REGULATORY AND POLICY DEVELOPMENTS

STENTOR SEEKS CABINET REVIEW OF CRTC RATE SETTING PRACTICES

By: John F. Blakney
Fraser & Beatty, Ottawa

On August 5, 1992 Stentor Telecom Policy Inc., on behalf of the federally regulated telephone companies, petitioned the federal cabinet requesting that the Cabinet vary portions of the CRTC's Interexchange Competition decision.[1]

Stentor has asked the Cabinet to relax the standards established in Decision 92-12 for the approval of telephone company long distance rate reductions and to require the CRTC to conduct an examination during 1993 of its practices for setting monopoly services rates to determine "the most efficient and equitable way of regulating" these services. Stentor wants the CRTC to consider alternatives to the traditional rate base/rate of return method of monopoly price and profitability regulation. This method has been used by the CRTC since 1976 when it was given its telecommunications jurisdiction including a net liability rate base and a net asset rate base, as well as price caps and other forms of incentive regulation.

This position picks up on the federal government's Competitiveness Initiative which has, among other matters, examined the possibility of improved economic performance flowing from incentive forms of regulation that do not involve the decision-making delays, evidentiary requirements and degree of cost-pass-through generally entailed in rate base/rate of return regulation.

The principal focus of the Stentor petition, however, is to make it easier for the telephone companies to lower long distance rates in response to, or in anticipation of, direct long distance competition from Unitel and other interexchange carriers.

Decision 92-12 establishes new standards for the review and approval of telephone company long distance rate decreases. The CRTC announced that it would grant interim *ex parte* approval to proposed long distance rates where it is satisfied on a *prima facie* basis the contribution loss would not be significant. This would require the applicant to file economic studies showing the forecasted change in contribution including cross-effects. The CRTC also stated that it would grant *ex parte* interim approval for long distance rates that would result in a significant reduction in contribution where the company establishes that the reduction in contribution amounts to the elimination of surplus revenues (i.e. revenues in excess of that required to earn an adequate corporate return on invested capital).

The Stentor proposal would shift the onus onto the Commission by requiring that all telephone company long distance rate decreases be approved within seven days "unless there is a strong reason not to do so". What would constitute a "strong reason" is not presented in the Stentor proposal.

One effect of the proposed variance to Decision 92-12 would also appear to be deletion from the Decision of the CRTC's conclusions that the telephone companies will, for the foreseeable future, continue to dominate the market, and that they control bottleneck facilities and have the ability to sustain non-compensatory rates. The Commission's conclusion that it will continue to require proof that telephone company long distance rates are compensatory may also be subject to deletion if the variance requested in petition is adopted without modification by the Cabinet.

The principal reason provided by Stentor in support of this more relaxed pricing standard is that Decision 92-12 imposes pricing constraints upon the telephone companies which will

excessively impinge their ability to compete effectively both domestically and globally. The petition states:

> The relief requested by Stentor in its petition to the Cabinet is unrelated to the relief sought from the Federal Court in the telephone companies' appeal from Decision 92-12. The telephone companies have asked the Federal Court to quash the CRTC's decisions to require the telephone companies to recover 70 percent of the network conversion costs associated with providing equal ease of access to competing long distance services and to provide a limited duration discount (starting at 25 percent) to the access contribution charges payable by Unitel and other interexchange carriers to the telephone companies.

At the time of writing, there had been no indication of how the Cabinet planned to address the Stentor petition.

Notes

[1] Telecom Decision CRTC 92-12, June 12, 1992; see (1992) 13:2 C.C.P.R. 13.

CALIFORNIA GAS WAR: NEB WALKS NOISILY, CARRIES SMALL STICK

By: N.J. Schultz
Fraser & Beatty, Ottawa

The National Energy Board ("NEB") has rebuked the California Public Utilities Commission ("CPUC") for its order requiring the state-regulated utility, Pacific Gas & Electric ("PG&E") to open up its access to Canada to allow its customers direct access to Canadian producers. At present, PG&E purchases its natural gas from a related company, Pacific Gas Transmission ("PGT"), which in turn purchases the gas at the Canadian border from another related company, Alberta & Southern ("A&S"). This monopoly gas supply arrangement dates back some 30 years when the California utility was seeking to supply its northern California markets with Canadian natural gas. A&S purchases the gas from a large pool of Canadian gas producers.

The A&S gas export licence was extended by the NEB in 1989 from its then-scheduled 1994 expiry date to a 2005 expiry date. The CPUC filed a letter with the NEB supporting the extension and endorsing the historic supply arrangements. The CPUC's recent actions were designed to open up the California gas market to competition. The result would be to displace the sales made by A&S.

The NEB determined that it would conduct a review of the A&S export licence. It issued interim orders restricting short-term exports into the California market and also restricting access to transportation on the connecting pipeline system, Alberta Natural Gas. The NEB's final decision prevents short-term exports into the northern California market with the effect that the only gas which can flow into this market is that contracted by A&S for sale to PGT. Access to capacity on the connecting ANG system has also been restricted.

The NEB's order is to remain in effect until the parties to the various contracts have negotiated "fair and equitable contractual arrangements" and all necessary regulatory approvals are in place. Meanwhile, discussions among the Alberta and B.C. Governments and the CPUC are continuing and could lead to a resolution of the problem.

The NEB did not question the competitive objective which the CPUC seeks to achieve. Rather, the NEB criticized the CPUC for providing an inadequate length for a transition and for making no provision for transition costs. The NEB took the view that the CPUC held out the promise of a regulatory environment which would afford secure and dependable markets and that Canadian gas producers undertook major commitments to finance the development of the additional gas supplies in Canada which would be needed to meet California's demand. The NEB concluded that the CPUC decision could strand substantial producer investments. At the very least, the NEB considered that the CPUC decision would undermine the contractual basis on which the investments were made and adversely affect their prospective economic viability.

The NEB acknowledged that regulatory change is a risk and a fact of life in the evolving North American gas market. However, it stated that

regulators need to be cognizant of the fact that such changes can impose costs on parties who have contracted on the basis of then-existing regulatory policies. The NEB considered that, as a matter of fairness and equity, regulators should provide an appropriate framework, including a sufficient period of time, for the parties they regulate and other affected parties to react and adjust to changes in the regulatory regime in which they must do business. The CPUC decision contemplated implementation as early as October 1, 1992 which, in the NEB's opinion, was too short a time for parties to arrive at fair and equitable settlements in private contractual negotiations.

The NEB rebuked the CPUC for infringing on the NEB's jurisdiction. The CPUC's objective could only be achieved by matching open access to Canadian pipeline and productive capacity. The NEB considered that the CPUC had presumed that the NEB would simply acquiesce by taking any necessary complementary regulatory action in Canada. The NEB, however, stated that it could not stand idly by when the regulatory actions of others adversely affected the basis upon which it was persuaded to issue a licence.

The NEB's tough talk masks a basic economic reality. The reality is that if northern California cannot get what it wants from the north; it will get it from the south. At present, northern California is largely served with Canadian gas entering from the north. Pipeline capacity from the south which would connect to U.S. gas supplies is constrained. However, little is required (in relative terms) to open up the systems to the south and, indeed, proposals to do just that are on the drawing boards. While California has an economic interest in avoiding stranding the capacity in the U.S. which brings in Canadian gas, there is a point beyond which restrictive Canadian action will simply become cutting off the nose to spite the face.

COMPETING ALLOCATION METHODOLOGIES CONSIDERED BY COPYRIGHT BOARD IN RETRANSMISSION PROCEEDING

By: J. Aidan O'Neill
Johnston, Buchan & Dalfen, Ottawa

At the cable retransmission right hearing which recently concluded before the Copyright Board, two very different allocation methodologies competed for the Board's approval. What is at stake is how the royalty pool generated from the retransmission of distant television signals will be divided up amongst the various collectives representing copyright owners. Since the collectives have proposed tariff schemes which, if adopted by the Board, will raise an amount in the order of $65 million from Canadian cable systems, every percentage point of allocation "share" is very valuable to these rightsholders.

The Existing Methodology

In its previous decision of October 2, 1990, the Board approved a viewership theory of allocation as the most appropriate means of measuring the relative value of television programming retransmitted on a distant basis. In other words, the Board held that a particular collective should be entitled to a share of the overall royalties generated which is proportionate to the viewing of television programming belonging to that collective's members. In determining this level of viewership, the Board relied on surveys conducted by the Bureau of Broadcast Measurement ("BBM") during a typical sweeps period. Because this BBM viewing data measures the popularity of television programs to cable subscribers, the Board considered that it represented the best way to allocate the retransmission royalties amongst the collectives.

In adopting this viewership methodology, the Board was not persuaded by arguments presented by a number of collectives to the effect that the Board's allocation of royalties should be based on the supply of television programming to cable subscribers. According to these arguments,

television programming should be weighted by the number of households that it reaches rather than by the relative degree to which it is actually watched by television viewers. Such a "supply-side" approach would mean, of course, that a program which attracted very few viewers would earn the same royalty for its owner as would a show that was immensely popular and had a significantly larger audience.

In the end, having to choose between these competing methodologies, the Board opted for the viewing approach, stating that this method recognized the different values of different programs, as well as the fact that cable subscribers and cable systems do not value all television programs equally. The Board was, however, prepared to make an exception in the case of Canadian television signals in order to reflect CRTC requirements regarding the carriage of a minimum of Canadian programming. As such, the Board weighted programs carried on Canadian signals by supply, thereby giving them a greater royalty share than the application of a pure viewership methodology would have produced. Nonetheless, because of the high viewership enjoyed by American programs in Canada, one collective—representing the interests of the American film and television industry—was awarded a full 57 percent share of the total retransmission royalty pool.

The New Allocation Proposals

In the retransmission right hearing which has just ended, the collectives whose television programming is less highly viewed than "mass appeal" American programming argued that the Board should make some adjustments to the existing viewership theory of allocation. In this regard, these collectives have suggested that the Board should take into account the true value of specific television programs to cable subscribers rather than merely measuring viewership.

For example, in the last proceeding, the Board was only prepared to make an exception to its decision to apply a viewership-based methodology in the case of Canadian television signals. All American signals, including distant PBS signals, were treated alike and thus received a royalty allocation equivalent to their BBM viewing share. The collective representing PBS argued, however, that the continued application of such a methodology would fail to attribute to PBS the monetary value accorded it by cable subscribers.

In the current proceeding, evidence was submitted to the Board which indicated that Canadian cable subscribers value PBS programming more highly than the amount generated by the application of the BBM viewing data would suggest. This evidence demonstrated that cable subscribers place a value on PBS signals that is greater than both their supply and viewership share. As a result, it was argued the Board should adjust its viewership methodology to recognize this subscriber valuation of PBS signals. In the written submission of the PBS collective, the Board was asked to approve an allocation methodology which would pay PBS a royalty equivalent to the true value of its programming. In the opinion of the collective, this should be no less than the amount calculated by multiplying the supply of PBS programs by the average value accorded by the Board to a distant signal.

Similar to the arguments made on behalf of PBS, the two collectives representing professional sports teams considered that a pure viewership methodology tended to undervalue their programming. Simply put, it was their position that major league sports programming is very important to cable systems in attracting subscribers and therefore has a value that exceeds the numbers derived from the BBM viewing data. According to this argument, because sports broadcasts are topical and available on a "live" basis, they create a high degree of interest amongst television viewers. Cable systems use this interest in professional sports to create a demand for their cable services. Sports programming thus has a value at both the subscriber and cable system levels that is not properly reflected by the application of a viewership methodology.

In addition to arguing that adjustments have to be made to any viewership-based allocation methodology in order to account for the value of programming, a number of collectives have also criticized the methodological basis of the BBM viewership statistics. These statistics are derived

from the so-called "diaries" that a representative sampling of television viewers are asked to complete, recording their daily television viewing patterns. The problem with these diaries is that there is no evidence that they are filled in within a reasonable period of time following viewing, a factor which would influence their accuracy. Furthermore, the response rate to diary surveys is in decline, with less than 20% of the representative television audience chosen by BBM actually participating in the surveys by returning completed diaries. These methodological shortcomings have allegedly resulted in an underreporting of the amount of viewing of PBS and independent television stations when compared to the viewership results obtained from using electronic "passive meters". This discrepancy in viewership between the BBM diary system and passive meters has been estimated to be in the order of 25 percent.

Conclusion

In the current retransmission proceeding, the Board will probably choose an allocation methodology from between the alternatives of a pure viewership model and one which takes into account the intrinsic value of television programming. In doing so, the Board will consider whether, in allocating royalties, it should have regard to the different values accorded to various kinds of television programming by cable subscribers, irrespective of viewing data. If it decides to recognize value as a relevant factor, the Board may well make adjustments to the viewership methodology previously approved in its 1990 decision so that PBS and sports programs are accorded more weight than their viewership would otherwise allow. This would mean that these programs would receive copyright treatment more analogous to that which the Board awarded to Canadian television signals in the last proceeding.

The Board's decision is expected in the autumn of 1992.

NEB CONSTITUTIONAL QUESTION: A MAILED FIST IN A VELVET GLOVE

By: N.J. Schultz
Fraser & Beatty, Ottawa

The National Energy Board ("NEB") has raised a jurisdictional question over a 300-metre pipeline which would link the NOVA pipeline system in Alberta to the proposed Altamont pipeline system in the United States. NOVA would be required to build a new 200 km line from its existing Princess compressor station to the connection with the proposed 300 metre Altamont Canada pipeline. The NEB has questioned whether the Altamont Canada pipeline, which is indisputably under federal jurisdiction, is not actually part of a larger "extra-provincial work" beginning at Princess and ending at the international border. NOVA is the provincially-regulated system in Alberta which gathers natural gas from areas all over the province and brings the gas through mainline transmission facilities to various existing points along the Alberta/Saskatchewan, Alberta/B.C. and Alberta/U.S. borders where NOVA connects with federally-regulated pipeline systems. The Altamont Canada proposal follows the same pattern as has been followed with other pipeline systems since the TransCanada pipeline system was constructed in the late 1950's.

The question raised by the NEB is interesting for two reasons. First, the question focuses only on the new line which NOVA would propose to construct from Princess to near the border. Second, by attempting to limit the focus of the question, the NEB appears to be like the camel attempting to get its nose into the tent.

The NEB's apparent attempt to limit the scope of the question to the new line from Princess is interesting in that NOVA proposes to build that line under provincial jurisdiction as part of its integrated provincially-regulated pipeline system. That system was constructed originally in the late 1950's for only one purpose, namely, to gather and transport gas to the Alberta/Saskatchewan border where the gas would be carried on to market by TransCanada PipeLines. Originally,

100 percent of the gas carried by NOVA was for ex-Alberta markets. The connections by other federally-regulated pipelines with NOVA have followed the original pattern. They connect with NOVA a few hundred metres inside the Alberta border. That is the way Alberta has wanted things done for almost 40 years. The original TransCanada proposal, going back to the early 1950's, had called for TransCanada to construct an extensive pipeline system in Alberta under federal jurisdiction which would continue on to eastern markets. This was not acceptable to Alberta. Alberta wanted to exercise control over its natural gas resources through control of the pipeline system within Alberta. Ernest Manning, the Alberta premier at the time, and C.D. Howe, the Minister of Everything, reached an understanding. TransCanada also saw the wisdom in accepting Alberta's point of view and revised its proposal to begin its system just inside the Alberta/Saskatchewan border where it would connect with the new Alberta-regulated pipeline system.

Presently, 75 percent of the gas transported by NOVA is destined for ex-Alberta markets. NOVA provides transportation within the province from receipt points in Alberta to its border delivery points which are also within the province. It does so under a single rate for service to any border delivery point.

The apparent attempt of the NEB to focus the question only on the line which NOVA would construct from Princess to the border is difficult to comprehend given NOVA's history and the nature of the transportation services it provides. If the NEB were inclined to assert federal jurisdiction over the NOVA line as far as Princess then it would seem that the reasons the NEB would have for doing so would apply equally to the NOVA system beyond that point.

Alberta has felt the push from the camel's nose. It has argued before the NEB that the NOVA line from Princess is properly under provincial jurisdiction. Given the present constitutional climate, it is a curious time for a federal camel to be poking its nose into a provincial tent.

THE PHOENIX ARISES: EMPIRE PROJECT REVIVED

By: N.J. Schultz
Fraser & Beatty, Ottawa

Last year, the National Energy Board ("NEB") denied TransCanada PipeLines Limited the authority to construct a spur pipeline which was needed to link with the proposed Empire State pipeline in New York. TransCanada's proposed Blackhorse Extension would take off from its existing Niagara Line and swing around the City of Niagara Falls for a crossing of the Niagara River at Grand Island. The Empire pipeline would then carry the gas to upstate New York markets.

The NEB had concluded that the Blackhorse Extension was unnecessary since TransCanada has an existing connection to U.S. pipelines below the Falls which could be expanded at less cost and with no environmental impact. The NEB reached this decision over the protestations of Empire and its supporters that they did not wish to enter into arrangements with the existing U.S. pipelines with whom they would compete.

The NEB's decision was made by a three-member panel. Other members of the NEB did not agree with the decision and the NEB decided to review the decision. The decision was made in response to an application for review filed by TransCanada PipeLines. The NEB's decision to begin the review found its way into the Federal Court Trial Division last fall where some members of NEB were disqualified from hearing the matter on the grounds of bias following a meeting with Empire sponsors. An effort to have the entire NEB disqualified because of the taint of that meeting was rejected by the Court.

In due course, the NEB conducted a public hearing before a new three-member panel. The decision of that panel of the NEB was to authorize construction of the Blackhorse Extension.

The NEB noted that the U.S. pipeline which connects with TransCanada below the Falls could not expand its facilities to meet the needs of Empire shippers without a contract with Empire or its shippers and that the Empire supporters did not wish to do business with that pipeline. The NEB found that the denial of the Blackhorse

Extension had had an adverse effect on producers in terms of lost sales revenue. The NEB was also persuaded that Empire's supporters had demonstrated a stronger market than in the previous hearing.

The NEB recognized that Empire was intended to achieve competition by establishing an independent alternative source of gas supply and transportation to that of the existing pipelines serving the area. The NEB was of the view, contrary to the position taken by the earlier panel of the NEB, that it would not be appropriate to involve one of the existing U.S. pipelines in providing transportation for Empire or its shippers.