



Telecom Public Notice CRTC 2005-3

Ottawa, 13 May 2005

Proceeding to consider extending the price regulation regime

Reference: 8678-C12-200505729

In this Public Notice, the Commission invites comments on extending the current price regulation regime for the large incumbent local exchange carriers.

Background

1. In *Price cap regulation and related issues*, Telecom Decision CRTC 97-9, 1 May 1997 (Decision 97-9), the Commission established the principles, components and framework of price cap regulation for the large incumbent local exchange carriers (ILECs). At that time, these companies were: BC TEL, Bell Canada, The Island Telephone Company Limited (Island Tel), Maritime Tel & Tel Limited (MTT), MTS NetCom Inc. (subsequently MTS Communications Inc. (MTS), now MTS Allstream Inc. (MTS Allstream)), The New Brunswick Telephone Company, Limited (NBTel), NewTel Communications Inc. (NewTel), and TELUS Communications Inc. (TELUS (Alberta)). Subsequent to Decision 97-9, TELUS (Alberta) and TELUS Communications (B.C.) Inc. (formerly BC TEL) merged into TELUS Communications Inc. (TCI), and Island Tel, MTT, NBTel and NewTel merged to become Aliant Telecom Inc. (Aliant Telecom).
2. In Decision 97-9, the Commission stated that price cap regulation, in general, allows for more efficient and effective regulation than rate base/rate-of-return regulation. The four-year regime, set out in Decision 97-9 and implemented in 1998, included a number of interrelated initiatives collectively designed to achieve the following objectives and principles:
 - 1) to render reliable and affordable services of high quality, accessible to both urban and rural area customers;
 - 2) to foster competition in the Canadian telecommunications markets;
 - 3) to provide incumbents with incentives to increase efficiencies and to be more innovative, and with a reasonable opportunity to earn a fair return for their Utility Segments; and
 - 4) to implement a price cap plan that is simple, straightforward, easy to understand and reduces the regulatory burden to the greatest extent possible.
3. In the initial price cap regime, the Commission imposed an overall price cap constraint equal to inflation less a productivity offset on revenues from a single basket of ILEC services. This basket was divided into three sub-baskets that were also subject to additional sub-basket, service or rate element pricing constraints:

- Basic residential local services;
 - Single and Multi-line Business local services; and
 - Other capped services.
4. Services that were priced to maximize contribution before the implementation of price caps, such as optional local services, and services for which the Commission considered that a price cap would be redundant, such as Special Facilities Tariffs, were generally not assigned to a capped services sub-basket. Competitor Services, as defined in *Implementation of price cap regulation and related issues*, Telecom Decision CRTC 98-2, 5 March 1998, were also not included in capped services. Rates for certain other services, such as 9-1-1 service and Message Relay Service, were subject to a price freeze.
 5. Saskatchewan Telecommunications (SaskTel) was not subject to this price cap regime, as the company only came under federal regulation on 30 June 2000. In *SaskTel – Transition to federal regulation*, Decision CRTC 2000-150, 9 May 2000, the Commission approved a transitional regulatory framework for SaskTel and indicated that the company would likely be included in the review of the price cap regime.

Objectives of the Current Regime

6. In the last year of the initial price cap regime, the Commission issued *Price cap review and related issues*, Public Notice CRTC 2001-37, 13 March 2001, to review the regime and to establish an appropriate regulatory regime to go into effect in 2002 for Aliant Telecom, Bell Canada, MTS, SaskTel and TCI. In that proceeding, parties raised a number of concerns regarding certain aspects of the price cap regime, including the state of local competition and its projected development, the significant disparity in the distribution of the benefits of price regulation, and the ILECs' unsatisfactory quality of service record.
7. In *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002 (Decision 2002-34), the Commission determined that price regulation, which allowed for greater efficiency within the industry, continued to be more effective than rate base/rate-of-return regulation. However, in light of the concerns raised during the proceeding, the Commission designed the second price regulation regime to achieve the following objectives:
 - 1) to render reliable and affordable services of high quality, accessible to both urban and rural area customers;
 - 2) to balance the interests of the three main stakeholders in telecommunications markets, i.e., customers, competitors and incumbent telephone companies;
 - 3) to foster facilities-based competition in Canadian telecommunications markets;

- 4) to provide incumbents with incentives to increase efficiencies and to be more innovative; and
 - 5) to adopt regulatory approaches that impose the minimum regulatory burden compatible with the achievement of the previous four objectives.
8. Based on these objectives, the Commission adopted a different structure for the new regime. In particular, the Commission decided to move away from the single basket structure of the initial price cap framework with its overall price cap constraint. Instead, the current price cap regime involves multiple baskets and service groups with individualized basket constraints, as well as specific rate element constraints in some cases. The current price regulation regime includes a greater number of baskets and service groups, thereby permitting the Commission to more finely tune its pricing constraints to implement the objectives.
 9. In particular, the revised basket structure and focused pricing constraints ensure that the benefits of productivity gains are more evenly distributed across the various types of services and, hence, are enjoyed by a greater range of customers. They also ensure that the ILECs cannot reduce prices in a competitive market and recoup the lost revenues by raising prices in a market where competition is weak or absent.

Basket structure, local competition and the application of a productivity offset

10. The price regulation regime includes eight baskets or groups of services: residential local services in high cost serving areas (HCSAs); residential local services in non-high cost serving areas (non-HCSAs); business services; other capped services; Competitor Services; services with frozen rates; public payphones; and uncapped services. Each of these baskets or service groups is subject to pricing constraints tailored to meet the circumstances of the relevant services.
11. The individual basket constraints rely on an inflation factor, a productivity factor and an exogenous factor, as appropriate. The Commission has selected the chain weighted GDP-PI published by Statistics Canada as the inflation measure and it has set the productivity offset at 3.5%. In addition to basket constraints, a variety of rate element constraints were imposed on specific services in light of competitive circumstances and related considerations. These rate element constraints provide customers with additional price protection. Based on an analysis of the state of local competition and its projected development, the Commission made several conclusions regarding the general grouping of services into baskets and the need for a productivity offset.
12. In the residential market, the Commission did not anticipate that competition would be sufficient to discipline the ILECs' residential local exchange and residential optional local service rates. Accordingly, the Commission considered it appropriate, with the exception of service provided in HCSAs, to subject these services to a productivity offset. The Commission therefore applied a basket constraint equal to inflation less a productivity factor to the non-HCSA basket of residential local services. The Commission did not consider it appropriate to impose a basket constraint on the HCSA basket of local residential services as such a constraint would have forced down local exchange rates in HCSAs which were already set below cost.

13. However, given the potential for adverse effects on local competition as a result of mandated rate reductions, the Commission implemented a deferral account mechanism to mitigate these potential effects. The deferral account mechanism applies only to revenues from residential local services in non-HCSAs.
14. With a deferral account mechanism, an amount equal to the revenue reduction required by the basket constraint is assigned to the deferral account and retained in that account, instead of reducing the revenues of the basket by means of rate reductions. The Commission considered that the creation of a deferral account for residential local services would assist in achieving the objective of balancing the interests of the three main stakeholders in telecommunications markets: customers, competitors and ILECs.
15. In addition, for the services in the HCSAs and non-HCSA residential sub-baskets, the Commission also decided to apply basket constraints and a number of service-specific rate element constraints in order to provide adequate price protection to subscribers where local competition was expected to develop slowly.
16. In the business market, the Commission was of the view that, given the extent to which market forces were present in the business market and the extent to which business rates were reduced in the initial price cap regime, it was not necessary to subject business services to a productivity offset.
17. With respect to the market for other capped services, the Commission considered that market forces could not be relied upon to sufficiently discipline the prices of these services and anticipated that the ILECs would continue to achieve productivity and efficiency gains in respect of these services. Accordingly, the Commission found it appropriate to subject these services to a productivity offset.
18. With respect to the market for Competitor Services, the Commission established two categories of Competitor Services. Category I Competitive Services are those services deemed to be in the nature of an essential service. These services were generally priced on the basis of Phase II costs plus a 15% mark-up. Since there were few, if any, competitive alternatives for services that were assigned to Category I Competitor Services and having regard to the expectation that ILECs would experience productivity and efficiency gains in respect of these services, the Commission considered that rates for Category I Competitor Services should reflect productivity gains on an ongoing basis. The pricing of these services was revised and made subject to pricing constraints to ensure that competitors have access to the relevant services at rates which will foster the development of facilities-based competition.
19. Category II Competitor Services include the remainder of Competitor Services (i.e., those not classified as Category I). These services are not in the nature of an essential service. The rates for these services are either mandated or market-based and are based on considerations in addition to or other than Phase II costs. The Commission considered it appropriate not to apply a productivity offset to the rates for these services.

20. With respect to the remaining services and their treatment under this regime, services which were grouped together and subject to frozen rate treatment in the initial price cap regime (e.g., 9-1-1 service, Message Relay Service) would continue to be subject to the same treatment. Public and semi-public pay telephones were placed in a separate category and their rates were frozen. All tariffed services not in one of the previous baskets or service groups were classified as uncapped services and are not subject to any upward pricing constraints.

Other components of the regime

21. In Decision 2002-34, the Commission required the ILECs to introduce, on an interim basis, a Competitor Digital Network Access (CDNA) service and price it in the same way as services in the nature of an essential service. The Commission ordered the development of the CDNA service, with a view to fostering facilities-based competition, because competitors were at a competitive disadvantage relative to the ILECs in the absence of such a service.
22. In *Competitor Digital Network Services*, Telecom Decision CRTC 2005-6, 3 February 2005, the Commission determined that the ILECs shall provide to competitors the following services and facilities as part of CDN services: DNA access and links, DNA intra-exchange, central office (CO) channelization, non-forborne metropolitan IX, copper and optical co-location links and other CO connecting links. The Commission also classified each of the CDN services as either a Category I Competitive Service or Category II Competitor Service, and established the appropriate pricing treatment for each service. The Commission set the rates, terms and conditions applicable to CDN services, as well as the appropriate compensation to be provided to the ILECs for their provision of CDN services to competitors.
23. With respect to quality of service, the Commission was not persuaded in Decision 2002-34 that competitive pressures in either the retail or competitor services markets were sufficient to ensure that ILECs could meet approved service quality standards. Moreover, there had been only limited competitive entry in the local exchange market and that entry had primarily occurred in the business sector in urban areas. In addition, many competitors had not yet constructed their own facilities, but instead relied on the resale of ILEC services, especially Centrex service, in order to provide local service to end users. In these circumstances, the drive to improve earnings at the expense of quality of service was not adequately checked by competitive pressures.
24. Accordingly, in Decision 2002-34, the Commission introduced, on an interim basis, quality of service mechanisms which provided for rate adjustments to customers and competitors if the ILECs failed to meet the Commission mandated quality of service indicators. These mechanisms were finalized in *Retail quality of service rate adjustment plan and related issues*, Telecom Decision CRTC 2005-17, 24 March 2005 and *Finalization of quality of service rate rebate plan for competitors*, Telecom Decision CRTC 2005-20, 31 March 2005.
25. In Decision 2002-34 and subsequent decisions, the Commission approved the Service Improvement Plans for all of the ILECs. These plans would extend service to unserved customers and upgrade service to underserved customers, and ensure that the Commission's basic service objective (BSO) would continue to be achieved in their territory. The BSO comprises individual line local service with Touch-Tone dialling, provided by a digital switch

with capability to connect via low-speed data transmission to the Internet at local rates; enhanced calling features, including access to emergency services, Voice Message Relay service, and privacy protection features (included in call management services); access to operator and directory assistance services; access to the long distance network; and a copy of a current local telephone directory.

26. In keeping with the ongoing effort to streamline and improve the efficiency of regulation, the reporting requirements of the ILECs were revised to eliminate the filing of Phase III/Split Rate Base reports, as well as intercorporate transaction reports. The Commission considered that the concept of a Utility Segment no longer had relevance. This was due, in part, to the introduction of a Phase II-based determination of the subsidy requirement starting in 2002 and the structure of the current regime. The Commission's annual monitoring process would be used to gauge the financial state of ILECs in order to ensure that the objectives of the price cap regime are being met.

Extending the current price regulation regime

27. The Commission determined that the revised price regulation regime for the ILECs would be in place for a period of four years, commencing 1 June 2002. The Commission noted that a review of the second price regulation regime should be completed prior to the end of the four-year period.
28. As explained above, the current price regulation framework was based, in large part, on the state of local competition and its projected development as well as the ILECs' ability to achieve productivity and efficiency gains in respect of certain services. The Commission considers that the factors and circumstances present at the time of the last review have not changed significantly and still exist at this time.
29. While competitive entry into the residential local services market through various initiatives, such as voice communications services using Internet Protocol (IP), may well increase the level of competition for residential local services in the future, the timing and magnitude of this impact are not clear at this time. In *Regulatory framework for voice communication services using Internet Protocol*, Telecom Decision CRTC 2005-28, 12 May 2005, the Commission set out the regulatory framework for voice communication services using IP. The Commission will need to assess the impacts of that Decision on the state of competition in the residential local services market and, consequently, any changes that may be required to the price regulation regime.
30. In addition, in *Forbearance from regulation of local exchange services*, Telecom Public Notice CRTC 2005-2, 28 April 2005, the Commission initiated a proceeding to consider the framework for forbearance from the regulation of residential and business local exchange services. The determinations in that Decision may impact the existing price regulation regime.
31. As outlined above, the current price regulation regime is comprised of many interrelated initiatives which collectively are designed to achieve the objectives set out in Decision 2002-34. The Commission considers that the current regime is achieving the objectives set out in Decision 2002-34 and, as such, current circumstances within the industry do not warrant a review at this time.

32. In light of the above, the Commission is of the opinion that an extension of the regime without any changes would be appropriate at this time. The Commission considers that a two-year extension is appropriate given the current circumstances. Accordingly, the Commission invites comments on its proposal to extend the existing price regulation regime for the ILECs for a period of two years.

Procedure

33. Aliant Telecom, Bell Canada, MTS Allstream, SaskTel and TCI are all made parties to this proceeding.
34. Other interested parties wishing to participate in this proceeding are required to notify the Commission of their intention to do so by **2 June 2005** (the registration date) and to provide their contact information. They should do so by contacting the Secretary General by mail at CRTC, Ottawa, Ontario, K1A 0N2, by fax at (819) 994-0218 or by email at procedure@crtc.gc.ca. They are to indicate in the notice their e-mail address where available. If such parties do not have access to the Internet, they are to indicate in their notice whether they wish to receive disk versions of hard copy filings.
35. The Commission will issue, as soon as possible after the registration date, a complete list of interested parties and their mailing addresses (including their e-mail addresses, if available), identifying those parties who wish to receive disk versions
36. All parties may file comments with the Commission on any matter within the scope of this proceeding by **13 June 2005**, serving a copy on all parties by that date.
37. All parties may file replies to any comments made pursuant to paragraph 36 by **27 June 2005**, serving a copy on all parties by that date.
38. The Commission will not formally acknowledge comments. It will, however, fully consider all comments and they will form part of the public record of the proceeding.
39. Where a document is to be filed or served by a specific date, the document must be actually received, not merely sent, by that date.
40. Parties can file their submissions electronically or on paper. Submissions longer than five pages should include a summary.
41. Each paragraph of your submission should be numbered.
42. Where the submission is filed by electronic means, the line *****End of document***** should be entered following the last paragraph, as an indication that the document has not been damaged during electronic transmission.
43. Please note that only those submissions electronically filed will be available on the Commission's web site and only in the official language and format in which they are submitted.

44. The Commission encourages interested parties to monitor the public examination file (and/or the Commission's web site) for additional information that they may find useful when preparing their submissions.

Important

45. All information submitted, including your email address, name and any other personal information as provided, will be posted on the Commission's web site. Documents received in electronic format will be posted on the Commission's web site exactly as you send them, and in the official language and format in which they are received. Documents not received electronically will be available in .pdf format.

Location of CRTC offices

46. Submissions may be examined or will be made available promptly upon request at the Commission offices during normal business hours:

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Secretary General

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