

CANADIAN COMPETITION POLICY RECORD

REGULATORY AND POLICY DEVELOPMENTS

NEW CABLE RETRANSMISSION TARIFFS CONSIDERED BY COPYRIGHT BOARD

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Last summer, as required by the *Copyright Act*, the various retransmission collectives filed with the Copyright Board new statements of proposed royalties in respect of the cable retransmission of "distant" television and radio signals during the 1992-94 calendar years. In these tariff proposals, the collectives have asked the Board for more than the approximately \$50 million approved in the last proceeding in 1989-90. Although it is difficult to measure accurately the financial impact of these new tariffs, it is estimated that, if approved by the Board, they would generate a royalty pool in the order of \$65 million. Not surprisingly, these proposals are being vigorously opposed by a number of objectors representing cable interests: the Canadian Cable Television Association (CCTA), Regional Cablesystems Inc. and Canadian Satellite Communications Inc. (Cancom).

The Existing Tariff

To understand fully the new proposals filed by the collectives, it is useful to review the Board's previous retransmission decision of October 2, 1990. There, the Board approved a formula by which cable operators paid royalties that increased with the size of their particular system, rather than by the number of distant signals which they carried. As long as they carried at least one distant signal, they were liable for the rate corresponding to the size of their system. This sliding-scale royalty structure for systems serving between 1,001 and 6,000 subscribers ensured

that there was a relatively smooth transition to the maximum rate of 70¢ per subscriber per month payable by systems over the 6,000 mark.

In order to reach this maximum rate, the Board adopted a "comparable services" approach in which it reviewed the wholesale rates paid by Canadian cable systems for a number of Canadian and American specialty services such as YTV and Arts & Entertainment (A&E). The Board considered that "the price of a similar good in another market could provide useful information" as to the proxy which could be used for the value of a distant signal. In the end, the Board decided that the 25¢ wholesale price paid for A&E was a useful starting point. It then proceeded to discount the 25¢ rate to 15¢ to account for distinguishing factors between the A&E service and distant signals. The Board then multiplied 15¢ by the 4.56 average number of distant signals received in Canada to arrive at the figure of 70¢ per subscriber.

For small cable systems, defined by regulation as those serving no more than 1,000 premises in the "same community," the *Copyright Act* requires that the Board adopt a preferential royalty rate. Based on the evidence before it, the Board held that a flat annual payment of \$100 was an appropriate rate for these systems to pay for their use of distant signals.

The monies thus collected from the cable companies are distributed amongst the collectives on the basis of a formula determined by the Board. This formula weights the viewing of the programs of a given collective by the supply, or reach, of that programming in Canadian households.

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The Collectives' Current Proposals

In their new statements of royalties, each of the retransmission collectives have proposed major changes to the existing tariff structure. They have proposed that the overall royalty rate be increased from 70¢ per subscriber per month to 90¢ to \$1.00, payable by *all* cable systems serving over 1,000 premises. As such, they would have the Board abandon its sliding-scale method for systems serving from 1,001 to 6,000 subscribers. Furthermore, several of the collectives have advocated the imposition of an additional surcharge of 20-30¢ for each U.S. superstation signal retransmitted to cable subscribers. Finally, they would do away with the flat annual \$100 preferential rate for small systems and replace it with one that would vary from 45¢ to 85¢ per subscriber per month.

Increased Royalty Rate

In arguing in favour of an increased overall royalty rate, a number of the collectives have adopted the approach already approved by the Board in its last proceeding. As already noted, this involves multiplying the average number of distant signals received by Canadian cable subscribers by the value of a distant signal. According to research filed with the Board by one of the collectives, the average number of distant signals received in Canada is in order of 5.14.

As for the value of a distant signal, the collectives argue that it has increased since the time of the last hearing. Several of them point out that the Canadian wholesale price for the A&E service has recently risen from 25¢ to 29¢. If the 15¢ value which the Board accorded to a distant signal in its 1990 decision was increased proportionately to reflect this rise in the A&E wholesale price, an amount of 17.4¢ would be reached. Multiplying this by 5.14 results in just under 90¢, a rate these collectives claim should be the minimum level of the possible range of royalty rates.

Calculating the maximum of the range would involve taking the current A&E wholesale price of 29¢ and discounting it by 20 percent—rather than by the 40 percent previously approved by the

Board. The argument in support of this reduced discount is that, in its previous decision, the Board placed too much emphasis on such factors as the marketing, packaging and penetration of A&E in reaching the 15¢ price. Using a 20 percent discount, the 29¢ A&E rate would be reduced to 23.2¢. This would result in a maximum royalty rate of \$1.19 when multiplied by 5.14.

Other collectives claim that strict reliance on the A&E wholesale price as an appropriate proxy significantly undervalues the price which should be attributed to distant signals. For example, the collectives representing professional sports programming argue that, as A&E does not carry any major league sports, its 29¢ wholesale price is too low when compared to the intrinsic value of distant signals. Another collective has suggested that, in addition to A&E, the Board should review the rates for a variety of specialty services, including YTV and Family Channel. The blending of these different rates would, of course, tend to increase the value to be given to distant signals.

Based on all of these arguments, the collectives suggest that the overall royalty rate approved by the Board could reasonably range from 90¢ to \$1.30. Accordingly, they take the position that an overall royalty rate of 90¢ to \$1.00 per subscriber per month is probably on the conservative side of the possible range of royalty rates.

U.S. Superstation Surcharge

A number of the collectives have also proposed an additional charge of 20¢-30¢ per subscriber per month for each U.S. superstation signal retransmitted. Because the growth in superstation penetration has not yet stabilized (or so they argue), they have found it difficult to integrate the existing information on superstation penetration into their statistics on the average number of distant signals received by Canadian cable subscribers. Even if this were not the case, they have apparently assumed that the cable industry would support the concept of such a surcharge, as it would avoid giving rise to a situation in which cable systems that did not carry superstations were required to subsidize the copyright liability of those that did. Furthermore, a surcharge that was separately established and identifiable could

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be readily passed through by cable operators to their subscribers.

This question of a superstation surcharge is obviously of importance to both the cable and Canadian pay television industries. The imposition of a special superstation surcharge—and the curtailment in the distribution of superstation signals that this would undoubtedly cause—could negatively affect the marketing of Canadian pay services such as First Choice, Superchannel and Family Channel which look to U.S. superstations as packaging partners.

It would appear, however, that the collectives do not care whether they are compensated for U.S. superstation carriage by the imposition of a separate surcharge or by adding the superstation penetration rate (to the extent it can be estimated) to the average number of distant signals retransmitted. While the merging of these two numbers would probably mean that all Canadian cable operators would have to pay a few cents extra on their overall royalty rate, it would eliminate any incentive to drop superstation signals.

The Position of the Objectors

For its part, the CCTA argues that the Board was incorrect when it held in its 1990 decision that the cable industry would be able to absorb the existing level of royalty rates while continuing to earn fair financial returns. Essentially, it is the CCTA's position that, applying an "ability to pay" criterion, the current royalty rates are unmanageable and should be reduced by the Board. In support of this argument, the CCTA suggests that, in comparison with the retransmission regime in effect in the United States, the total royalty pool payable by Canadian cable operators should only be in the \$25-38 million range.

With respect to using the A&E wholesale price as an appropriate proxy, the CCTA claims that there are a number of factors which would tend to discount the A&E price by more than the 40 percent allowed by the Board in its last decision. These factors include the cost of importing and marketing distant signals, as well as the closely regulated market into which the A&E service is sold in Canada. Adding up the various

adjustments required by these factors, the CCTA attributes a value of approximately 8¢ to the A&E service and, consequently, to a distant signal. This would result, according to the CCTA, in a maximum royalty rate in the order of 36¢ per subscriber per month, instead of the 90¢-\$1.00 proposed by the collectives.

The concerns of Cancom and Regional Cablesystems in this proceeding relate predominantly to the proposed U.S. superstation surcharge, the abandonment of the sliding-scale method for systems serving between 1,001-6,000 premises and the 45-85¢ preferential rate for small systems. It is their position that U.S. superstation signals should not be distinguished from other distant signals and should therefore receive the same treatment from the Board. Moreover, they claim that the imposition of such a surcharge could have a serious impact on public policy objectives under the *Broadcasting Act* which encourage the distribution of Canadian pay television services.

Conclusion

The Copyright Board will have the difficult task of deciding between competing arguments and methodology and having to decide what would be fair and equitable to both copyright owners and users. At issue is whether the existing royalty pool of \$50 million is too low or too high. According to a timetable adopted by the Board, final argument by the various collectives and objectors on this issue will be made at the end of July. A decision should be released by the Board some time during the fall.

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GOVERNMENT ELIMINATES FOREIGN INVESTMENT RESTRICTIONS IN ENERGY SECTOR

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With the blunt statement that "the target of 50 per cent Canadian ownership of the upstream oil and gas industry" is now "history," Energy Minister Jake Epp has announced the end of foreign investment restrictions in the Canadian energy sector. Mr. Epp presented the policy change in Calgary on March 25, 1992.

Under the now-abandoned Oil and Gas Acquisitions Policy, foreign investors were not allowed to acquire Canadian-controlled petroleum companies and assets worth more than \$5 million, unless the company to be acquired was in clear financial difficulty. According to the federal government and some in the industry, the policy inhibited access to capital not only from abroad but from Canada as well, since Canadian companies did not have complete freedom to rationalize their holdings of petroleum properties, and were also less attractive as investment vehicles for Canadians.

The result will be, after the passage of the necessary changes to the *Investment Canada Act*, that for the purposes of review by Investment Canada, acquisitions of oil and gas companies or assets will be treated the same as virtually anything else. This means that direct acquisitions valued at more than \$5 million will be reviewable but will be approved if they are determined to be of "net benefit to Canada." For indirect acquisitions (i.e., where the foreign parent of a Canadian subsidiary is being acquired), the threshold for review will be \$50 million. Under amendments to the *Investment Canada Act* in 1989 as a result of the *Canada-U.S. Free Trade Agreement*, the threshold for U.S. investors in a direct acquisition has this year reached \$150 million. As of 1992, there is no longer any review of indirect investments by Americans. Although Investment Canada occasionally insists on the provision of certain undertakings by investors in a review, since its creation in 1985 it has never refused

outright to approve an acquisition.

In making the policy announcement, Mr. Epp linked the change to the government's competitiveness initiative, and to the "fundamental concept" of the government's energy policy that "competitive markets should be the principal determinant of private decisions regarding energy supply, demand, price, and trade." Indeed, the Oil and Gas Acquisitions Policy was one of the last remnants of the interventionist energy program of the previous Liberal government. Few in the West appear to lament its passing.

CRTC DECIDES TO REGULATE RESELLERS AND ROGERS NETWORK SERVICES

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On the day before the CRTC's major decision permitting increased long distance competition, the Commission released two related decisions, one on the regulatory status of telecommunications services resellers, and the other concerning the supply of private line data and voice services by Rogers Network Services (RNS), an organizational unit of Rogers Cable TV Limited.¹ In both decisions, the CRTC found that the particular businesses were federal undertakings, i.e. undertakings of an extra-provincial nature, and "companies" as that term is defined for the purposes of the CRTC's jurisdiction under the present *Railway Act*.

Given the extensive opportunities for increased competition in the long distance market created by Telecom Decision 92-12 (see related commentary in this issue), it should not come as a surprise that the CRTC has also elected to assert its regulatory jurisdiction over two types of businesses that will, in the short term at least, generate a very high level of entry into the long distance market. After all, the new entrants pose a significant threat to the CRTC's capacity to manage, in a politically acceptable fashion, reductions in long distance rate levels and the extent to which long distance revenues contribute

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to fixed access costs in order to keep local rates very low.

While the CRTC's decisions make sweeping changes, they do not truly constitute blind regulatory ambition (the CRTC has already been thinly stretched to deal with all the users arising from the dominant telephone companies). Rather, the Commission has taken the necessary steps to maintain the political viability of its overall policy towards long distance competition. In fact, it would be very difficult for the Commission to adopt such a liberal open entry régime as that contained in Decision 92-12 while simultaneously assuring government and consumer interests that it is capable of keeping local and long distance rates at the levels necessary to protect such social policy requirements as universal telephone service format and, at the same time, permitting one of the most significant elements of the long distance sector to price at virtually any level and attract virtually any market share without the possibility of some form of regulatory constraint. For better or for worse, it is probably true that the open entry régime adopted in Telecom Decision 92-12 is, at least for the next year or two, politically acceptable only if the CRTC can demonstrate that it can prevent its carefully balanced chemical reaction from blowing up.

Moreover, over the next year or two the CRTC would inevitably be faced with the difficult question of determining the point at which a services reseller had suddenly become transformed (through some form of commercial or legal alchemy) from an unregulated go-between into a full-fledged telephone company under the *Railway Act*. The current definition of a "company" in this legislation offers no basis for excluding some businesses on the basis of the balance between equipment and transmission facilities rented, and equipment and transmission facilities owned. It should also be noted that the new improved definitions under the *Telecommunications Act* (Bill C-62) do not offer any assistance in this respect either. Strategically, it may well have been wise for the Commission to try to put the issue of whether resellers should be subject to CRTC rate regulation to the resellers' sector as soon as possible following the Commission's major decision on long distance competition. This would

have ensured that, if necessary, the matter would have been tested before the courts at the earliest possible date in the new open entry régime.

However, the most ambitious resellers would have already sensed that as their business grow and they add more switching and transmission assets, they would eventually have to be considered companies under the *Railway Act*, regardless of any interim artificial boundary between businesses that own and businesses that rent productive resources. Consequently, the CRTC might also be betting that resellers might be in favour of some regulatory certainty and be willing to pay the offsetting price caused when the CRTC, in the extreme case, makes resellers change their prices and certain marketing practices.

The CRTC's reseller decision was prompted by an application of the Telecommunications Workers Union (TWU) requesting review and variance of a number of previous decisions which established that resellers were not companies subject to regulation under the *Railway Act*. To act on the TWU application, the Commission was required to re-examine its interpretation of the definition of a company under the *Railway Act*. Under this definition, a business is subject to CRTC rate regulation if it owns or operates a telephone line or system. In previous decisions, the CRTC had implied that it did not consider resellers as operators of a telephone line or system, and appeared to place primary weight on the aspect of ownership of a telephone line or system.

The Commission took into account the manner in which modern resellers configure their networks and the assets involved in their businesses. Specifically, resellers generally own or lease an advanced switch, assemble traffic from their customers by way of direct access lines or local telephone company networks, aggregate traffic or transmission to other exchanges, and select (from a number of possible leased transmission paths) the appropriate method of transmission to a remote telephone company switch for distribution to the ultimate destination. The Commission has now determined that this form of business constitutes operation of a telephone system.

The Commission specifically rejected the contention of certain resellers that only the telephone companies' supply and underlying

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services actually constituted a tele-communications system:

[I]n the Commission's view, resellers may determine which services or facilities to lease in order to provide their services and may aggregate and switch the traffic to be sent over their systems. Furthermore, in certain circumstances resellers do control the routine of messages over their leased services or facilities. Resellers typically lease services and facilities from carriers and program their switches to determine how to route their traffic over these services and facilities. In such cases, it is the reseller, not the carrier, who determines the routing, thereby operating the system carrying the traffic.

The Commission therefore concluded that by offering end-to-end basic telecommunication service (i.e., either voice or data transmission which does not involve enhancements such as store-and-forward capacity) by means of interprovincial services or facilities that they configure, and by exercising control over the carriage and routing of the traffic, resellers have brought themselves under federal jurisdiction as operators of a telephone system or line within the definition of company under the *Railway Act*. Resellers registered in order to obtain private line resale rights have been directed to submit proposed tariffs for Commission approval by October 9, 1992, or to show cause why they should not be required to do so.

The Commission's reasons suggest that resellers who can demonstrate that they do not exercise control over the carriage and routing of their traffic would not be subject to CRTC rate approval jurisdiction. However, the decision does not provide much assistance to resellers in determining the level of carriage and routing control that would be low enough to disqualify them from regulation. Presumably, any time the reseller's switch directs a local call received over the telephone companies' network from a private line to a distance exchange of a telephone company for delivery, the reseller is, to some degree, controlling the carriage and routing of the traffic. On the other hand, the Commission's reasons depend heavily on the notion that the operation of a telephone system requires some degree of network management (i.e., some degree of selection among alternative routing patterns to achieve an

overall efficient result).

It is also worth noting that there appears to be no basis within the Commission's reasons for not extending its jurisdiction to resellers involved in the supply of enhanced services (as long as such resellers meet the conditions of leasing of interprovincial services or facilities), and exercising some (albeit undefined) degree of control over the carriage and routing of this traffic. The logic of the CRTC's decision, therefore, leads not only to the regulation of the voice grade service resellers sector, which could threaten the delicate balance of Decision 92-12, but also to the commercial basis of interprovincial supply for enhanced services which are not competitive substitutes for conventional voice grade telephony.

The CRTC's decision to regulate RNS follows a somewhat different track. The decision itself flows from Bell Canada's application to have Rogers Cable TV declared a company within the CRTC's jurisdiction. The Bell Canada application was prompted by Rogers' offering advanced private line (voice data and enhanced) services to businesses in various Canadian cities through Rogers' own cable TV capacity and additional transmission facilities added to its cable architecture. Rogers also offered intercity links through the resale of telephone company private line capacity. In this respect, Telesat Canada channels were principal sources of private line transmission capacity for Rogers.

Rogers' position was that even if it was in the telecommunications business, it was essentially acting as a local telecommunications service supplier and not as an interprovincial undertaking. Rogers also contended that its telecommunications business was incidental to its activities as a regulated broadcasting undertaking, and that if it was to be regulated it should continue to be regulated in all its business as a broadcasting undertaking.

The Commission rejected Rogers' argument that its telecommunications undertaking could not legally be separated from its broadcasting undertaking. In fact, the Commission concluded that a corporation could be regulated under both the *Broadcasting Act* and the *Railway Act*. The Commission was also not swayed by Rogers' argument that even if it was a telephone company,

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it was only a local telephone company. Although the bulk of the assets involved in the RNS business would probably fall under the constitutional concept of a local work or undertaking, the Commission noted that Rogers used its own facilities in more than one province to provide telecommunications services that crossed provincial boundaries. The fact that these linkage facilities were leased was immaterial to the CRTC. In reaching its decision, the Commission applied the principal test of the Supreme Court of Canada as established in a 1990 Alberta Government Telephone decision. Basically, this test directs decision-makers to look beyond the physical structures or their geographic location and to concentrate instead on the service which is provided by the undertaking through the use of its actual equipment. Using this test as a guideline, the Commission found as a fact that interprovincial services were, to some extent, being provided by Rogers. Apparently, the Commission did not consider whether the interprovincial services were a large enough part of the total output of the RNS operation to qualify Rogers as an interprovincial undertaking. Instead, the Commission noted that Rogers' own marketing literature referred to an integrated interprovincial and local service portfolio with local distribution systems in more than one province.

Therefore, in contrast with the reseller decision described above, the Commission's focus in the Rogers case was upon the presence of a number of local network structures under common ownership in more than one province linked, to some extent, by private line services. It should also be noted that the Commission's RNS decision did not mention control over the carriage and routing of traffic as an essential element of a *Railway Act* company, nor did it make the distinction between basic and enhanced services present in the reseller decision. Instead, the entire RNS telecommunications activity, regardless of the extent to which it provides intra-provincial services, and regardless of whether voice data or enhanced services are supplied, has remained subject to CRTC rate regulation under the *Railway Act*.

In conclusion, the reseller and RNS decisions established two separate streams for finding that

non-traditional suppliers are subject to CRTC jurisdiction. In the reseller decision, the emphasis was upon the capacity of the supplier to assemble and route the transmission of basic voice grade long distance calls, while in the RNS decision, the Commission's approach was based on the operation of a number of discrete intra-provincial networks offering all forms of telecommunications services within one overall business organization involving common direction and, to some extent, linkage through simple resold private line capacity, but not involving any major degree of interprovincial network management activity.

Notes

- ¹ Telecom Decision CRTC 92-11, *Application by TWU—Status of Resellers under the Railway Act*, and Telecom Decision CRTC 92-10, *Bell Canada v. Rogers Cable TV Limited, carrying on business as Rogers Network Services—Application to Acquire the Filing of Tariffs of Polls by Rogers Cable TV Limited*, both decisions dated June 11, 1992.