REGULATORY AND TRADE DEVELOPMENTS

CRTC RELAXES REGULATION OF STENTOR COMPANIES

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With two Decisions released in late December 1997 followed by a third very recent Decision (March 24), the CRTC has dramatically reduced the extent of regulatory burden and price innovation controls that have been applied to the long distance and private line services of the Stentor member companies since the advent of long distance services competition earlier this decade, and as well joint marketing prohibitions with respect to wireless and wireline services of the Stentor member companies and their affiliates.

In Telecom Decision CRTC 97-19 the Commission elected, with only minor exceptions, to effectively deregulate the pricing of toll services and toll discount services of the Stentor companies, including toll-free 800 and 888 type services. The exception is the retention of a price-cap for the basic toll service schedule of the Stentor companies. Otherwise, for all other discount and toll-free long distance services, the Stentor companies will now no longer have to obtain prior CRTC approval for rate changes. In addition, such discount innovations will no longer have to be justified through the application of an "imputation test" which had been used by the Commission since 1994 to establish an incremental cost-based pricing floor for all new toll service rate reductions of the Stentor companies.

In the Fall of 1994, the CRTC announced that it would consider deregulation of toll service pricing of the Stentor companies if certain prerequisites in the marketplace had been satisfied. These included local service unbundling to facilitate local service competition, the establishment of a workably competitive environment in the provision of toll services and effective implementation of a price cap regime, which confined residual regulation to core monopoly local services of the Stentor member companies. In 1996, the Commission announced that all conditions for telephone service deregulation would appear to have been or soon would be satisfied, but that it wished to be first satisfied that the level of competition in toll services on a market by market basis was sufficient. Decision 97-19, therefore, focused exclusively on whether the market power of Stentor companies had declined sufficiently in toll services to support price approval requirements and price floor requirements (in the powers of the *Telecommunications Act,* "Regulatory Forbearance"). The Commission's approach to assessing the level of competition in toll markets adopted the analytical construct developed by the Competition Bureau in its *Merger and Predatory Pricing Guidelines.*

The Commission concluded that the toll market consisted of two sub-markets, basic and discount direct dial ("DDD") services. The Commission

concluded they were distinctive because of the great ease of movement of customers from supplier to supplier and because of an extensive number of alternative suppliers. By contrast, it was in the toll-free service market where the Commission found that the costs to customers of switching between suppliers remained very high and that there were no other comparable toll service substitutes for 800 and 888 service. With respect to the DDD component, the Commission found that Stentor's market power had been effectively mitigated by:

(1) a loss of market share which had declined to approximately 64% by 1997;

(2) the extensive presence throughout Canada of a variety of hybrid network configurations of proprietary and rented links of alternative suppliers such as AT&T Canada LDS, fONOROLA and Call-Net (which overcame any residual concern that there may have to be at least one complete ubiquitous facilities-based competitor to Stentor); and

(3) evidence of vigorous entry and extensive rivalry as between competitors in relation to marketing, branding, comparative advertising and pricing innovation.

Notwithstanding the greater degree of customer inertia for toll-free services, the Commission still found that there should be no reason now to continue to require prior price approval and an imputation test for such services.

In addition to the price cap condition for deregulation applied to the basic toll schedule (a service offering which the Commission found not to be subject to intense competition having regard to the fact that, since the advent of toll competition, the rate level and rate structure of the Stentor companies basic toll schedule had remained virtually unchanged despite the introduction of massive discounts keyed on fairly modest calling volumes), several other conditions were imposed on the Stentor companies:

(1) a requirement to continue to provide a special discount on TDD (speech impaired) customers for long-distance services;

(2) no route diverging in order to maintain the benefits of competition for high-cost areas;

(3) mandatory notices to subscribers of any toll rate increases; and

(4) an obligation to maintain the same rate structure for all customers.

The Commission concluded that the imputation test was no longer necessary given the current state of toll service competition and that retention of the Commission's residual remedial power in relation to price discrimination would act as a sufficient incentive against any below cost pricing by the Stentor company members.

In a parallel Decision (Telecom Decision CRTC 97-20) the Commission applied the same market power analysis to the private line services (fixed point-to-point links) of the Stentor member companies. However, the Commission arrived at a somewhat more restrictive approach to price regulation reform.

The Commission categorized the Stentor member companies private line services into two categories:

(1) voice grade and other analog services for which the Commission found that the Stentor market share remained in between 80 to 90% for all Canadian provinces; and

(2) high capacity and digital data services which primarily serve large businesses and organizations and for which there was the greatest growth in capacity across Canada and in the number of facilities-based suppliers.

Because of the absence of competitive entry to the voice grade and analog service component of the private line market, the Commission concluded that there was not yet sufficient evidence to support regulatory forbearance of Stentor pricing in these services.

With respect to the high capacity and DDS market, the Commission found that it was necessary to conduct a route specific analysis in order to assess the level of competition. The Commission concluded that on the densest truck routes, those covered by the Stentor high capacity 45 service serving the major intercity corridors in Canada, there was a sufficient level of capacity and competition to support regulatory forbearance. However, the Commission declined to extend this finding to high capacity routes within local calling areas (such as Toronto to Brampton or within business clusters).

The Commission also advised that it was prepared to consider regulatory forbearance from prior regulatory pricing approval for other high capacity routes, on a route by route basis, where the Stentor companies could establish that there was at least one direct competitor on the route that had established at least one high capacity link using terrestrial facilities to at least one customer.

The Commission's decision to forebear regulation of Stentor pricing of high capacity data corridor services underscores the rapid growth of hybrid facilities based competition in Canada since the advent of substantial long distance and data service and competition in 1993 involving several new carriers owning and operating high capacity intercity fibre optics paths.

However, the Commission's decision to forebear from regulating toll and private line services remains conditional. In the event of any significant change in the competitive environment, for example, as a result of significant industry consolidation, it remains open to the Commission to introduce a greater degree of regulatory intervention to mitigate any reduction in competition that might flow from a reduced number of competitors or greater market power in the hands of fewer suppliers.

CRTC's March 24, 1998 Decision (Telecom Decision CRTC 98-4) to permit joint wireless and wireline service marketing between Stentor members and their wireless (cellular and PCS) service affiliates is a further recognition that the CRTC has accepted that, apart from the local switched and private line service markets (calling within a particular calling area), the Canadian telecommunications service marketplace has, with only a very few exceptions, reached a general level of sustainable and workable competition. These exceptions primarily relate to the rural and remote areas of the country.

The Commission's original policies prohibiting joint marketing of wireless and wireline services among Stentor companies and their affiliates were originally designed to prevent the dominant wireline Stentor carriers from conferring any undue preference or advantage on their wireless affiliates. The basic joint

marketing prohibition was first established in 1987 at a time when the only alternative wireless service supplier, Cantel Cellular, could not develop any relations with any wireline suppliers because of an absence of competition and was forced basically to offer stand alone cellular service to the public. Although the CRTC did not directly refer to the relationships of non-Stentor wireless service suppliers in its Decision, it is well recognized that all cellular and PCS suppliers not affiliated with the Stentor companies have established a variety of marketing, cross-branding, and service bundling arrangements with other long distance service suppliers and equipment vendors over the last several years which have improved their consumer attractiveness *vis-à-vis* the Stentor companies.

The Commission noted in its Decision that lifting joint marketing restrictions on Stentor wireline and wireless activities forms part of a continuum of liberalization of such restrictions started in 1995 with the Decision that such restrictions no longer had to extend to the paging operations of Stentor affiliates. Subsequent to that Decision, the CRTC permitted the joint marketing of Stentor Internet services through Phonecentres as well as the marketing of Liberti cellular phone sets at Phonecentres.

In reaching its conclusion, the Commission explicitly found that there was now sufficient wireless rivalry and consumer awareness of wireless products that the prospect of the Stentor affiliate wireless services obtaining any preference from the Stentor local services company no longer applied. The Commission also concluded that joint marketing of wireless and wireline services by the Stentor companies would better satisfy consumer requirements and likely lead to more cost effective services.

Therefore, in addition to lifting the prohibition against joint marketing and advertising of wireless and wireline Stentor products, the Commission also found that it was no longer necessary to require Stentor members to provide neutral customer referrals with respect to wireless services. Nor was it necessary any longer to restrict exchanges among Stentor wireless and wireline companies of competitively sensitive information or to prohibit explicitly cross-subsidization between those two business lines.

For the time being with respect to long distance, private line and wireless services that are now no longer subject to regulatory pricing and marketing descriptions, the Commission has still found that, where regulated local monopoly services are bundled with these competitive services, in approving any rate changes for the local monopoly services, such services must still be shown to be supplied on a cost recovery basis as reflected in the current tariff rates for such services.

It is fair to say that the general Canadian market for telecommunication services has matured sufficiently to support these deregulatory initiatives of the CRTC. Although, non-Stentor service suppliers sought to restrict the extent of deregulation of Stentor activities in the days before the CRTC, none of the three CRTC Decisions has yet to be appealed to the Federal Cabinet or the Courts, and the CRTC has yet to be asked to reconsider them from a correctness perspective.