



Telecom Decision CRTC 2005-69

Ottawa, 16 December 2005

Extension of the price regulation regime for Aliant Telecom Inc., Bell Canada, MTS Allstream Inc., Saskatchewan Telecommunications and TELUS Communications Inc.

Reference: 8678-C12-200505729

In this Decision, the Commission extends the current price regulation regime without changes for Aliant Telecom Inc., Bell Canada, MTS Allstream Inc., Saskatchewan Telecommunications and TELUS Communications Inc. for a period of one year, to 31 May 2007. The Commission will initiate a proceeding to review the existing price regulation regime in the first half of 2006 following the release of the decision in the proceeding initiated by Forbearance from regulation of local exchange services, Telecom Public Notice CRTC 2005-2, 28 April 2005.

Introduction

1. In *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002 (Decision 2002-34), the Commission established the existing price regulation regime for Aliant Telecom Inc. (Aliant Telecom), Bell Canada, MTS Allstream Inc. (MTS Allstream), Saskatchewan Telecommunications (SaskTel) and TELUS Communications Inc. (TCI). The four-year regime ends on 31 May 2006. In Decision 2002-34, the Commission determined that a review of the existing price regulation regime would be initiated in the final year of the plan.
2. In *Proceeding to consider extending the price regulation regime*, Telecom Public Notice CRTC 2005-3, 13 May 2005 (Public Notice 2005-3), the Commission invited comments on its proposal to extend the existing price regulation regime without changes for a period of two years for these incumbent local exchange carriers (ILECs). The Commission based its proposal on the following factors.
3. The Commission stated that 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 considered that the factors and circumstances present at the time of the establishment of the current price regulation regime had not changed significantly.
4. The Commission further stated that while competitive entry into the residential local services market through various initiatives, such as voice communication 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 was not clear at that time. In *Regulatory framework for voice communication services using Internet Protocol*, Telecom Decision CRTC 2005-28, 12 May 2005 (Decision 2005-28), the Commission had set out the regulatory

framework for voice communication services using IP. The Commission stated in Public Notice 2005-3 that it would need to assess the impact of Decision 2005-28 on the state of competition in the residential local services market and, consequently, any changes that might be required to the price regulation regime.

5. In addition, the Commission stated that it would need to assess the impact of the proceeding arising out of *Forbearance from regulation of local exchange services*, Telecom Public Notice CRTC 2005-2, 28 April 2005 (Public Notice 2005-2). In Public Notice 2005-2, the Commission initiated a proceeding to consider the framework for forbearance from the regulation of residential and business local exchange services.
6. The Commission further stated that the current price regulation regime was comprised of many interrelated initiatives which were collectively designed to achieve the objectives set out in Decision 2002-34. The Commission considered that the current regime was achieving the objectives set out in Decision 2002-34 and, as such, current circumstances within the industry did not warrant a review at that time.

Process

7. Aliant Telecom, Bell Canada, MTS Allstream, SaskTel and TCI were made parties to the proceeding. Public Notice 2005-3 originally required parties to file comments by 12 June 2005 and reply comments by 27 June 2005. In a letter dated 8 June 2005, the Commission extended the deadlines to file comments to 20 June 2005 and to file reply comments to 4 July 2005. The deadline extensions were granted in partial response to a request made by the Public Interest Advocacy Centre as counsel for various consumer groups (the Consumer Groups) on 3 June 2005 for an extension and an interrogatory process.
8. Aliant Telecom, Bell Canada, the Canadian Cable Telecommunications Association (the CCTA), the Consumer Groups, MTS Allstream, SaskTel and TCI filed comments on 20 June 2005. The City of Calgary (Calgary) filed comments on 27 June 2005. Aliant Telecom, Bell Canada, the CCTA, the Consumer Groups, MTS Allstream, SaskTel, TCI and Xit telecom inc. (Xit telecom) filed reply comments on 4 July 2005.

Positions of parties

9. Parties' views varied on the Commission's proposal to extend the current price regulation regime. Some parties supported an extension of two years while others suggested that a one-year extension would be appropriate. Some parties opposed any extension at all without a full review of the price regulation regime. A number of parties suggested that changes should be made to the current regime if it were to be extended. Parties' comments and reply comments are summarized below.

Comments

Aliant Telecom

10. Aliant Telecom submitted that a one-year extension of the regime would be appropriate as it would allow industry resources to focus on the resolution of key regulatory issues being addressed in various proceedings, such as the Public Notice 2005-2 proceeding and the

Telecommunications Policy Review initiated by the federal government. Aliant Telecom submitted that market conditions were significantly different today than they were four years ago. Aliant Telecom submitted that given the instability in the marketplace and the necessity of a policy review, it would be unwise to extend the price regulation regime for a period of two years.

Bell Canada

11. Bell Canada stated that it would not object to a one-year extension of the existing price regulation framework in order to allow the Commission and the industry to focus on other pressing regulatory issues, such as the establishment of a framework for forbearance from regulation of local exchange services and the Telecommunications Policy Review. Bell Canada submitted, however, that if a two-year extension were to be put into place, the requirement to augment the deferral account¹ annually should be removed.
12. Bell Canada stated, in this regard, that the communications landscape was fundamentally different today than it was at the time of Decision 2002-34 and continued to change at a very significant pace. Bell Canada submitted that many cable companies had launched telephony services and the opportunity to capture a share of the telephony market using IP technologies had enticed more than two dozen service providers to offer voice over IP (VoIP) services in Canada.

MTS Allstream

13. MTS Allstream was of the view that a two-year extension was neither necessary nor appropriate. MTS Allstream submitted that if the Commission determined that the price regulation regime should be extended, it should be extended for no more than one year.
14. MTS Allstream was of the view that a delay in the review of the price regulation regime pending the conclusion of the Public Notice 2005-2 proceeding and the assessment of the impact of Decision 2005-28 was neither necessary nor warranted. MTS Allstream stated that it was not clear that the outcome of the forbearance proceeding would directly affect the analysis of the appropriateness of the current price regulation regime.
15. MTS Allstream submitted that any extension should not preclude undertaking some focused refinements to the regime during the extension period, given the delays in full implementation of the regime and the need to immediately address certain issues. MTS Allstream submitted that these refinements should include, but not be limited to:
 - i) the closing out of the deferral account of each of the ILECs and the elimination of the deferral account mechanism as of the end of the current regime;

¹ The Commission implemented the deferral account mechanism in Decision 2002-34. For more information on the deferral account mechanism, refer to paragraphs 403 to 414 of Decision 2002-34.

- ii) the consideration and implementation of measures by the Commission to streamline the review and approval process for competitor services tariffs; and
 - iii) the implementation of explicit measures to monitor the relationship between ILEC retail rates and underlying competitor services rate levels.
16. MTS Allstream argued that the deferral account mechanism had clearly failed as an efficient means of addressing regulatory adjustments, including adjustments arising from the approval of exogenous factors, as evidenced by the length and complexity of the proceeding initiated by *Review and disposition of deferral accounts for the second price cap period*, Telecom Public Notice CRTC 2004-1, 24 March 2004 (Public Notice 2004-1). MTS Allstream was of the view that extending the deferral account mechanism an additional two years would result in increased regulatory costs for all stakeholders, including the Commission.

SaskTel

17. SaskTel submitted that it generally supported the Commission's proposal to extend the current price regulation regime for an additional two years, conditional upon the Commission performing a review of the industry in early 2006 to determine if such an extension was warranted.
18. SaskTel agreed with the Commission's suggestions that the determinations made in the proceeding initiated by Public Notice 2005-2 and the impact of widespread VoIP deployment on the local services markets could have a significant impact on the selection of a price regulation regime that would be appropriate in the increasingly competitive local services market. SaskTel submitted that the results of the Telecommunications Policy Review could also have an impact upon the nature of any future regulatory framework.
19. SaskTel submitted that the current state of local competition and the prospects of local competition had changed since early 2002. SaskTel submitted that the major cable companies throughout Canada, as well as many of the smaller cable operators, had either entered or announced their intention to enter the telephony market.

TCI

20. TCI stated that it was prepared to support the two-year extension proposed in Public Notice 2005-3, provided the following two changes were made to the existing price regulation regime:
- i) eliminate the price constraint in non-high cost serving areas (non-HCSAs). The funds that would otherwise accrue in a deferral account when productivity (X) was greater than inflation (I) could then be directed to reducing rates as discussed in the second change below; and

- ii) allow ILECs to offer competitive choices to customers by reducing prices within rate bands for residential services in non-HCSAs and for business services (i.e. rate de-average).² This would be achieved by reducing rates in areas within a band where customers have a choice of local service suppliers.
21. TCI submitted that these changes would help the Commission better achieve its objectives for the current price cap regime. TCI appended to its submission a statement, *The Consumer Benefits of Pricing Flexibility for Incumbents*, by Dr. Robert W. Crandall (Dr. Crandall's Statement). In TCI's view, Dr. Crandall's Statement reinforced the notion that its proposed changes would further the Commission's objectives.
 22. TCI considered that consumers in non-HCSAs would benefit more from eliminating the I-X constraint entirely and allowing prices to decline in response to competition, than through continuation of the restriction on rate de-averaging within a band and the deferral account mechanism. TCI submitted that this would be accomplished by setting X equal to I for the extension period. TCI stated that rate reductions could be implemented on a selective basis within bands in response to competition according to its proposal for increased pricing flexibility.
 23. Concurrent with setting X equal to I, TCI proposed that any further accruals to the deferral accounts would cease and that the ILECs would undertake additional actions in the form of programs or rate reductions to eliminate the remaining liabilities at the end of the current price cap regime.
 24. TCI submitted that the factors and circumstances present at the time of the last price regulation regime review had changed significantly. TCI stated that since the time of the last review the competitive local exchange carriers (CLECs) had restructured; ILECs were now competing in each other's territories; giant cable providers had launched or would soon be launching telephone services; VoIP technologies had enabled more than 20 companies to provide telephone service in Canada; and wireless service was becoming an increasingly attractive alternative service to wireline service.
 25. TCI was of the view that the Commission drew the wrong conclusion that Decision 2005-28 warranted an extension of the price cap period. TCI stated that it was observing very rapid growth in VoIP services and concluded that the price regulation period could not be extended without providing further pricing flexibility to the large ILECs to meet that competition.
 26. TCI was of the view, however, that the Public Notice 2005-2 proceeding could be used to justify an extension of the current price regulation period. TCI stated that when the Commission determined the criteria for forbearance for local exchange services it would apply those criteria to remove services, or services offered in certain geographic areas, from the price regulation regime.

² In Decision 2002-34, the Commission determined that for residential local exchange services, residential optional services and bundles consisting of residential local exchange services or optional local services, single and multi-line business local exchange services and Other capped services, rates should not generally be de-averaged further within a rate band.

The CCTA

27. The CCTA stated that it agreed with the Commission's proposal. The CCTA agreed with the Commission's assessment that there had not been significant enough changes in the state of competition, particularly with respect to residential local exchange services, to warrant a review of the current price regulation framework. The CCTA stated that an extension would provide the Commission and interested parties with the opportunity to consider future outcomes of a number of outstanding regulatory and market shifts that might affect services subject to the price regulation regime, such as the issues raised in the Public Notice 2005-2 proceeding and the impact of VoIP services.

Calgary

28. Calgary agreed with the Commission's proposal, noting certain significant events in the industry such as the proceeding initiated by Public Notice 2005-2, the recent release of Decision 2005-28, and the Telecommunications Policy Review.

The Consumer Groups

29. The Consumer Groups did not agree with the Commission's proposal. The Consumer Groups submitted that, although they appreciated the timing difficulties, the proper approach was to establish a framework for a full review and to assemble a reasonable evidentiary record. The Consumer Groups suggested that the setting of interim rates could be considered, if there were time constraints, until the proceeding was completed.
30. The Consumer Groups submitted that the state of local competition had not significantly changed in the four years since the evidence giving rise to Decision 2002-34 had been heard by the Commission.

Reply comments

Aliant Telecom

31. Aliant Telecom concurred with other ILECs that certain changes to the deferral account should be considered if the current regime were extended for a two-year period.

Bell Canada

32. Bell Canada stated that it supported TCI's proposal to remove the rate de-averaging prohibition.
33. Bell Canada submitted that MTS Allstream's proposals regarding competitor services had no merit. Bell Canada noted that the Commission had already addressed requests to establish a link between price reductions for retail and wholesale services involving similar underlying facilities. Bell Canada stated that the implementation of measures to streamline the review and approval process for competitor services tariffs could be addressed via a separate process, as was done for retail tariff filings.

MTS Allstream

34. MTS Allstream submitted that the state of competition was virtually unchanged since the time of the last price cap review, as the ILECs had retained their overwhelming dominance of the local market. MTS Allstream considered that TCI's proposal on de-averaging would weaken rather than enable the development of local competition.
35. MTS Allstream argued that the current price cap regime was not designed or intended to be extended indefinitely, and the fact that there were ongoing government policy reviews or other Commission proceedings did not justify delaying the scheduled review of the regime.

SaskTel

36. SaskTel stated that it supported the recommendations to eliminate the deferral accounts since this would significantly reduce the regulatory burden and the level of uncertainty that existed in the industry.
37. SaskTel stated that it was also supportive of the proposals to remove the pricing constraint applied to residential services in non-HCSAs. SaskTel was of the view that elimination of this constraint would support the Commission's objective to place more reliance upon market forces, rather than regulatory constructs, to establish prices for retail services.
38. SaskTel argued that MTS Allstream's proposal regarding competitor services was part of the Commission's tariff approval process and could be reviewed at any time in a separate proceeding without regard to the specific price cap rules that are in place at any given point in time.

TCI

39. TCI stated that its evidence clearly showed that a large number of fundamental changes had occurred in the competitive environment for local exchange services since the time of the last price cap review. TCI noted that the CCTA's members had provided statements in the press indicating the success of cable telephone service, contradicting the CCTA's position.
40. TCI argued that MTS Allstream's request for monitoring the relationship between ILEC retail rates and the underlying competitor service rates was essentially the same request made by MTS Allstream's predecessor, AT&T Canada Corp., and rejected by the Commission, and should be rejected again for the very same reasons.
41. TCI submitted that the streamlining of competitor services tariff implementation was a process issue that should be addressed by the Commission within its overall management of the tariff filing and approval process.

The CCTA

42. The CCTA submitted that if the Commission considered that an extension shorter than two years was warranted, the current price cap regime could be extended by a minimum of 12 months, on an unaltered basis.

43. The CCTA was of the view that de-averaging would be more likely to deter competitive entry and expansion than encourage it. The CCTA submitted that it was not necessary to grant the ILECs further pricing flexibility when they had not availed themselves of the flexibility they already had. The CCTA noted that in Decision 2002-34, the Commission had stated that the ILECs may propose rate reductions for residential local services as a result of competitive pressures.
44. The CCTA submitted that it was important to keep the deferral account mechanism in place until the review of the price cap regime was completed. The CCTA submitted that eliminating the deferral account would be inconsistent with the objectives of the price regulation regime as it would allow the deferral account funds to flow to the ILECs to be used at their discretion.

The Consumer Groups

45. The Consumer Groups submitted that any changes brought about by the Commission's decision in the Public Notice 2005-2 proceeding and by the Telecommunications Policy Review were likely not dependent on the term of the extension of the current price regulation regime. The Consumer Groups supported the elimination of the deferral account, but did not agree that the ILECs should keep the funds that would otherwise be placed in the account.

Xit telecom

46. Xit telecom submitted that the continuation of the current price cap framework for a period of two years was absolutely necessary to provide the Commission with sufficient time to decide several outcomes, such as the proceeding initiated by Public Notice 2004-1 and various competitive disputes.

Commission's analysis and determinations

Extension of the price regulation regime

47. The Commission notes that in Public Notice 2005-3, the proposal to extend the current regime was based principally on three factors: the state of local competition; the need to assess the impact of VoIP services on the local market; and the need to assess the outcome of the Public Notice 2005-2 proceeding.
48. In Decision 2002-34, the Commission established the current price regulation regime based essentially on its analysis of the state of competition. With respect to the argument that there have been significant changes in the industry since the last review, the Commission notes that while there have been some competitive inroads made recently in the local market, the ILECs in general continue to dominate, especially in the residential market.
49. The Commission is hopeful that VoIP technology, utilizing existing cable and ILEC infrastructure, will lead to increased competition, including facilities-based competition, in the local services market and particularly in the residential market. The Commission notes, however, that the use of VoIP technology to provide local services is in its early stages of deployment and that it is too early to assess the impact of VoIP services on the local market.

50. The Commission notes that the Public Notice 2005-2 proceeding is addressing the criteria and framework for forbearance from the regulation of residential and business local exchange services. The Commission considers that the outcome of the Public Notice 2005-2 proceeding has the potential to impact the price regulation regime and that there is merit in resolving the issues in that proceeding prior to establishing the next price regulation regime.
51. The Commission accordingly considers that the existing price regulation regime should be extended beyond 31 May 2006.
52. As to the duration of the extension, in light of the fact that a decision in the Public Notice 2005-2 proceeding is expected in early 2006, and the desire of many parties in this proceeding to see an extension shorter than two years, the Commission extends the current price regulation regime for Aliant Telecom, Bell Canada, MTS Allstream, SaskTel, and TCI for a period of one year, to 31 May 2007. The Commission intends to initiate a proceeding to review the existing price regulation regime in the first half of 2006 following the release of the decision in the Public Notice 2005-2 proceeding.

Rate de-averaging within a band

53. The Commission notes that its policy with respect to de-averaging was established in Decision 2002-34. The Commission notes that in *Review of price floor safeguards for retail tariffed services and related issues*, Telecom Decision CRTC 2005-27, 29 April 2005 (Decision 2005-27), the Commission reaffirmed the rate de-averaging policy specified in Decision 2002-34. In Decision 2005-27, the Commission considered that allowing the ILECs to respond to market forces within a geographic area of a rate band through de-averaged rates would allow for a degree of targeted pricing which could subject other customers in the rate band to an undue disadvantage, result in rates that were not just and reasonable, and slow the development of fair and sustainable competition.
54. Based on the record of this proceeding, the Commission is of the view that the reasons set out in Decision 2005-27 to support the Commission's policy prohibiting any further rate de-averaging still apply and that a review of this policy is therefore not warranted at this time.
55. Accordingly, the rate de-averaging policy enunciated in Decision 2002-34 and reaffirmed in Decision 2005-27 will continue to apply during the one-year extension of the price regulation regime.
56. The Commission notes that in *Bell Canada proposal for VoIP service pricing in Ontario and Quebec*, Telecom Decision CRTC 2005-62, 20 October 2005, it approved, on an interim basis, Bell Canada's Tariff Notice 6900 which allows Bell Canada to price its Bell Digital Voice service differently in Ontario and Quebec. A final decision with respect to this matter will be made in a separate proceeding.

Pricing constraints and the deferral account for residential non-HCSAs services

57. With regard to the proposals made by certain parties to remove the I-X constraint on the residential non-HCSA basket, the Commission notes that in general the ILECs continue to dominate the residential local market. In these circumstances, the Commission considers that

removal of the I-X constraint would eliminate a necessary measure of price discipline. The Commission also considers that removal of this constraint would also remove the incentive for the ILECs to meet the expected productivity target. As for the argument made by TCI that consumers in non-HCSAs would benefit more from eliminating the I-X constraint and allowing prices to decline in response to competition, the Commission notes that the ILECs have the pricing flexibility within the current framework to reduce prices in response to competition.

58. With respect to the proposals by a number of parties to discontinue the deferral account or to stop augmenting the balance in the deferral account, in light of the current state of competition in the residential market, the Commission considers this proposal to be inappropriate.
59. In light of the above, the Commission determines that the I-X constraint and the deferral account mechanism for the non-HCSA residential services basket will be maintained during the one-year extension of the price regulation regime.

Proposals relating to competitor services

60. With regard to the proposals made by MTS Allstream regarding competitor services, the Commission considers that they are beyond the scope of this proceeding or have been previously dealt with by the Commission.

Other Matters

61. TCI and the Consumer Groups raised issues with respect to the procedural fairness of the process set out in Public Notice 2005-3. They also questioned the Commission's authority with respect to the deferral account. TCI submitted that a decision involving an extension of the price cap regime would be a rate-setting decision and that if the Commission proceeded with the proposed extension it would be violating established legal principles for setting just and reasonable rates.
62. The Commission considers that the process established in Public Notice 2005-3 was fair and that the Commission has the authority under the *Telecommunications Act* to extend the price regulation regime as specified in this Decision.

Secretary General

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