

## REGULATORY AND TRADE DEVELOPMENTS

### THE CRTC-COMPETITION BUREAU INTERFACE: AN ALTERNATIVE TO BLAKNEY & BUSHELL<sup>1</sup>

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#### Introduction

In the Winter 2002-2003 issue of this journal, Blakney & Bushell ("Merger Review of Broadcasting Businesses: An Evaluation of the Competition Bureau Proposal") advocate that the Canadian Radio-television and Telecommunications Commission be given sole jurisdiction over broadcast media acquisitions. They state (at 88):

As part of any initiative to give the CRTC exclusive merger jurisdiction over the broadcasting sector, the government could also issue a policy direction to the Commission that required it to be particularly mindful of avoiding substantial anti-competitive effects on unregulated markets, such as the market for advertising services which has been an important aspect of the Bureau's own assessment of broadcasting mergers.

The authors' policy prescription is a response to a presentation by the Commissioner of Competition to the Standing Committee on Canadian Heritage.<sup>3</sup> In his submission, the Commissioner advocated that the mandate of the CRTC be clarified in order to

- specify that the CRTC has a responsibility to preserve a diversity of voices within the broadcasting system; and
- at the same time, focus the CRTC review of broadcasting transactions solely on the impact that the mergers would have on core cultural values and diversity of voices.

This would leave assessment of a transaction's potential impacts on competition (usually in media advertising markets) the sole jurisdiction of the Competition Bureau. Blakney & Bushell are of the view that if responsibility for media mergers were to be divided along the lines advocated by the Commissioner, it would "undermine achievement of the objectives of the *Broadcasting Act*."

We think the wrong policy question is being addressed. This should not be a question of how responsibility for achieving the objectives of the *Competition Act* and the *Broadcasting Act* should be divided between the CRTC and the Competition Bureau. That approach assumes a "turf war" between the agencies, and it places one more constraint on the policy problem than is necessary. A simpler, more constructive approach is to simplify the question: How best to achieve the objectives of both Acts with respect to media mergers and acquisitions? This leads to a policy option, set out below, which allows (a) those objectives of the *Broadcasting Act* the CRTC currently pursues to be achieved<sup>4</sup>, (b) the Competition Bureau to play its usual role vis-à-vis Section 92 of the *Competition Act*, (c) a

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resource saving to the economy, and (d) likely less burden on consumer-taxpayers.

### The Principal Source of Conflict

Section 1.1 of the *Competition Act* and Section 3 of the *Broadcasting Act* set out the two relevant sets of objectives. If they were to conflict, no policy would be mutually satisfactory to the CRTC and the Competition Bureau. Fortunately, this is not so. The conflict between the CRTC and the Competition Bureau, perhaps best exemplified by their different treatments of the recent *Astral-Télémedia* transaction noted by Blakney & Bushell, is caused by how these objectives are pursued, not the objectives *per se*. The bare bones of the conflict is that the CRTC, by its actions, supports the creation and protection of market power in media advertising markets.<sup>5</sup> Not surprisingly, the Competition Bureau favours competition in these markets.<sup>6</sup>

We are concerned only with the criteria the CRTC applies when it receives an application for the transfer of ownership or control of a broadcasting licence, not regulations that every broadcaster must comply with as a condition of licence, such as Canadian content and ownership rules, and special services for the hearing- and sight-impaired. Fifteen recent decisions by the CRTC are examined from this perspective in Townley (2003).<sup>7</sup> As revealed by these decisions, the CRTC's two major concerns are that transactions satisfy the CRTC's relevant "tangible benefits" test (described below) and that any diversity concern be mitigated.<sup>8</sup>

Blakney & Bushell (at 82) state that applicants "must demonstrate that the acquisition will produce 'significant and unequivocal benefits' to the Canadian broadcasting system (now by convention defined as special benefits having a value of approximately 10%

of the value of the acquisitions spread over the term of the target's license)." This is not quite correct. The test for radio licence acquisitions is summarized by the CRTC's Commercial Radio Policy (Public Notice CRTC 1998-41<sup>9</sup>):

The Commission has revised its benefits policy to ensure support for the development and promotion of Canadian music talent, and to foster cooperation between the radio and music industries. Specifically, the Commission has amended the benefits test for commercial radio to require, as a general rule, a minimum direct financial contribution to Canadian talent development representing 6% of the value of transactions involving transfers of ownership and control. Consistent with the Commission's existing benefits policy, the Commission will not impose benefits requirements in the case of transactions involving unprofitable undertakings.

...

The Commission will expect financial contributions to be distributed as follows:

- 3% to be allocated to a new Canadian music marketing and promotion fund;
- 2% to be allocated, at the discretion of the purchaser, to FACTOR<sup>10</sup> or MusicAction<sup>11</sup>; and
- 1% to be allocated, at the discretion of the purchaser, to either of the above initiatives, to other Canadian talent development initiatives, or to other eligible third parties directly involved in the development of Canadian musical and other artistic talent, in accordance with Public Notice CRTC 1995-196,

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as may be amended from time to time.

It is noteworthy that in the *Power, Standard, Rogers, Newfoundland, Astral, Wawa I* and *Wawa II* decisions, exactly 6% of the value of each radio transaction was “offered” and accepted. The CRTC levies a tax in all but name.

It would appear that, in some radio cases, the transaction costs associated with the test are minor. For example, the CRTC decisions in the *Wawa I* and *II* cases were only eleven and ten paragraphs in length, respectively, probably because the applicants adhered to CRTC guidelines precisely. In other cases, disputes arose because the applicant wished its “donation” to go elsewhere than a CRTC-approved beneficiary. Such cases are necessarily longer and more complicated, and the *Astral* decision is an example of this.

The CRTC’s “tangible benefits” test for television acquisitions is somewhat different. The dollar value of the benefits required to satisfy the CRTC was clarified in Public Notice 1999-97 (at ¶-22):

The Commission hereby amends its benefits policy in respect of all transfers of ownership or control involving television broadcasting undertakings, including conventional, pay, pay-per-view and specialty television undertakings. It will generally expect applicants to make commitments to clear and unequivocal tangible benefits representing a financial contribution of 10% of the value of the transaction, as accepted by the Commission. This policy will apply to any application filed on this date or after. [emphasis added]

This 10% levy may consist of monies paid to CRTC-approved beneficiaries (similar to radio acquisitions) and new (CRTC-approved) expenditures on

programming initiatives. These applications are quite complicated, and thus one expects the transaction costs associated with them to be substantial. For example, in the *Quebecor* case, both the applicant and the CRTC hired experts just to figure out the value of the transaction. (See Townley (2003) for a full accounting of CRTC policies and recent decisions regarding the transfer of television broadcast licences.)

As the “tangible benefits” test for radio acquisitions is simpler, and as the following analysis also applies to television acquisitions but with only minor variations, we will direct the following discussion to the 6% test only.

Blakney & Bushell (at 83) state that this “benefits test” policy “derives from the CRTC’s basic statutory mandate to regulate the broadcasting sector to increase the amount of Canadian broadcasting content above the level that would be expected solely through the operation of market forces.” Whereas Canadian content rules may flow from the *Broadcasting Act*, it is not so clear that the power to levy a quasi-tax does. Still, it is important, when thinking in terms of policies capable of accommodating both sets of objectives, to distinguish Canadian content regulations from the objective of providing pecuniary support to Canadian content producers, the latter being the ultimate recipients of the 6% levy.

Blakney & Bushell make the point that the CRTC grants applicants market power (and maintains it by restricting entry) – and thus grants the right to profits in excess of what would be earned in competitive media advertising markets. The CRTC does this in order that licence acquirers might pay the “tangible benefits” they promise with these above-normal profits. They state (at 86):

In all entry-restricted regulated industries, it has been accepted that a

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necessary corollary to entry control is to control acquisitions of regulated businesses. Acquisitions control is seen as necessary to prevent shareholders from capitalizing and appropriating for themselves the economic rents created by regulation for policy purposes, and to ensure that the merged entity will fully adhere to the public policy commitments of the individual licenses established pre-merger. The CRTC's "benefits test" is primarily directed at the first concern, whereas the Commission's broad treatment of ownership concentration has been primarily at this second concern.

Whereas Blakney & Bushell's statement links the 6% levy to the level of excess profits granted and protected by the CRTC, they miss the main point.<sup>12</sup> It is true that no profit-maximizing applicant would be willing to pay this levy unless it could recover at least this amount from advertisers. However, the actual above-normal profits earned could be several times this amount, depending on just how much market power the CRTC bestows on a particular applicant. This will depend on specific market conditions.<sup>13</sup> "Regulation is for the regulated", and the CRTC, Blakney & Bushell's "expert regulator", need not fear criticism from licence holders, the recipients of its largesse.

There is more to it. It is true that advertisers will pay rates higher than those that would prevail in competitive media advertising markets. As Blakney and Bushell state (at 86):

Whether we like it or not, the generation of economic rents through regulation will create a wide range of price and supply distortions in the acquisition of inputs by that sector and also in the pricing of its outputs. These distortions are not restricted to less competition in the pricing of

advertising services, and hence higher advertising rates.

However, Blakney & Bushell do not go far enough. Although advertisers may advertise less than otherwise, thus causing deadweight losses in these markets, one can be sure that these higher advertising rates will be passed on in the form of higher prices for the goods advertised.<sup>14</sup> Private sector producers who do not recover their costs do not stay in business. That is, it is consumers who ultimately pay the CRTC's levy ... and more, depending on the market power bestowed by the CRTC. Any conclusion that this "tax" sticks to broadcasters or advertisers is not credible. The same market forces that cause higher costs to be reflected in higher prices cause lower costs to be reflected in lower prices.

#### A Policy Alternative

As Canadians ultimately bear the burden of this levy in a variety of product markets, an obvious alternative to the CRTC's arrangement would be to use general tax revenues to fund the same objectives and not to allow the acquisition of market power. That is, a better policy prescription would be to remove the reason for the CRTC to levy its tax and to leave competition matters to the Competition Bureau. A discussion of the dimensions and implications of adopting such a policy alternative follows.

#### *Who Benefits?*

Roughly, the benefits principle of taxation is that those who benefit from public (government) provision of a good or service should pay for it. Even if individuals acquiring radio station licences did (ultimately) pay (suffer the incidence of) the CRTC's levy, they are not the sole beneficiaries of the activities these monies fund. Surely, if the funding of music-related cultural activities benefits licence acquirers, it must benefit all

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licence holders. All radio station owners benefit, but only some pay.

If it were true that all radio station owners were the sole, ultimate beneficiaries of these cultural grants and promotion schemes, an across-the-board levy on licences might make sense. Voluntary contributions would not suffice because of free-riding. That is, an individual radio broadcaster would rather other broadcasters pay, knowing that he or she would reap the benefits without paying for them. However, it is not true that the benefits, if they exist, would accrue only to radio licence holders. Presumably, the grant recipients and television broadcasters, for example, would also benefit from augmented music production.<sup>15</sup>

Indeed, if cultural benefits actually result from these cultural grants, would they not accrue to all members of the culture, the general public? If true, then application of the benefit principle would suggest that the activities the CRTC's levy finances be funded from more broadly defined sources. The public purse is an obvious alternative.

#### *Magnitude and Stability of Funding*

As described above, two principal recipients of the CRTC's levy are music marketing and promotion funds, FACTOR and MusicAction. Examples of what activities they fund are the production of recording demos, songwriting grants, video production grants and touring grants for individual artists.<sup>16</sup>

FACTOR and MusicAction (jointly called FMC) already receive additional funding from the Department of Canadian Heritage – \$5,115,000 and \$3,410,000, respectively, in 2001-2002.<sup>17</sup> In their joint 2000-2001 Annual Report, they state: "This year, the Department of Canadian Heritage contribution to FMC remained at \$8,525,000, the same as it has been over the past four years." FMC also lists \$2,182,214 in "Private

Contributions", composed of \$1,716,547 to FACTOR and \$465,667 to MusicAction. Of interest here is what portion of these private contributions are the result of the CRTC's 6% levy. The Annual Report states:

Voluntary radio contributions to FACTOR from its Sponsoring Radio stations totaled \$932,166. As well, FACTOR received \$784,381 from radio stations resulting from the recent CRTC decision allowing multiple ownership of stations in a single marketplace.<sup>18</sup>

Thus, it appears that the Department of Canadian Heritage has effectively delegated responsibility for administering cultural grants for broadcast-related activities to FACTOR and MusicAction. Because their activities are specialized, it would not be surprising if these associations performed their tasks in a more informed, efficient manner than possible for employees of the Department of Canadian Heritage. On the other hand, we note that this department funds diverse music-related activities under a variety of umbrella organizations including Arts Presentation Canada, Canada Council for the Arts, Canada Music Fund (in addition to FMC) and the Cultural Industries Development Fund.<sup>19</sup> If there is considerable overlap of their activities and those of FMC, wasteful duplication may be the result, and a case for more centralized administration of the grant monies involved could be made.

For our purposes, it does not matter if the arrangements with MusicAction and FACTOR are optimal; we simply take them and other funding arrangements as given. The relevant question is whether they would be indifferent to receiving either \$x *via* the CRTC's "tangible benefits" scheme or an additional \$x from the Department of Canadian Heritage.

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We cannot think of any financial reason why funding out of general tax revenues would be less attractive than *via* the CRTC. Indeed, the Department of Canadian Heritage provided 70% of the funds FMC received in 2000-2001 for disbursement – thus from general tax revenues. That same year, FACTOR received only 10% of its financing from levied ‘tangible benefits’.

In any case, there may be a good reason why direct government funding may be preferred. Financial commitments made by parties usually involve equal payments, typically over seven years. The flow of funds to the recipient from a particular licence acquirer, therefore, is stable over this time horizon. However, total funding from all licence acquirers is not likely to be stable from year to year. To be so, the aggregate value of radio station transactions, for which the transfer of licences is required, would have to be stable year after year. This circumstance seems quite unlikely. Theoretically, at least, should the Department of Canadian Heritage increase its contribution to FMC and other funds in order to replace what would no longer be derived from the CRTC’s levy, stable (total) funding could result. Presumably, this would allow the various recipients to plan their activities on a longer-term, more forward-looking basis.

#### *Transaction and Other Costs*

Although the amounts are not large, if general tax revenues were to replace monies raised by the CRTC’s levy, some additional deadweight loss due to taxation would result. On the other hand, other deadweight losses would be eliminated if acquisitions that would result in a substantial lessening of competition were no longer allowed. Changing the rules for new licence transfers would not affect the market power granted by the CRTC previously unless that agency also ceased

restricting entry except on the basis of bandwidth capacity.<sup>20</sup>

The consequences of the proposed funding arrangement for transaction costs are clearer. They would be negligible for the Department of Canadian Heritage, because this agency already provides the bulk of funds various (approved) cultural associations distribute to Canadian content providers. Indeed, transaction costs would likely decrease for these cultural associations (like FACTOR) and, moreover, they may save on lobbying effort. Applicants for the transfer of broadcast licences would save because it would no longer be necessary to set out a “tangible benefits” section in their applications. Perhaps the largest savings would accrue to the CRTC. It would no longer have a reason to assess any economic or financial criteria, including market conditions and the size and composition of its levy. Although this effort is minor in some cases, it is apparent from many of the cases examined in Townley (2003) that this effort can be time-consuming and expensive. Obviously, having one agency rather than two assessing the economic dimensions of acquisitions would entail major cost savings, a point that derives from Blakney & Bushell.

#### **Conclusion**

Blakney & Bushell propose that the CRTC be the sole assessor of media mergers, doing what they do currently plus taking into account any potential anti-competitive consequences in media advertising markets.<sup>21</sup> This suggests a trade-off among diversity, support for Canadian content producers and the benefits of competition that is not necessary.

The major source of conflict between the CRTC and the Competition Bureau is their different views regarding the creation and strengthening of market power in media advertising markets. The CRTC, in

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pursuit of its objective of supporting Canadian performers, producers and the like, applies “tangible benefits” tests when assessing applications for the transfer of ownership or control of broadcast licences. In order to afford these additional costs, broadcasters must earn above-normal profits; i.e., profits greater than what would obtain in competitive advertising markets. The CRTC assures this by bestowing on these licence holders market power in media advertising markets. Moreover, it protects these above-normal profits by restricting entry which, we note, also restricts diversity. These above-normal profits exceed payments made in the form of “tangible benefits”. As a result of the exploitation of this market power, advertisers pay rates above those which would obtain in competitive markets and, ultimately, this results in higher prices for consumers.

A large part (all in the case of radio) of these “tangible benefits” is in the form of grants to CRTC-approved cultural associations, yet the total is small in comparison to what they receive currently from other government sources, notably the Department of Canadian Heritage. A less distortionary and less costly policy alternative would be to fund all of what these beneficiaries receive out of general tax revenues (*via* Heritage Canada) and for the CRTC to cease applying its “tangible benefits” tests. Such an alternative would have a number of advantages relative to the current policy, including reduced transaction costs for the CRTC and applicants. Although we have provided no detailed analysis, it is likely that the incidence of the CRTC’s levies is more burdensome to consumers-taxpayers than the extra tax revenues required by the alternative policy. Moreover, protection of excess profits would no longer be a rationale for restricting entry, and entry would further the CRTC’s diversity objectives.

This policy alternative would have no impact on the CRTC’s ability to enforce other rules (e.g., Canadian

content and ownership rules) and at least the same support for current CRTC-approved grant recipients could be achieved. Importantly, the objectives of the *Broadcasting Act* would be served, and this policy would allow the Commissioner of Competition to pursue the objectives of the *Competition Act* with respect to media mergers more effectively.

## Notes

<sup>1</sup> This paper draws heavily on Townley (2003), which is a more extensive, detailed study of the scope for conflict and compatibility between the CRTC and the Competition Bureau.

<sup>2</sup> The author is Professor of Economics at Acadia University and was holder of the T.D. MacDonald Chair in Industrial Economics at the Competition Bureau until June 2003. The views expressed are the author’s own, and are not purported to be those of the Commissioner of Competition or any other person. The author thanks Gwill Allen and Gernot Kofler for helpful comments on an earlier draft. Correspondence should be addressed to peter.townley@acadiu.ca

<sup>3</sup> K. von Finckenstein, Q.C., “Remarks to the Standing Committee on Canadian Heritage on the Study of the State of the Canadian Broadcasting System” (3 April 2002).

<sup>4</sup> This should not be construed to mean that the author supports any objective of the *Broadcasting Act* or action of the CRTC.

<sup>5</sup> Although other CRTC interventions, usually in response to rent-seeking behaviour by industry participants, have negative consequences, the extent to which they interfere with the ability of the Competition Bureau to fulfil its mandate is less clear.

<sup>6</sup> From his submission, it would appear that the Commissioner of Competition is sympathetic to the CRTC’s views concerning ownership concentration and diversity. Those views, however, are uninformed by economic analysis and recent evidence from the United States and Europe. See Allen & Townley (2002) and Townley (2003).

<sup>7</sup> By short title, CRTC decision number and type, they were the following: (1) *CHUM*, Decision 2000-219, Competing applications for a new television station in Victoria; (2) *CanWest*, Decision 2000-221, Acquisitions by CanWest Global of television stations (five in British Columbia, four in Alberta, one in Ontario, and one in Québec); (3) *CTV-BCE*, Decision 2000-747, Acquisition by BCE of control of CTV to BCE (involving television broadcast licences); (4) *TSN*, Decision 2000-86, CTV acquiring various television properties, one potential result being common ownership of TSN and SportsNet; (5) *Power*, Decision 2000-87, Acquisition of radio and television assets in Ontario, New Brunswick and Québec; (6) *CTV*, Decision 2001-457, Renewal of licences by CTV (after BCE’s acquisition of CTV and the *Globe & Mail*); (7) *Standard*, Decision 2002-91, Acquisition of radio

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and television assets; (8) *Rogers*, Decision 2002-92, Acquisition of various radio stations and a radio network; (9) *Winnipeg*, Decision 2002-224, Competing applications for a new radio station in Winnipeg; (10) *Newfoundland*, Decision 2000-141, Transfer of ownership of seven radio stations in Newfoundland; (11) *Global*, Decision 2001-458, Television licence renewals (after the acquisition of the *National Post* by Can West Global); (12) *Astral*, Decision 2002-90, Acquisition of radio stations in Québec and the Maritimes; (13) *Quebecor*, Decision 2001-384, Acquisition of television assets; (14) *Wawa I*, Decision 2002-258, Acquisition of radio assets; and, (15) *Wawa II*, Decision 2002-259, Acquisition of radio assets.

<sup>8</sup> Blakney & Bushell (2003: 81) state: "The Commission has in the past refused to approve a number of acquisitions on competition/concentration of ownership grounds." Nevertheless, according to Public Notice CRTC 1992-42, failure to satisfy the relevant "tangible benefits" test "was cited as the main justification in the majority of denial cases" between 1985 and 1991.

<sup>9</sup> All CRTC public notices and decisions cited in this paper may be retrieved from <http://www.crtc.gc.ca/eng/dno.htm>.

<sup>10</sup> FACTOR is *The Foundation to Assist Canadian Talent on Records*, a private, non-profit organization that provides financial support to all facets of the Canadian recording industry (artists, labels, distributors, producers, engineers, etc.) See <http://www.factor.ca/geninfo.html#>.

<sup>11</sup> According to its web site ([http://www.cbsc.org/alberta/search/display.cfm?Code=2942&coll=FE\\_FEDSBIS\\_E](http://www.cbsc.org/alberta/search/display.cfm?Code=2942&coll=FE_FEDSBIS_E)),

MusicAction is a non-profit organization which specializes in providing assistance with sound recordings, video, tours, promotion and the marketing of recordings. MusicAction is an autonomous organization which provides financial support to the independent Canadian sound recording industry.

In order to qualify for support, applicants must satisfy citizenship and French-language requirements.

<sup>12</sup> To put this 6% levy into perspective, in the CRTC's decisions it ranged from \$9,924 over 5 years in *Wawa II*, \$6-million over 7 years in *Rogers*, and \$15.3-million over 7 years in *Astral*.

<sup>13</sup> There may be an additional bias. It seems likely that if the CRTC had to choose between two applicants, it would choose the one with the greater potential for anti-competitive harm, as this applicant would be better able to guarantee the CRTC its promised "tangible benefits".

<sup>14</sup> A full-blown analysis of the incidence (ultimate burden) of this levy, which can involve both backward and forward shifting, is beyond the scope of this paper.

<sup>15</sup> CRTC Notice 1992-42 requires that television "tangible benefits" provide benefits "both to the system and to the Canadian viewers it serves."

<sup>16</sup> An accounting of how they distribute funds can be found in their (joint) 2000-2001 annual report, which is available at [http://www.factor.ca/annrep/FMC\\_2001\\_Activity\\_Report-English.pdf](http://www.factor.ca/annrep/FMC_2001_Activity_Report-English.pdf).

A separate report for FACTOR for the year 2001-2002 is available at [http://www.factor.ca/annrep/FACTOR\\_2002\\_Annual\\_Report.pdf](http://www.factor.ca/annrep/FACTOR_2002_Annual_Report.pdf).

<sup>17</sup> A member of the Department of Canadian Heritage sits as an observer on the FACTOR Board of Directors.

<sup>18</sup> Although it matters little here, we note that the CRTC applies its levy to all transfers of ownership, not just those involving multiple ownership.

<sup>19</sup> Descriptions of these and others are available at [http://www.canadianheritage.gc.ca/pc-ch/sujets-subjects/arts-culture/musi/index\\_e.cfm](http://www.canadianheritage.gc.ca/pc-ch/sujets-subjects/arts-culture/musi/index_e.cfm).

<sup>20</sup> As it seems unlikely that the Competition Bureau would (or could) proceed under Section 79 of the *Competition Act*, for example, because licence holders' behaviour is regulated, expanding the number of licences in such geographical markets may be an adequate remedy to existing, anti-competitive situations.

<sup>21</sup> We leave aside the question of whether the CRTC possesses the expertise to assess competitive impacts adequately.

## REFERENCES

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### THE CRTC ADOPTS NEW RULES TO ENCOURAGE TELECOMMUNICATIONS COMPETITION IN MULTI-DWELLING UNITS

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#### Introduction

The Canadian Radio-television and Telecommunications Commission ("CRTC") has recently concluded a lengthy proceeding (initiated by Public Notice CRTC 2000-124, 25 August 2000) on Local Exchange Carrier ("LEC") access to multi-dwelling unit ("MDU") customers or end-users by issuing:

new requirements applicable to all LECs designed to facilitate LEC access to MDU end-users; and

guidelines to building owners defining fair and unfair access terms, including compensation, backed by the threat that the Commission's broadly drafted expropriation power could be used in appropriate cases, and following a hearing of a complaint, to enforce these guidelines on building owners. (*Provision of telecommunications services to customers in multi-dwelling units* (30 June 2003) Telecom Decision CRTC 2003-45, online: CRTC<<http://www.crtc.gc.ca/archive/ENG/Decisions/2003dt2003-45-htm>>).

MDUs are broadly defined to include condos, resident and mall tenants, in addition to office building and industrial park tenants.

This fairly aggressive decision is premised on the CRTC concluding that MDU access has the potential to become a serious barrier to the development of local telecommunications competition, and that certain

building owner practices, including exclusivity agreements with local carriers, had in fact acted as a barrier to local competition.

The Commission has recently been criticized by a Parliamentary Committee for not doing enough to facilitate (wireline) local exchange service competition, the regulatory framework for which had been established by the CRTC in 1997. To date, Competitive Local Exchange Carriers ("CLECs") have been largely limited to the business sector in major urban centres, and then often as an add-on to the carrier's interexchange and data communication services. The major Incumbent Local Exchange Carriers ("ILECs"), Bell Canada and its affiliates in Eastern Canada, and Telus and its affiliates in Alberta, British Columbia, and parts of Quebec (which have also begun to compete directly, primarily in data communication), have retained a preponderant local service market share in their respective markets. There are now only a few remaining CLECs, of which only one, namely Allstream (formerly AT&T Canada), is attempting to establish a national local exchange service platform for business customers. All other servicing CLECs have a regional or even a metropolitan area focus. Few CLECs, including Sprint Canada, a major national interchange and data services supplier, are offering residential local exchange services and then only in a few urban areas.

Several factors help to explain the currently low level of local services competition. The actual rollout of intercarrier arrangements necessary to provide for head-to-head competition among LECs did not begin until 1998. At that time, the voice calling activities of both consumers and business had begun to shift rapidly away from wireline and to wireless (cellular) technology. Data communications (such as email and other internet based services including instant text messaging and chat-rooms) also experienced dramatic

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growth in the late 1990's, and now effectively replace voice communications for many types of communication.

For its part, the CRTC has made a conscious decision to avoid requiring ILECs to provide essential unbundled local network service components to CLECs at rates below long run marginal cost (i.e. at implicitly subsidized rates). Moreover, local exchange services were typically seen as net recipients of service cross-subsidization, in contrast to interexchange services, which generated substantial arbitrage margins and therefore which could support significant entry for some time after head-to-head long distance competition was implemented by the CRTC in 1993.

Interexchange server prices were driven down in the late 1990's, at which point significant consolidation occurred in this sector. Any ability of new interexchange service entrants to support entry into the local exchange market was therefore curtailed by price competition on the interexchange market prior to the establishment of the full regulatory framework for CLEC entry.

Finally, the bursting of the telecom bubble (internet stock bubble in 2000 which was driven to a large extent by excessive telecom carrier debt loads) severely restricted carrier access to capital markets.

Nevertheless, ILEC/CLEC competition is a significant component of the CRTC's "facilities-based competition" model, under which it is assumed that sustainable long run telecommunication services competition throughout Canada, and a resulting permanent withdrawal of the CRTC from much direct price regulation of incumbent carrier services in most markets, can only be achieved if there are several carriers in major (urban) markets that own and operate substantial switching and transmission assets.

Although it is arguable that wireless service suppliers offer a form of facilities-based competition, only one national cell phone service, Rogers AT&T Wireless, offers a true national wireless platform and is not an affiliate of the major ILECs (Bell Canada and Telus).

The CRTC therefore continues to place considerable emphasis on facilitating more wireline LEC competition.

### Review of Decision

The principal questions facing the Commission were:

- (a) whether further regulatory intervention was necessary to increase competition in the supply of telecommunication services to MDU end-users;
- (b) if so, what services should be subject to the new regulatory measures;
- (c) the extent to which the Commission could, and should, rely on additional conditions of service applicable to LECs under its regulatory jurisdiction; and
- (d) whether, and if so to what extent, the Commission should impose remedial measures on building owners themselves, to facilitate any desired increase in competition.

Extensive written submissions and interrogatory responses were submitted to the Commission by all significant LECs and by building owner representatives.

Since it is well established that the Commission could impose further obligations (including facility construction of access and inter-connection) on LECs serving MDUs, in order to level the competitive playing field in supplying particular MDUs, the principal issue

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in this proceeding was the extent to which the Commission could, and should, override the private property rights of building owners to achieve a sufficient mix of remedies.

Much of the Commission's discussion of the seriousness of MDU entry barriers in frustrating local exchange service competition may be seen as the Commission explaining (a) why there may be good reasons to ultimately expropriate building owners in some fashion, and (b) why the Commission's enabling legislation, the *Telecommunications Act*, ought to provide, and in fact (constitutionally and through proper statutory construction) has provided, the Commission with jurisdiction to do so.

In this regard, the CRTC's principal findings were:

- (a) LECs must be able to freely choose the technologies with which to access MDU end-users. The Commission has concluded that merely requiring competitor access to existing paired copper wiring inside wiring is insufficient as follows [numbers refer to paragraph numbers in the decision]:

117. In the Commission's view, however, while access to end-users in MDUs through leased unbundled loops represents an important alternative to facilitate entry and the development of facilities-based competition, such access alone is not sufficient. Reliance on unbundled loops binds LECs to the technology and rate structure of another LEC, to the detriment of service differentiation, service innovation, price competition and, ultimately, end-user LECs must be able to physically connect to end-users through the facilities of their choice in order to be able to respond to the needs of end-users. The ability to connect through

their own facilities is essential to the operation of their undertaking.

118. The Commission therefore considers that, while LECs have the right to access end-users via unbundled loops, they should not be obliged to use unbundled loops as a result of being denied access to end-users via their own facilities.

- (b) the MDU market is significant enough to warrant special regulatory measures. The CRTC estimates that it represents between 22% and 42% of residential customers (2.8 million lines and \$1.1 billion in annual revenues), and 66% of all business lines (5 million lines and \$3 billion in annual revenues);
- (c) CLEC penetration of the MDU market is necessary to achieve necessary cost efficiencies and scale economies, particularly for higher paying business customers; and
- (d) the record of the proceeding had demonstrated the existence of a variety of significant barriers to entry limiting end-user choice in MDUs, and that a number of these barriers related to MDU owner conduct, including entry fees and other forms of price discrimination.

It is noteworthy that the Commission's reasons would appear to assign the bulk of the anti-competitive conduct to building owners. Nevertheless, the principal remedy emerging from this proceeding is a new "competitor access facilitation" condition applicable to all LECs (similar to a LEC condition of supplying services to shared tenant services that has been in place for some time):

The Commission requires that the provision of telecommunications service by a LEC in an MDU be subject to the condition that all LECs

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wishing to serve end-users in that MDU, are able to access end-users in that MDU on a timely basis, by means of resale, leased facilities or their own facilities, at their choice, under reasonable terms and conditions (the MDU access condition).

This new access condition has been established pursuant to section 24 of the *Telecommunications Act* which authorizes the Commission to impose conditions on the offering or provision of any telecommunication service (without any express limitations).

The Commission has notably declined (for the time being) to issue an order that would directly bind building owners, such as mandated building access codes or standard form building access agreements.

Rather, the Commission has chosen only to assert (in a probably non-justifiable manner) that it could, and if appropriate, would employ the general expropriation/mandatory supply powers of section 42 of the *Telecommunications Act* to issue remedial orders on a case-by-case basis. Section 42 states that:

Subject to the contrary provision in any Act other than this Act or any special Act, the Commission may, by order, in the exercise of its powers under this Act or any special Act, require or permit any telecommunications facilities to be provided, constructed, installed, altered, moved, operated, used, repaired or maintained or any property to be acquired or any system or method to be adopted, by any person interested in or affected by the order, and at or within such time, subject to such conditions as to compensation or otherwise and under such supervision as the Commission determines to be just and expedient.

The Commission's carefully drafted suggestion of possible future direct action against building owners is framed as follows:

143. The Commission expects building owners to cooperate with LECs to enable them to access end-users in their MDUs in satisfaction of the MDU access condition. In section E below, the Commission sets out guidelines that, in its view, should assist parties in their negotiation of access arrangements on the basis of just and expedient conditions. These guidelines take into account the responsibilities of building owners to ensure the safety, security, appearance and condition of their properties and the safety and convenience of tenants and other persons.

144. In cases where negotiations on access cannot be concluded on a timely basis and where, following a process under Part VII of the *CRTC Telecommunications Rules of Procedure*, the Commission determines that access to an MDU has not been, or is not likely to be, provided on a reasonable basis, the Commission will take such further action as is appropriate, depending on the circumstances of each case, to ensure that all LECs are able to provide telecommunications services in an MDU, in accordance with the MDU access condition. In particular, the Commission will be prepared to issue an order under section 42 of the Act, subject to such conditions as to compensation or otherwise as the Commission determines to be just and expedient.

With respect to building owners, the CRTC has only asserted that it is prepared to issue a remedy under its expropriation powers, without specifying the actual nature of any such future remedy, and then only after

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an adversarial proceeding that would likely take several months. This reticence appears to be prudent. The Commission's position avoids creating inappropriate expectations of what the Commission is committed to do, which may affect private access negotiations. Moreover, the CRTC's first expropriation order directed at a building owner will be subject to an appeal before the courts. If an appeal against the Commission's preferred building owner conduct were to be launched now, many building owners would likely feel entitled to ignore the CRTC's position until it was approved by the courts, a result that could likely take up to a couple of years.

It should also be noted that, in addition to empowering the Commission to issue expropriation orders ("... permit any telecommunications facilities to be provided, constructed [etc.] ... by any person interested in or affected by the order ..."), section 42 would also appear to authorize the Commission to require building owners to actually construct telecommunications facilities on their premises ("... require ... any telecommunications facilities to be provided, constructed [etc.] by any person interested in or affected by the order") [emphasis added]. Clearly, any CRTC order to a building owner requiring it actually to construct certain access facilities, such as new conduit where existing conduit was full, would be a novel and controversial regulatory remedy. However, this would be precisely the remedy that a carrier having trouble serving MDU end-users would seek if it was unable to ride on LEC facilities required to be supplied under the new commission-imposed access condition. Thus, any initial examination of a building owner order under section 42 would likely focus on the more vulnerable and novel aspect of the section. If this aspect of section 42 were successfully challenged, then it is possible that the effectiveness of the more conventional expropriation component of section 42 could be undermined. The

Commission's ability to use a complementary power (section 43) access to transmission facility support structures has recently been restricted to federally regulated carrier facilities (the CRTC had ordered access to electrical utility support structures) by the Federal Court of Appeal (in *Barrie Public Utilities v. Canadian Cable Television Association*, [2001] 4 F.C. 237 (C.A.)).

It would therefore appear that the CRTC expects to enforce its MDU policies primarily, and possibly even entirely, through LEC's, and that the Commission hopes that, where building owners are exercising private property rights, their behaviour will be disciplined by the reasonableness of the CRTC's announced policies and by tenant/condo owner pressure.

Accordingly, the Commission has introduced detailed building fee guidelines which it hopes will provide a basis for consistent non-exclusionary cost recovery based on fees to be negotiated between building owners and LECs.

These fee guidelines are modelled on the cost causation principles that were employed in *Ledcor/Vancouver-Construction, operation and maintenance of transmission lines* in Vancouver (25 January 2001), Telecom Decision CRTC 2001-23, to establish compensation guidelines for municipalities (and a compensation order against Vancouver) where a carrier requires access to municipal property to construct transmission facilities.

In the Federal Court of Appeal decision of *Federation of Canadian Municipalities v. AT&T Canada Corp.*, 2002 FCA 500, for which an application for leave to appeal to the Supreme Court of Canada has been filed, the CRTC compensation order against Vancouver was

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upheld as a lawful exercise of section 43 of the *Telecommunications Act* (which provides a municipal expropriation power very similar to the more general section 42 power) stating:

As noted above, it is clear from a plain reading of section 42 to 44 of the *Telecommunications Act* that the Commission has authority to pronounce upon all terms and conditions, including compensation and costs, that govern the relationship between Canadian municipalities and Canadian carriers and distribution undertakings. It is difficult to envisage a more competent public body than the Commission to embark on the tasks of prescribing terms and conditions and an appropriate costing methodology. The Commission's comprehensive treatment of costs in the three phases of the Cost Inquiry is unrivalled in Canada and, indeed, in the world.

...

In the present instance, the exercise by the CRTC of its jurisdiction involved the exercise of a discretionary power to grant access to a carrier and to determine the conditions of such access. At most, it can be argued that the CRTC erred in law in the exercise of its jurisdiction or that it improperly exercised its discretion in granting access and fixing the conditions that it did. That being the case and since the decision relates to issues that fall squarely within the domain of expertise of the CRTC, this Court ought to defer to the CRTC. Consequently, this means the applicable standard of review of the CRTC's legal conclusions on matters within its expertise is that of reasonableness: see *British Columbia Telephone Co. v. Shaw Cable Systems (B.C.) Ltd.*, [1995] 2 S.C.R. 739 at

Page 759, *Canadian Broadcasting Corp. v. Métromédia CMP Montréal Inc.*, [1999] F.C.J. No. 1637 (F.C.A.). Patent unreasonableness governs the review of its factual findings. With these standards in mind, I now turn to a review of the decision.

...

The appellants' main attack was directed at the CRTC's findings on costs and compensation, two matters squarely falling within the board's expertise. Whether or not such findings were findings of law, of fact or of mixed law and fact, I cannot conclude that they were unreasonable, let alone patently unreasonable. In addition, no evidence was adduced to show that the CRTC exercised its discretion capriciously or arbitrarily. [emphasis added]

The Federal Court of Appeal also made it clear that the municipality compensation guidelines were not a justiciable issue:

It is true that, in the context of settling the dispute before it, the CRTC elaborated a number of principles with a view to assisting carriers and municipalities in their future negotiations of terms and conditions of access. These principles are therefore not binding on anyone and the Commission expressly refrained from adopting "any particular model or agreement to serve as a starting point for discussions between municipalities and carriers": see the end of paragraph 44 of the decision. It is possible that these principles, although well intended, may in effect turn out to be less helpful and more problematic than anticipated. However, it is not open to us in these appeals, nor would it be advisable to

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do so, to review or sanction the principles set forth by the CRTC.

The main elements of the Commission's new building fee guidelines are:

- (1) building owners may charge a fee for use of in-building wiring to recover any unrecovered capital costs reasonably incurred for in-building wiring, but a fee for unrecovered capital costs where the owner acquired responsibility and control of these facilities at no cost would be inappropriate;
- (2) owners may be compensated for reasonable in-building wiring maintenance costs, space occupied by telecommunications facilities (based on fees for an alternative use of the space, costs reasonably incurred for the provision, installation, construction and construction supervision of additional facilities requested by a LEC);
- (3) there should be no up-front, construction-related charges for utility infrastructure housed in MDUs;
- (4) there should be no fees associated with the cost of negotiating access arrangements. Access fees for the right to enter MDUs that are in the nature of an admission or an entry fee are not appropriate; and
- (5) installation of in-building wiring and other facilities in MDUs: LECs that wish to install or upgrade new in-building wire and related facilities in an MDU should, subject to the building owner's reasonable acceptance of a wiring plan, be given access to the closets, panels and any common pathways required for the purpose of installing or upgrading their facilities. Building owners that install or

upgrade the in-building wire and related facilities at the request of an LEC should be compensated for the costs associated with the installation or upgrade.

The Commission has also prohibited LEC/MDU or other party exclusivity arrangements (where the effect is to restrict another LEC from accessing or serving MDU end-users). However, the Commission concluded that "preferred" marketing arrangements, which are limited to marketing an LEC's services in an MDU, and do not have the effect of limiting access by other LECs to the MDU, are acceptable as the arrangements may benefit end-users. To create an element of market transparency, complete MDU/LEC access agreements, including fees, are to be posted on the LEC's website.

As well, local loop providers must now provide LECs with the option of terminating lease unbundled loops, either at the service provider demarcation point or the customer demarcation point, regardless of who has responsibility and control of inside wiring. LECs should have responsibility and control of copper in-building wiring on an MDU to permit other LECs to connect and use the in-building wire at no charge. LECs that make use of such facilities are responsible for their maintenance.

### **Resellers/Shared Tenant Services**

Although the MDU decision does not address reseller conduct (although a number of office towers are served by specialized resellers known as "shared tenant services", in part because resellers are not subject to direct CRTC regulation), it can be expected that the CRTC and ILECs will interpret a reseller/shared tenant service condition that the reseller must provide the carrier supplying local services to the reseller with direct access, under reasonable terms and conditions, to tenants who wish to receive service from the carrier

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rather than, or in addition to, service from the reseller, as importing the policies of Decision 2003-45.

It is unclear to what extent in practice this reseller condition will be effectively employed to impose the same access policies that the CRTC has now imposed on LECs. This condition, as it is presently worded, refers only to "direct access". It is potentially arguable that this condition applies only to physical access and does not extend to preferential arrangements between the shared tenant service and the building owner.

### Conclusion

The CRTC's MDU access decision is one of several decisions issued over the last year and a half designed to remove demonstrated barriers to LEC competition. Other recent local competition oriented decisions include:

- (1) a three month freeze on ILEC efforts to win back former customers (*Application of the winback rules with respect to the primary exchange service* (January 2002) Telecom Decision CRTC 2002-1, and *Compliance with workback rules* ((4 December 2002) Telecom Decision CRTC 2002-73);
- (2) maximum ILEC service intervals in supplying unbundled local loops to CLECs ((8 March 2002) Telecom Decision CRTC 2002-14);
- (3) extending the time period during which certain CLEC access services supplied by ILECs are to be supplied at cost-based rates and inclusion of intra-exchange channel components of Digital Network Access Service within the regulated "competitor" service category available to CLEC's (*Regulatory framework for the second price cap period* (30 May 2002) Telecom Decision CRTC 2002-34).

- (4) restrictions on bundling of regulated Bell Canada and unregulated Bell Canada affiliate services ((12 December 2002) Telecom Decision CRTC 2002-76);

and, most recently

- (5) requiring ILECs to provide retail high speed internet service to CLEC residential local service customers whose telephone service is provided by local loops leased from the ILECs (Telecom Decision CRTC 2003-49).

Each decision deals with a narrowly framed market foreclosure issue. The individual or combined impact of these decisions on supporting further local facilities-based telecommunication competition will undoubtedly be a matter of debate for some time. An improved business climate and a filling of the massive network capacity deployed in the late 1990's may still be needed to support viable local competition in the long run. Regulatory intervention alone is unlikely to provide this support.

Nevertheless, it is clear that the CRTC continues to be prepared to exercise its broadly framed regulatory powers in a creative fashion to eliminate demonstrated barriers to competition. Still, as the MDU decision demonstrates, the CRTC's meticulous development of an adjudicative record, where a novel or creative regulatory solution is required, may result in significant delays in issuing remedial orders. In the MDU case, the decision was published almost three years from the initiating Public Notice. In more straightforward applications for a remedy against ILEC foreclosure conduct, the "regulatory lag" has however been as short as six months, a turnaround that, while somewhat lengthy for the aggrieved party, compares favourably with reviewable practice inquiry timeframes under the alternative, the *Competition Act*.

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