6] The regulator may determine that market forces and outcomes serve the purposes of the relevant legislation as well if not better than regulation. By forbearing, the regulator does not abdicate or transfer his responsibilities but merely refrains from certain forms of market intervention. If this decision turns out to be incorrect, the *status quo ante* can be restored. As a result, forbearance may be conditional or unconditional, further, it may apply to some sellers in a market or to all of them.[7]

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[5] THE FOLLOWING IS BASED ON GUNDERSON, MONTEIRO AND ROBERTSON, *SUPRA*, NOTE 3.

[6] SEE RICHARD J. SCHULTZ AND HUDSON JANISCH, *FREEDOM TO COMPETE: REFORMING THE TELECOMMUNICATIONS REGULATORY SYSTEM*, (BELL CANADA CORPORATE AFFAIRS, MARCH 1993).

[7] THE *TELECOMMUNICATIONS ACT (TELECOMMUNICATIONS ACT*, S.C. 1993) MAKES A DISTINCTION BETWEEN THE TWO CONDITIONS UNDER WHICH THE CANADIAN RADIO-TELEVISION AND TELECOMMUNICATIONS COMMISSION (CRTC) MAY FORBEAR, AND WHERE FORBEARANCE IS MANDATORY. UNDER SECTION 34(1) OF THE *TELECOMMUNICATIONS ACT*,

> "THE COMMISSION *MAY* MAKE A DETERMINATION TO REFRAIN, IN WHOLE OR IN PART AND CONDITIONALLY OR UNCONDITIONALLY, FROM THE EXERCISE OF ANY POWER OR THE PERFORMANCE OF ANY DUTY UNDER SECTIONS 24 (CONDITIONS OF SERVICE), 25 (RATE APPROVALS), 27 (JUST AND REASONABLE RATES), 29 (APPROVAL OF WORKING AGREEMENTS ON INTERCONNECTION) AND 31(LIMITATIONS ON LIABILITY) IN RELATION TO A TELECOMMUNICATIONS SERVICE OR CLASS OF SERVICES PROVIDED BY A CANADIAN CARRIER, WHERE THE COMMISSION FINDS AS A QUESTION OF FACT THAT TO REFRAIN WOULD BE CONSISTENT WITH THE CANADIAN TELECOMMUNICATIONS POLICY OBJECTIVES."

UNDER SECTION 34(2), BY CONTRAST, FORBEARANCE IS MANDATORY WHEN THE

> "COMMISSION FINDS AS A QUESTION OF FACT THAT A TELECOMMUNICATIONS SERVICE OR CLASS OF SERVICES PROVIDED BY A CANADIAN CARRIER IS OR WILL BE SUBJECT TO COMPETITION SUFFICIENT TO PROTECT THE INTERESTS OF USERS, THE COMMISSION *SHALL* MAKE A DETERMINATION TO REFRAIN, TO THE EXTENT THAT IT CONSIDERS APPROPRIATE, CONDITIONALLY OR UNCONDITIONALLY, FROM THE EXERCISE OF ANY POWER OR THE PERFORMANCE OF ANY DUTY UNDER SECTIONS 24, 25, 27, 29 AND 31 IN RELATION TO THE SERVICE OR CLASS OF SERVICES."

HOWEVER, SECTION 34(3) HAS A CONSTRAINING EFFECT ON THE REGULATOR WHEREBY

> "THE COMMISSION SHALL NOT MAKE A DETERMINATION TO REFRAIN UNDER THIS SECTION IN RELATION TO A TELECOMMUNICATIONS SERVICE OR CLASS OF SERVICES 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 FOR THAT SERVICE OR CLASS OF SERVICES."

THE ISSUE OF WHETHER A DECISION TO FORBEAR, IN WHOLE OR IN PART, IS SUFFICIENT TO ELIMINATE THE AVAILABILITY OF THE RCD HAS NOT BEEN RESOLVED. THERE IS SUPPORT IN SOME QUARTERS FOR THIS INTERPRETATION (I.E., THAT THE ACT DOES APPLY), HUNTER *ET AL* ARGUE THAT THERE MAY BE SOME UNCERTAINTY PARTICULARLY IN CASES OF PARTIAL RATHER THAN TOTAL FORBEARANCE FROM REGULATION OF PARTICULAR ACTIVITIES. (PLEASE SEE LAWSON A.W. HUNTER *ET AL*, *ALL WE ARE SAYING, IS GIVE COMPETITION A CHANCE – THE ROLE OF COMPETITION IN INDUSTRIES IN TRANSITION FROM REGULATION TO COMPETITION* (PAPER PRESENTED AT A ROUNDTABLE ON THE COMPETITION ACT, TEN YEARS ON: A STOCKTAKING, UNIVERSITY OF TORONTO FACULTY OF LAW, DECEMBER 8, 1995). FURTHERMORE, THE CRTC

V. COMPETITION BUREAU INTERVENTIONS IN THE TELECOMMUNICATIONS AND BROADCASTING SECTORS

The promotion of competition in the Canadian telecommunications markets has been a priority of the Competition Bureau for more than a quarter of a century. Real momentum on this front began with liberalization in the terminal attachment market, moving forward to long distance competition and now competition in local telecommunications services.

The following section discusses some of the more significant interventions of the Competition Bureau in the 1990's which have facilitated an opening up of telecommunications markets to competition. Between 1991 and 1999 the Competition Bureau made 31 interventions in the telecommunications and broadcasting sectors. The issues raised have ranged from competition in the long distance telephone market, pay telephones, private business lines, the policy framework for telecommunications markets to competition, and the highly complex and important issue of opening local telecommunications markets moving to competition, including network interconnection, unbundling of essential facilities and services and rebalancing and restructuring local rates. Throughout these interventions the Bureau has advocated that certain fundamental principles should govern the regulatory framework for the development of competition in communications services. In summary, these principles are:

- maximize the reliance on competition and market forces at the outset;
- as a corollary to the first, minimize regulation for incumbents and avoid imposing economic regulation on the new entrants;
- adopt market-based pricing as soon as possible in local telecommunications and, if necessary, introduce specific, targeted mechanisms to address social policy objectives;
- establish clear rules governing incumbents' obligations to provide access to their networks by competitors and adopt appropriate pricing principles to induce efficient competition;
- establish timely and effective dispute resolution mechanisms to ensure incumbents do not attempt to delay access to their networks; and
- liberalize foreign ownership rules for communications networks to assist in the rapid construction and development of communications networks.

1. Long Distance Competition (CRTC 92-12)[8]

In June 1992, the Commissioner intervened before the CRTC regarding the issues of competition in the long-distance market, as well as alternative types of interconnection, the basis for rates to be paid

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RETAINS THE AUTHORITY TO REVIEW, RESCIND OR VARY ITS FORBEARANCE ORDERS, THEREBY RAISING THE POSSIBILITY OF RE-REGULATION. EXPERIENCE WITH THIS CONCEPT AND JURISPRUDENCE ON THE MATTER WILL PROVIDE ESSENTIAL INSIGHTS ON HOW THE RCD APPLIES TO SUCH SITUATIONS.

[8] THE CANADIAN RADIO-TELEVISION AND TELECOMMUNICATIONS COMMISSION, TELECOM DECISION 92-12, OTTAWA: JUNE 12, 1994. THE COMMISSION'S DECISION ALSO LIBERALIZED PREVIOUSLY ESTABLISHED RULES GOVERNING RESALE AND SHARING OF PRIVATE LINES, EXTENDING THEM THROUGHOUT ALL CANADA, AND ALSO PERMITTING THE RESALE OF WIDE AREA TELEPHONE SERVICE. PLEASE SEE MACROBUTTON HTMLRESANCHOR HTTP://WWW.CRTC.GC.CA FOR A FULL LISTING OF CRTC PUBLIC NOTICES, DECISIONS, AND PRESS RELEASES.

for interconnection and their relationship to costs, existing tariffs, productivity, and quality of interconnection.

The principal theme of the Commissioner's intervention was that competition was feasible and in the public interest, and that an open entry model establishing interconnection would create competition where members of Telecom Canada currently enjoyed a monopoly position. The Commissioner's submission argued that "a single integrated monopoly provider had failed to respond fully to the diverse needs of its customers", and that competition would expand consumer choice, stimulate productivity gains, and enhance network efficiencies without necessarily jeopardizing the affordability of local telephone services.

The CRTC's report took note of the Commissioner's views concluding that "competition (in the long distance telecommunications market) will result in greater choice, supplier responsiveness and services diversity, particularly in the business sector and on high density routes ... (and that competition) not only can be expected to increase pressure to reduce rates, but increase choice and supplier packages tailored to address the specific needs and application of a greater variety of user groups".

2. Long-Distance Forbearance

In November 1996, the Commissioner intervened in a proceeding established by the CRTC to determine if the market for long distance telephone services was sufficiently competitive to warrant forbearance from regulation by the CRTC of the services provided by dominant carriers. The Competition Bureau's submission argued that the market for long distance services was sufficiently competitive to warrant broad forbearance of these services. With the exception of ensuring that access to transmission capacity be made available for resale and sharing for a period of two or more years, the Bureau advocated full deregulation of long distance services.

In its analysis, the CRTC adopted the concept of market power [9] as the standard by which to determine whether a market is, or is likely to become, workably competitive. The Commission found that "a determination to forbear from regulation of the services provided by the Stentor companies [10] ... would, under subsection 34(1) of the *Telecommunications Act*, be consistent with the Canadian telecommunications policy objectives, including section 7(c) of the Act - to enhance the efficiency and competitiveness of Canadian telecommunications, and section 7(f) of the Act - to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective". In addition, the Commission expressed the view that it would be appropriate under subsection 34(2) of the *Telecommunications Act* to forbear as it found that the toll and toll free markets were subject to a level of competition sufficient to protect the interests of users of toll and toll free services, and that "to forbear would not impair unduly the establishment or continuance of a competitive market for toll or toll free services". The Commission did find "that the retention of a ceiling on basic toll rates would be appropriate .. (as this) ... would preclude the Stentor companies from generating increased revenues from the basic toll sector of the toll market which could be used to finance

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[9] THE COMMISSION CITED AS AN ACCEPTED DEFINITION OF MARKET POWER THE ABILITY OF A FIRM TO IMPOSE UNILATERALLY AND PROFITABLY A SIGNIFICANT, NON-TRANSITORY PRICE INCREASE WITHIN THE RELEVANT MARKET. IN ASSESSING WHETHER CARRIERS POSSESS MARKET POWER, THE COMMISSION CONSIDERED A NUMBER OF FACTORS: (I) MARKET SHARES OF THE DOMINANT AND COMPETING FIRMS; (II) DEMAND CONDITIONS; (III) SUPPLY CONDITIONS; AND (IV) EVIDENCE OF RIVALROUS BEHAVIOUR.

[10] AGT LIMITED, NOW TELUS COMMUNICATIONS INC. (TCI), BC TEL, BELL CANADA (BELL), THE ISLAND TELEPHONE COMPANY LIMITED (ISLAND TEL), MANITOBA TELEPHONE SYSTEM, NOW MTS NETCOM INC. (MTS), MARITIME TEL & TEL LIMITED (MT&T), THE NEW BRUNSWICK TELEPHONE COMPANY, LIMITED (NBTEL) AND NEWFOUNDLAND TELEPHONE COMPANY LIMITED, NOW NEW TEL COMMUNICATIONS INC. (NEW TEL) (COLLECTIVELY, THE STENTOR COMPANIES, I.E., INCUMBENT LOCAL EXCHANGE CARRIERS (ILECS)).

below cost pricing in areas of the market which are highly competitive. The retention of a ceiling would also provide consumers in the less competitive non-equal access areas with an additional safeguard against unjust or unreasonable rate increases in a de-tariffed environment". In an effort to ensure that basic long distance rates continued to be "just and reasonable", the Commission placed a ceiling on the telephone companies' overall rates for basic long distance service for the next four years. In addition, it required telephone companies to provide reasonable advance notice to subscribers of any price increases to basic long distance rates, and to publish those rates.

3. Local Competition and Interconnection and Unbundling (Open Entry Model)

(a) Rate Rebalancing

In 1992 the CRTC launched a review of its approach to the regulation of telephone companies that provide telephone service in order to ensure that "the manner in which it regulates is efficient, effective and in the public interest".[11] At the time, the CRTC noted that "technological change and increasing competition (had) significantly altered the nature of the telecommunications industry (and that) changes had allowed the telephone companies under its jurisdiction that provide local exchange service to develop a wide range of new audio, video and high-speed data services to satisfy the demands of both business and residence consumers in the local and long distance markets". However, despite the fact that the aggregate effect of previous CRTC decisions had allowed more competition in a number of market segments, the telephone companies continued "to maintain effective control of the provision of network access and local services and to dominate the public long distance market".

The Commission sought proposals dealing with *inter alia* the most appropriate form of monopoly regulation, alternatives to traditional rate base rate of return regulation, and incentives for telephone companies to be innovative.

In his submission, the Commissioner stressed that: (1) pricing based on costs is necessary in order to improve economic efficiency, deter uneconomic entry, send proper investment signals and ensure that competition in local markets is not precluded by below-cost pricing; (2) a pricing system that subsidizes users regardless of need is inefficient; and (3) rate restructuring is unlikely to significantly affect the goal of universality, given the extremely low percentage of household income spent on local telephone service, relative to the value derived, and the offsetting effects of lower long distance rates on subscribers' monthly bills.

The Commissioner also stated that the CRTC should forbear from regulation as soon as possible in markets that are workably competitive. Further, if there is some question as to the degree of sufficiency of competitive forces in a particular market, the Commission should err on the side of forbearance, i.e., it should cease regulating and allow competition to unfold. The Commissioner also noted that section 34 of the *Telecommunications Act* requires the Commission to forbear not only when it finds that a market is workably competitive, but also when it finds that a market will likely become competitive in the future. The Commissioner also submitted that public policy should not concern itself with market power *per se*, but rather with the abuse of market power.

In its decision[12], the Commission concluded that the subsidy from long distance to local service "is substantially larger than necessary to maintain affordable access to telecommunications and imposes an inequitable and unnecessary burden on many long distance users". In its view, "meaningful regulatory reform (could not be) undertaken without a significant reduction in the subsidy that users of long distance services are currently providing in order to keep rates for local/access service low". The Commission

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[11] **TELECOM PUBLIC NOTICE CRTC 92-78 (PUBLIC NOTICE 92-78).**

[12] **CRTC TELECOM DECISION 1994-19.**

observed that "the objective under the (*Telecommunications*) Act of affordable telecommunications applies to long distance services, as well as local services, and is of the view that maintaining contribution and toll rates at higher levels than necessary would be inconsistent with the achievement of that objective". The Commission stated that while productivity improvements and revenues from new optional services would help to reduce the local/access shortfall, these factors alone would not be sufficient to bring the subsidy down to a more appropriate level.

The CRTC expressed concern that while penetration is the most reliable indicator of affordability, many low-income subscribers, particularly the majority who do not make substantial use of long distance service, will have less disposable income after rate rebalancing. As a result, the CRTC constrained the increase on the local side to a specific dollar amount and required that rate rebalancing be implemented over a transitional period to further mitigate the impact on subscribers. [13]

(b) Interconnection and Unbundling

In April 1996, the CRTC initiated proceedings to establish the necessary frameworks for co-location, local number portability, unbundling and interconnection. [14] The purpose of the proceedings was to give effect to the conclusions reached by the Commission in Decision 94-19 that increased local competition is in the public interest.

In his submission, the Commissioner argued that the objective of interconnection and unbundling must be the maximization of the benefits to the public that flow from competition. The Commissioner submitted that the sharing of the costs of facilities between two interconnecting networks provides an incentive to cooperate in minimizing the costs of joint interconnection.

In its decision, the Commission set out the framework for facilitating entry of new providers into the residential and business local service market. The thrust of the Commission's decision was to create conditions for robust and genuine competition, thereby encouraging industry to offer new services which will better respond to the needs of consumers.

The key features of the decision were that: (1) telephone companies were required to unbundle essential components of their local networks so that new entrants can have access to these components at reasonable rates; (2) all local telephone companies were mandated to provide interconnection with one another to ensure efficient interconnection for all consumers; (3) dominant telephone companies were to be regulated through price caps effective 1 January 1998, for an initial period of four years; consumer rates charged by the new entrants were not to be regulated; (4) limits were placed on the role of resale in order to encourage facilities-based competition; and (5) cable companies were to be allowed to enter the local telephone market at the time of the decision, and telephone companies were permitted shortly thereafter to apply for broadcasting licences to enter the distribution market.

VII. COMPETITION BUREAU'S POLICY DEVELOPMENT ACTIVITIES IN THE TELECOMMUNICATIONS SECTOR

In addition to its formal submissions to the CRTC, the Competition Bureau also engages in efforts to influence public policy in the telecommunications sector. These policies are very largely the

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[13] EFFECTIVE JANUARY 1, 1995 RATE REBALANCING CALLED FOR THREE ANNUAL INCREASES OF $2 PER MONTH IN RATES FOR LOCAL SERVICE, WITH CORRESPONDING DECREASES IN RATES FOR BASIC TOLL SERVICE.

[14] IMPLEMENTATION OF REGULATORY FRAMEWORK - LOCAL INTERCONNECTION AND NETWORK COMPONENT UNBUNDLING – ORAL HEARING, TELECOM PUBLIC NOTICE CRTC 96-11 THE COMMISSION HELD AN ORAL PUBLIC HEARING TO RECEIVE VIEWS IN AUGUST- SEPTEMBER 1996

policies of the Federal Government, but the Bureau also participates in the policy development activities of several international bodies, such as the Competition Law and Policy Committee of the OECD.

Policy development activities arise not just from the initiative of the Bureau, but also because its advice is frequently sought by others as telecommunications policy is developed. The Bureau tries to choose those policy activities, such as regulatory reform in the telecommunications sector, in which it has a comparative advantage and where there is reasonable chance of having a beneficial effect, consistent with the objectives of the *Competition Act*.

From the Bureau's perspective there is a trade-off between devoting resources to policy development and spending those resources enforcing the *Competition Act* or appearing before regulatory bodies such as the CRTC. The advocacy of competition in the policy development process can replace or reduce the need for enforcement actions or regulatory interventions. In contrast, they can also increase the responsibilities of the Bureau in terms of the amount of economic activity which is subject to the *Competition Act*. Certainly this has been the case in the telecommunications sector.

In the telecommunications sector, the Bureau's policy development activities have taken various forms:

(i) Intradepartmental Policy Activities

The Competition Bureau participates in policy development activities within Industry Canada, the department within which the Bureau is located. The involvement of Bureau staff with the telecommunications sector branch can be extensive, in particular in the preparation of regulatory interventions before the CRTC. The Bureau also participates in the establishment of positions adopted by Industry Canada on specific issues that arise.

(ii) Interdepartmental Policy Development Activities

Policy making is a collaborative effort, bringing together many departments and agencies with diverse interests. Activities may include the preparation, analysis, discussions and briefings of draft policy papers from other departments on telecommunications, the review of draft legislation and Memoranda to Cabinet. The Bureau is also extensively involved in the development of the positions taken by the Federal Government in international institutions.

(iii) Participation in International Bodies

The Competition Bureau participates in discussions involving competition policy issues arising in the telecommunications sector. Bureau officials are active participants in the activities of the OECD, APEC, UNCTAD and INTELSAT.

(iv) Speeches and Seminars

The Commissioner of Competition and senior personnel of the Bureau are frequently asked to appear before and make presentations to the business and academic communities. Bureau staff also participate in the deliberations of Committees of the House of Commons and the Senate on telecommunications issues. These activities help not only to diffuse the Bureau's own analysis and research but also to bring back into the Bureau the ideas and analyses of others.

(v) Research

The Bureau conducts its own research, much of which is made available in papers published under its own auspices or Industry Canada or in scholarly journals. It also contracts academics and other independent experts to undertake research on competition policy related issues.

(vi) Outreach

The Bureau conducts regular meetings with individual firms, industry associations and industry experts in the communications industry to exchange views and experiences on the evolution of this sector of the economy. In addition, Bureau staff regularly attend domestic and international conferences and exchange views with competition policy and regulatory officials in other jurisdictions to keep up to date on market and technological developments. These are extremely useful exercises as they provide the Bureau staff the opportunity to benefit from the insight of corporate and other specialists who have detailed knowledge about changes in the market and to discuss the likely development and impact of new services and products.

VIII. CONCLUSIONS AND LESSONS LEARNED

The advocacy role provided under Canada's *Competition Act* has permitted the Competition Bureau to successfully promote competition principles as a key focus in the decision-making process of the Canadian Radio-television and Telecommunications Commission. In addition, the Commission has been willing to forbear in a number of key decisions. This is a natural response to rising demands for greater competition in the telecommunications sector. The nature and thrust of the pro-competitive case of the Bureau is found in the Commission's conclusions and decisions.

The Competition Bureau's advocacy of competition in the telecommunications sector has had important results. Introducing competition into the telecommunications market has encouraged the entry of new firms, reduced prices and increased the variety of products and/or services for consumers. This is most obvious in the market for long distance services which has seen the emergence of new entrants and the growth in the number and assortment of pricing plans. With the introduction of competition in long distance services, the average rate per conversation-minute in 1998, expressed in real terms, was one-sixth the rate in 1970. Accompanying this fall in prices was a nine-fold increase in volume. And while competition in the local telephony market has been slow to develop, it can be expected that the benefits will be even greater than those derived from deregulation in the long distance market.

Despite the positive results, it has at times been a difficult and frustrating exercise. The Bureau has learned a number of lessons.

1. Advocacy on the part of competition authorities is absolutely essential if the regulator is to obtain a clear appreciation of the benefits that can be derived from competitive markets (and conversely the losses of not adopting a pro-competitive solution). No other participant in regulatory reform is likely to have the knowledge and expertise of a competition authority to develop and make proposals based on well-founded and accurate analysis that can effectively counterbalance entrenched interests.

2. The competition authority needs to develop and maintain a good working relationship with the regulator. This allows for a free exchange of ideas, analysis and other relevant information that can prove critical to the regulator's decisions. At times, by its very nature, advocacy can be confrontational, but it should not be allowed to damage this relationship.

3. The advocacy must be public, because its major purpose is to build up a constituency for pro-competitive reform. Competition authorities have very few allies at the beginning of the reform process, other than the consuming public at large. They need to find ways to garner public support for pro-competitive reform if it is to achieve credibility as an impartial expert in

competition issues which are at the core of regulatory reform. Sound and effective advocacy action can best demonstrate that the competition authority is advancing the general interest.

4. The competition authority needs to be adequately resourced to ensure that its advocacy efforts are well researched and prepared. Its work must be of the highest quality to withstand the scrutiny of all participants.

5. The Bureau's experience in advocacy implies a specific institutional arrangement. As noted above, the Act provides explicit statutory authority for the Commissioner to make interventions before federal and, when requested, provincial regulatory agencies. We believe that statutory authority to intervene is a pre-condition to effective, timely and meaningful advocacy.

6. Finally, advocacy is but half the battle. Once markets are opened, it is important that competition authorities remain vigilant to anti-competitive activities that can thwart the benefits from deregulated and liberalized markets. Advocacy needs to be supplemented and reinforced with enforcement activity.

ANNEX A

The following table refers to recorded cases in which written submissions have been made by the Competition Bureau to boards, commissions or similar entities from the period 1976 to March 1999.

Sectors	**No**	**Yes**	**Number**
Telecommunications			65
Broadcast TV			1
Cable TV			8
Satellites			7
Postal Services			1
Passenger Air Transport			28
Air Freight Transport			1
Road Freight Transport			12
Intercity Bus			3
Railroad – passenger			4
Railroad – freight			4
Maritime Transport			2
Local Taxi			1
Local Bus			
Retail Distribution			
Pharmacies			
Newspaper Distribution			
Electricity			11
Gas			15
Oil			2
Professional services generally, including:			12
- Lawyers' services			
- Doctors' services			
- Accountants' services			
- Dentists' services			
- Architects' services			
- Engineers' services			
- Opticians' services			
Agriculture			13
Financial Services			11
Insurance			
Product Standards			
Construction			
Environment			1
Other: Pharmaceutical Patent Policy			1
Other: *Copyright Act*			1
Other: Economic Union			1
Other: Beer			1
Other: Dumping / Imports / Tariff			14
Other: Radio Common Carrier			10
Other: Transport (General)			1

Other: Petroleum			1
Other: *Special Import Measures Act*			1
Other: Franchise Disclosure Legislation (provincial)			1
Total			**234**