Telecom Decision CRTC 2007-106

Ottawa, 9 November 2007

Further rate de-averaging for pay telephone and business services for large incumbent local exchange carriers

Reference: 8678-C12-200708026

In this Decision, the Commission removes the prohibition on further rate de-averaging for pay telephone and business services that include single and multi-line business local exchange services, other capped services, and uncapped services offered by the large incumbent local exchange carriers.

The dissenting opinion of Commissioner Langford is attached.

Introduction

1. In Telecom Decisions 2002-34 and 2002-43, the Commission, among other things, explicitly prohibited any further rate de-averaging within a rate band for residential local exchange services, single and multi-line business local exchange services, and other capped services. As a result of the Commission's prohibition on further rate de-averaging, large incumbent local exchange carriers (ILECs) could not lower a rate for these services in one part of a rate band without lowering the rate across the entire band. In those decisions, the Commission also capped rates for public and semi-public pay telephone services at the then current levels.

2. In Telecom Decision 2007-27, the Commission removed the prohibition on further rate de-averaging for residential local exchange services, and optional local services. The Commission also approved the flexibility for large ILECs to increase the local call charge for a pay telephone cash call up to a maximum rate of $0.50, and to increase collect, third number, Calling Card or commercial credit card charges up to a maximum rate of $1.00.[1] However, the Commission considered that the record of that proceeding was insufficient to determine whether the prohibition on further rate de-averaging should be removed for pay telephones and business local exchange services.

3. In Telecom Public Notice 2007-11, the Commission invited comments regarding the appropriateness of removing the prohibition on further rate de-averaging for pay telephone, single and multi-line business local exchange services, other capped services, and uncapped services offered by the large ILECs.

4. The Commission received comments dated 30 July 2007 from Bell Aliant Regional Communications, Limited Partnership, Bell Canada, Saskatchewan Telecommunications, and Télébec, Limited Partnership (collectively, Bell Canada et al.); MTS Allstream Inc.,

[1] In Telecom Decision 2007-60, the Commission concluded that the determinations set out in Telecom Decision 2007-27 would also apply to Télébec, Limited Partnership.

Rogers Communications Inc., and Quebecor Media Inc. on behalf of itself and Videotron Ltd. (collectively, the Competitors); Public Interest Advocacy Centre (PIAC); TELUS Communications Company (TCC); and l'Union des consommateurs (UC).

5. The record of this proceeding closed with reply comments dated 15 August 2007.

Positions of parties

6. The Competitors indicated that they supported maintaining the prohibition on further rate de-averaging for business local exchange, other capped and uncapped services. They argued, generally, that the *status quo* remained appropriate because (i) the current state of competition (i.e. no evidence of vibrant competition) in those exchanges that had not been forborne from regulation, and (ii) the removal of the prohibition on further rate de-averaging would amount to virtual forbearance.

7. Bell Canada et al. and TCC submitted that the current prohibition on further rate de-averaging for pay telephone, business, other capped services, and uncapped services offered by the large ILECs should be removed. In support of their submission, these parties argued that (i) the elimination of the ban could only benefit consumers; (ii) the existing pricing safeguards established in Telecom Decision 2007-27 ensured that rates remained just and reasonable; (iii) the state of competition was not a necessary condition for rate de-averaging; and (iv) maintaining the prohibition on further rate de-averaging would be inconsistent with the Policy Direction.[2]

8. While UC submitted that allowing rate de-averaging for pay telephone services could only result in some consumers benefiting through lower prices, PIAC argued that there was a lack of suitable competition in the pay telephone market to support the removal of the prohibition. In addition, PIAC suggested that the ILECs might engage in inappropriate pricing strategies whereby rural, remote and low-income users of pay telephone services would always have the highest rates, while those with access to competitive options would benefit from lower prices.

Commission's analysis and determinations

9. The Commission notes that its approach to rate de-averaging has always been guided by subsections 27(1), (2) and (4) of the *Telecommunications Act* which state, respectively, that every rate charged by a Canadian carrier for a telecommunications service shall be just and reasonable; no Canadian carrier shall, in relation to the provision of a telecommunications service or the charging of a rate for it, unjustly discriminate or give an undue or unreasonable preference toward any person, including itself, or subject any person to an undue or unreasonable disadvantage; and the burden of establishing before the Commission that any discrimination is not unjust or that any preference or disadvantage is not undue or unreasonable is on the Canadian carrier that discriminates, gives the preference or subjects the person to the disadvantage.

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[2] *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006 (the Policy Direction).

10. In addition, the Policy Direction requires that the Commission, when relying on regulation of an economic nature, should use measures that neither deter economically efficient competitive entry into the market nor promote economically inefficient entry. The Policy Direction also requires that when relying on regulation, the Commission should use measures that are efficient and proportionate to their purpose.

11. In light of the above, the Commission has examined whether its prohibition on further rate de-averaging remains necessary to ensure that pay telephone and business local exchange service rates are just and reasonable, and to prevent unjust discrimination or undue preference in the charging of these rates.

12. The Commission rejects the argument made by some parties that removing the prohibition would amount to virtual forbearance. The Commission notes that the framework for forbearance from the regulation of local exchange services is set out in Telecom Decision 2006-15 and in *Order varying Telecom Decision CRTC 2006-15*, Order in Council P.C. 2007-532, and that ILECs need to satisfy the required test to achieve forbearance in these markets.

13. The Commission disagrees with PIAC's submission that the ILECs may engage in inappropriate pricing strategies for pay telephone services. The Commission considers that the ability to price pay telephone services in a differentiated manner could promote economic efficiency (for example, some rates might be lower in the case of older, less technologically sophisticated pay telephones). In addition, the Commission notes that most of the ILECs' pay telephone rates are already at the maximum levels permitted by the Commission. As such, the Commission considers that de-averaging pay telephone rates would largely produce benefits to customers since it would involve primarily price decreases.

14. The Commission notes that the current price cap framework set out in Telecom Decision 2007-27 places upward constraints on the prices for single line and multi-line business local exchange services, other capped services, and on the rates for pay telephone service. Additionally, business and other capped service rate increases are limited to the rate of inflation overall and to a maximum increase of 10 percent per year for individual rates. The Commission considers that these constraints will ensure that the rates charged to subscribers for these services do not rise to unreasonable or unjust levels. For example, pay telephone service rates are permitted to increase up to a maximum rate of $0.50 per cash call, and a maximum rate of $1.00 per non-cash call.

15. The Commission also notes that the current price cap framework includes downward constraints on services. Specifically, any proposal to reduce rates for these services must generally be accompanied by supporting rationale that demonstrates the proposed rates continue to pass an imputation test. The Commission is satisfied that these safeguards will deter anti-competitive pricing strategies for services offered by ILECs.

16. In light of the above, the Commission considers that, even with the removal of the prohibition on further rate de-averaging, pay telephone and business local exchange services would remain just and reasonable under the price cap regime established in Telecom Decision 2007-27.

17. As noted in Telecom Decision 2007-27, with the removal of the prohibition, the Commission retains the ability to determine, on a case-by-case basis, whether the particular pricing strategies of the ILECs lead to discrimination that is unjust or confer a preference or disadvantage that is undue or unreasonable.

18. Accordingly, the Commission concludes that it is appropriate to remove the prohibition on further rate de-averaging for pay telephone, single and multi-line business local exchange services, other capped services, and uncapped services offered by the large ILECs.

19. The dissenting opinion of Commissioner Langford is attached.

Secretary General

Related Documents

- *Follow-up to Decision 2007-27 – Show cause submission related to the appliction of the price cap regime to Télébec, Limited Partnership*, Telecom Decision CRTC 2007-60, 30 July 2007, as amended by Telecom Decision CRTC 2007-60-1, 10 August 2007

- *Further rate de-averaging for pay telephone and business services for large incumbent local exchange carriers*, Telecom Public Notice CRTC 2007-11, 4 June 2007

- *Price cap framework for large incumbent local exchange carriers*, Telecom Decision CRTC 2007-27, 30 April 2007

- *Forbearance from the regulation of retail local exchange services*, Telecom Decision CRTC 2006-15, 6 April 2006

- *Implementation of price regulation for Télébec and TELUS Québec*, Telecom Decision CRTC 2002-43, 31 July 2002

- *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002, as amended by Telecom Decision CRTC 2002-34-1, 15 July 2002

Dissenting opinion of Commissioner Stuart Langford

Further deaveraging dissent

I disagree with the majority decision in this matter because, in my opinion, it is both inconsistent with the government's December 2006 Policy Direction and contrary to consumer interests. It is almost certain to deter economically efficient competitive entry into the market and to result in too many consumers, as far as business and pay-phone telecom services are concerned, continuing to live in what amounts to a monopoly environment. Neither result is in the public interest.

The background:

Until recently, because phone companies carried on business as actual or virtual monopolies in their operating territories, the Commission was compelled to regulate service and price levels so as to protect Canadian consumers from the abuse of corporate power. One way it did this was to divide each phone company's territories into sections called rate bands, each identified for ease of reference by a letter: A, B, C, etc.

Generally speaking, these bands were designated on the basis of population and phone line density, with "A" being the business or centre-town district of a typical city, "B" being the suburbs, "C" being further outlying areas and the designations D, E, F and G being applied to areas ever further removed from densely populated areas.

Before new-entrant service providers like cable companies began to compete for the established phone company's customers, the Commission, at the request of the former monopolies, approved, with some clear and narrowly-defined exceptions, band-wide prices for services. As a result, generally speaking, everyone in each band paid the same for residential and business usage. The idea behind this rule prohibiting further rate-deaveraging within a band was that it would be unfair for some customers to subsidize the lower rates of other customers when the costs of providing services across a band were more or less the same.

Even after competition started and new entrants began to attract customers away from the monopolies, the prohibition against rate-deaveraging within a band was maintained. The Commission's intention in doing so was to prevent the former monopolies from killing off competition before it could take hold by offering sweetheart deals to customers planning to switch to a competitor.

Today's telecom landscape:

Following issuance by the government of its December 14th, 2006 Policy Direction (the Policy Direction) and its April 5th Order in Council (the Order), Canada's telecom landscape began and continues to change dramatically as a reliance on market forces supersedes regulatory oversight in an increasingly competitive environment. Based on the Order's simplified test for determining whether sufficient competition exists in any given telephone exchange to justify reliance on market forces to protect consumer interests, forbearance applications from former monopoly phone companies anxious to cast off the yoke of regulation have been pouring into the Commission's offices. It is no exaggeration to suggest that very soon as many as 70% of Canadian consumers, except in cases of gross abuse of market power, will find themselves reliant on the salesmanship of new competitive entrants rather than regulatory oversight to keep prices just and reasonable.

It is vitally important to understand that the majority decision in this matter does not affect this 70% of consumers now or soon to be living and/or working in forborne areas with access to alternate sources of telecommunications services as defined in the Order. What is at issue here is the fate of the remaining 30%, those who live and work in non-forborne areas. What is on the table is the continuance or discontinuance of an established regulatory technique (the prohibition against further rate-deaveraging within a band) for protecting consumers who do business and/or use pay phones in exchanges where competitive forces, as defined in the Order, are **NOT** strong enough to do the job.

In my view, the majority's conclusion that without this protective rule, "de-averaging pay telephone rates would largely produce benefits to customers since it would involve primarily price decreases" (paragraph 13), is an exercise in self-delusion. So too is the majority's contention in paragraph 15 of its decision, that the so-called "imputation test" (proof that services are not being sold below cost) "will deter anti-competitive pricing strategies."

Wishful thinking:

Keeping in mind, always, that we are dealing here with areas of Canada where by definition monopoly or near-monopoly conditions exist, one must ask precisely how the majority has concluded that consumers will be protected and benefit from lower prices. What will force pay-phone prices down? Presumably, the entry into the market of a competitive pay-phone provider will do so. Fine, but how long will prices stay down? In my opinion, that will last for only as long as it takes for the incumbent monopoly phone company to crush the new entrant. Today's majority decision provides them with the power to do just that.

Consider this scenario. A convenience store operator in a strip mall invites an alternative pay-phone company to take over the phone booth inside his store from the incumbent phone company. The rate for all cash pay-phone calls in the area in and around the strip mall is 50 cents cash or $1.00, non-cash (the maximum charges permissible under Telecom Decision 2007-27). The new pay-phone company takes over the booth and matches the incumbent phone provider's rates. Armed with the power given it by today's majority decision, the incumbent responds by slashing its pay-phone rates for booths in and around the convenience store. Very soon, it is goodbye, new entrant and goodbye competition. Expect, as well, a return to higher rates once the competitor has been dispatched.

In this scenario, the rule prohibiting further rate-deaveraging, abandoned by the majority today, would have prevented the incumbent from lowering rates unless it did so for every phone booth in the band. A reluctance to incur such revenue losses to hang onto one pay phone, it is safe to assume, would make the incumbent unlikely to do so. Thus, given the opportunity to compete with the incumbent on reasonable terms, the new entrant would be positioned to gain a foothold in the market and, hopefully, bring the benefits of competition to consumers living there.

The majority's belief that the prohibition against selling below cost will deter anti-competitive pricing strategies is, in my view, yet another exercise in wishful thinking. There is so much profit built into optional service pricing – they typically sell for four, five or even seven dollars each, but, because they are computer generated, cost only pennies to provide – that the scope for short term anti-competitive pricing is almost limitless.

To crush a new entrant's competitive strategy, an incumbent can offer business customers thinking of switching, a price for a bundle of local and optional services that no competitor could match. That is because, with this decision the incumbent near-monopoly phone company need not slash prices across the band. It can target price discounts right down to the individual customer who will benefit from lower prices for only so long as it takes the incumbent to kill off the competition. The consumer benefits the majority refers to are largely illusory; in theory, they could result from today's decision, but in reality such an outcome is highly unlikely.

The long game:

If the benefits of established competition are ever to accrue to all Canadian business and pay phone telecom customers, the Commission, as instructed by the Policy Direction, must concentrate on creating an environment conducive to fostering facilities-based competition in all parts of Canada. That, as the saying goes, must be the long game. The majority decision will do just the opposite.

Cable television providers, at least for the foreseeable future, represent the most likely source of sustainable, facilities-based, competitive activity in most parts of Canada. These companies, like the former monopolies, have the key element required to provide ubiquitous service; that is, a network of hard wiring connecting most of the buildings in the territories they serve. In non-forborne areas where cable companies now lack a connected presence, huge investments of capital will be required if they are to develop one.

If the Commission is to promote business service competition, it must make decisions that encourage cable companies to shoulder the enormous costs of rolling out new networks in non-forborne exchanges. In my view, today's majority decision will discourage not encourage that process. It serves notice on cable companies that they may never be able to build the customer base needed to justify the expense of expanding into new markets. It gives monopoly and near-monopoly phone companies in the 30% of the Canadian market still under price regulation a virtual lock on business and pay phone customers for many years to come.

Such results fly in the face of the government's Policy Direction not to deter efficient competitive entry, and of the Commission's obligation contained in paragraph 7(*f*) of the *Telecommunications Act*, "to foster increased reliance on market forces." In the public interest, I would have maintained the prohibition against further rate de-averaging within a band until such a time as facilities-based competition in the business and pay phone markets affected was sufficiently established in any given exchange, to support a case for deregulation in the form of a successful forbearance application.