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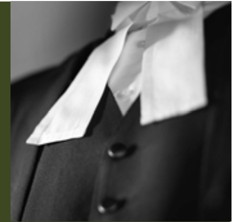

Dial "D" for deregulation

Massive deregulation and $15 m fines for abuse of dominance among major changes in Canada's telecommunications industry

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Canada's telecommunications industry is about to experience a massive shift from intrusive sectoral regulation to open markets. From the recent flurry of telecom-related activity by the Competition Bureau and the federal government, three recent events stand out. First, in September, the Bureau released guidance on the application of the abuse of dominance provisions of the *Competition Act* to the telecommunications industry. Second, on December 7, Industry Minister Maxime Bernier introduced legislation to amend the *Competition Act* to provide for fines of up to $15 million against a telecommunications service provider found to have abused its dominant position. Third, on December 11, Mr. Bernier announced changes to CRTC rules that could result in the deregulation of local telephone services in Canada's major cities by summer 2007. This will significantly increase the Bureau's jurisdiction over telecommunications.

What's up?

The telecommunications industry in Canada is in a state of rapid flux. Not long ago, Canadians could only purchase telephone and cable television services from local monopoly carriers. Today, Canadians can obtain Voice over Internet Protocol (VoIP) telephone services from cable companies and television over Internet Protocol (IPTV) from some phone companies.[1] For the more adventurous, services like Skype offer free long distance video calling to other Skype users anywhere in the world![2]

Technological change is driving regulatory change. On March 22, 2006, the federally-appointed Telecommunications Policy Review Panel (TPR) issued a report recommending reliance on market forces and competition policy, instead of regulation, in the telecom sector. The TPR discussed the changes that are occurring in telecommunications industries. The TPR found that the shift to Internet Protocol (IP) based networks that is underway will lead to a decoupling of services and applications from underlying networks, making possible a four-way convergence of industries: traditional telecom, entertainment and content, consumer electronics, and computing and software. The TPR recommended that there should be a presumption against regulation in this sector – the opposite of Canada's current approach.[3]

Canada's telecom regulator, the Canadian Radio-television and Telecommunications Commission (CRTC), has, however, resisted the erosion of its regulatory powers. Shortly after the TPR Report, on April 6, 2006, the CRTC issued rules on when it would forbear from regulating local telephone services (known in industry parlance as "local forbearance"). These rules were considerably more restrictive than those proposed by the Bureau and incumbent telephone companies (known in industry parlance as incumbent local exchange carriers, or ILECs).[4] The government announced on December 11 that it plans to overrule the CRTC and loosen the conditions for local forbearance.[5]

As well, in May, the federal Cabinet asked the CRTC to reconsider its 2005 decision to regulate VoIP telephone services offered by ILECs.[6] In September, the CRTC reconfirmed its original decision. Cabinet was not long in acting: on November 15, it ordered the CRTC to forbear from regulating VoIP telephone services offered by ILECs.[7]

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The Bureau's draft bulletin

Forbearance or deregulation of parts of the telecommunications industry transfers those parts from a regulated to an open market, and from CRTC to Bureau jurisdiction. The Bureau has signalled that it is keen to exercise this jurisdiction. On September 26, 2006, it issued a draft Bulletin on the Abuse of Dominance in Telecommunications for public consultation.[8]

Abuse of dominance

The *Competition Act* provides a remedy for anti-competitive business practices of dominant firms. Where a firm that substantially or completely controls a market engages in a practice of anti-competitive acts that causes or is likely to cause a substantial lessening or prevention of competition, the Competition Tribunal can prohibit the firm from engaging in the practice.

The draft Bulletin considers how the concepts of market definition, dominance, anti-competitive acts, and substantial lessening and prevention of competition apply to telecommunications markets. The Bureau is inviting comments, which are due by December 29, 2006. A few of the Bulletin's key points are discussed below.

Market shares in telecom markets

Since "dominance" means substantial or complete control of a market, market definition and an assessment of market power are always an important part of any abuse of dominance case.

The Bulletin suggests (but not expressly) that traditional and VoIP telephone services are in the same product market. Geographic market definition is best accomplished by looking at overlapping infrastructure networks, the Bulletin finds. Market share for telecommunications services should be based on capacity in the sense of network coverage. Thus, where two or more networks offer competing telecommunications products in the same area, and are not capacity constrained, each will have equal market share, regardless of the number of customers they each have or their revenue. If there are two networks, each has 50%; if there are three, each has 33%.

Although market shares are not the only indicator of market power, in every abuse case in the Competition Tribunal to date, market shares have been extremely high (80-100%). Consequently, the likely result of the Bureau's capacity-based approach to market shares is that it will be very difficult to establish dominance in telecommunications markets where there are two or more networks available to consumers.

Anti-competitive acts

The Bulletin focuses principally on three types of anti-competitive acts:

- raising rivals' costs and market foreclosure;
- denial of access to an essential facility; and
- predatory pricing.

Raising rivals' costs and market foreclosure would include attempts to disrupt compatibility, reduce the quality of service offered by rivals, or raise rivals' costs. However, the Bulletin notes, the kind of conduct that would have this effect remains subject to CRTC regulation, and is thus not within the Bureau's jurisdiction.

The Bulletin states that denial of access to a facility that is essential for competition can be an anti-competitive act. While the essential facilities doctrine has been the subject of discussion for years, it has yet to be adopted in Canada under the abuse of dominance provisions,[9] and the US Supreme Court has recently questioned it.[10] The discussion of essential facilities in the Bulletin is generic, which suggests that the Bureau regards the doctrine as applicable to any industry.

The Bulletin also provides what is perhaps the most complete articulation to date of the Bureau's approach to predatory pricing. Prices are not predatory unless they are below cost. The Bulletin confirms that the appropriate measure of costs is "avoidable costs", that is, costs that would be avoided by not offering the product or service in question. This measure is deceptively simple in theory and extraordinarily complex in application.[11]

Significantly, the Bulletin accepts the so-called meeting the competition defence, that is, an incumbent is allowed to match prices set by an

entrant, even if the incumbent is driven below its costs.

However, the Bulletin suggests that "targeted pricing", that is, low prices that are offered to customers who have switched, may be an anti-competitive act, even if the dominant firm's prices are not below cost. The Bulletin recognizes, however, that targeted pricing is used in many sectors and is not inherently anti-competitive. Moreover, targeted pricing may be expensive for an incumbent, as other customers may switch in order to take advantage of the targeted pricing.

Fines for abuse of dominant position by telcos

Industry Minister Maxime Bernier introduced Bill C-41 on December 7.[12] The bill would allow the Tribunal to impose fines, or "administrative monetary penalties" (AMP) of up to $15 million against a "telecommunications service provider" found to have abused its dominant position under the *Competition Act*.

The bill draws upon the definition of "telecommunications service provider" in the *Telecommunications Act*.[13] In the *Telecommunications Act*, the term "telecommunications service provider" is defined very broadly, and built up from a complex series of interlocking definitions. The definition captures not only telephone and cable companies, but also, arguably, any business that provides any apparatus that can be used for telecommunications and theoretically even any business conducted using telecommunications.[14] The potential scope of these new AMPs is thus vast.

Proposed AMPs unconstitutional?

This legislation will raise an important constitutional question: are AMPs of $15 million a "true penal consequence" that would attract the safeguards provided for in s. 11 of the *Charter*. These safeguards include the standard of proof beyond a reasonable doubt. Currently, abuse of dominance need only be proven on the civil standard of balance of probabilities.

The *Competition Act* currently provides for AMPs for misleading advertising, but the maximum penalty is about ten times lower.[15] The term AMP was chosen to avoid the use of the word "fine", which would clearly suggest a true penal consequence. Bill C-41 also states that the purpose of AMPs is to promote compliance by the entity on which they are imposed. This is known as specific deterrence. Bill C-41 thus seems to disavow general deterrence as an objective in imposing an AMP.

Whether these attempts to insulate AMPs for abuse from *Charter* scrutiny will stand up is open to question. To complicate matters further, the Supreme Court recently stated that provincial securities commissions can consider general deterrence when setting a financial penalty in the public interest.[16] However, the maximum penalty was $100,000, which is similar to the AMPs available in misleading advertising cases. By contrast, the $15 million AMPs proposed in Bill C-41 are $5 million *higher* than the maximum penalty that can be imposed for conspiracy, which is the most serious criminal conduct dealt with by the *Competition Act*.

Even if AMPs for abuse are not unconstitutional, they radically change the nature of the abuse of dominance provisions. Currently, none of the activities that might be considered anti-competitive is unlawful, until the Tribunal tells the dominant firm to stop. This is consistent with the remedial nature of the abuse of dominant provisions. It also reflects the fact that many business practices can be either *anti*-competitive or *pro*-competitive, depending on the circumstances and details of their implementation. A dominant firm considering a proposed business practice may be uncertain as to whether it would be considered anti-competitive or pro-competitive without conducting in-depth legal and economic analysis.

That being said, from an international perspective, the proposed AMPs are neither unprecedented nor unusual, as both the US and the EU impose financial penalties for abuse of dominant position.

New rules will accelerate local forbearance

Currently, the CRTC regulates local telephone services provided by ILECs with the goal of fostering competition by so-called competitive local exchange carriers (CLECs). The CRTC regulates

pricing by CLECs and has rules designed to make it difficult for ILECs to win back customers from CLECs. (Long distance prices have been deregulated since the late 1990s.)

In its local forbearance decision, the CRTC decided it would forbear from regulating local telephone services in geographic markets where the CLECs' market share reaches 25%, provided that the services provided by ILECs to CLECs meet certain criteria. However, the CRTC decided to use Statistics Canada's census metropolitan areas to define geographic markets. Because these areas are very large, the CRTC's local forbearance test was more restrictive than it appears.[17]

Several ILECs, notably Bell Canada, Telus, SaskTel and Aliant, petitioned the government to vary this decision. On December 11, Mr. Bernier announced that the government plans to impose new criteria for local forbearance on the CRTC and remove restrictions on winbacks by ILECs.

The new criteria are easier to meet than the CRTC's in two important respects. First, local geographic markets are smaller. The CRTC is to use either local interconnection regions (LIR) or individual local telephone exchanges. LIRs are based on provincial administrative regions such as municipalities, counties, etc.

Second, the test for forbearance is to be based on a competitive infrastructure test, that is the presence of competing facilities-based service providers (i.e., networks), instead of a market share test. The new test offers three alternative criteria, any one of which is sufficient:

- The existence of *two* independent facilities-based service providers, plus certain additional factors such as entry, lack of capacity constraints, and vigorous rivalry. This was the test proposed by the Bureau in its submission to the CRTC.
- The existence of *three* independent facilities-based providers of residential telephone services, *including wireless* services.[18]
- The existence of *two* independent fixed-line facilities-based providers of business telephone services.

As well, an ILEC applying for forbearance must demonstrate that it has met certain quality of service standards for services provided to competitors.

The government proposes expressly to invite forbearance applications in Canada's largest cities,[19] and promises a decision within 120 days. According to Mr. Bernier, about 60% of Canadians live in areas that meet the new test for local forbearance.[20] Telephone service for a large percentage of the Canadian population could thus be almost completely deregulated before summer, 2007.[21] This, in turn, will greatly enlarge the jurisdiction of the Bureau over the telecommunications sector.

Winback rules abolished

The government also intends to abolish CRTC rules relating to promotions and winbacks. These rules currently prevent ILECs from attempting to win back customers who have switched by offering them special, targeted pricing.

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[1] For instance, MTS TV:
http://www.mts.ca/portal/site/mts/menuitem.a4903ea45593ae3cb60c5ee8408021a0/?vgnextoid=8f679b83c1d57010VgnVCM1000000408120aRCRD

[2] www.skype.com

[3] For a more detailed discussion of the TPR report, see: Canadian telecom review calls for deregulation and reliance on market forces,
http://www.agolaw.com/reslibrary_article.asp?article=_telecom20060328

[4] Telecom Decision CRTC 2006-15,
http://www.mts.ca/portal/site/mts/menuitem.a4903ea45593ae3cb60c5ee8408021a0/?vgnextoid=8f679b83c1d57010VgnVCM1000000408120aRCRD

[5] Industry Canada Press release, 11 Dec 2006, Canada's New Government Proposes to Accelerate Deregulation of Local Telephone Service in the Interests of Canadian Consumers,
http://www.ic.gc.ca/cmb/welcomeic.nsf/ddb0aecf65375eb685256a870050319e/85256a5d006b9720852572410055c041!OpenDocument

[6] Industry Canada press release, 5 May 2006, Government of Canada Refers CRTC Decision on VoIP Back to the Commission for Reconsideration,
http://www.ic.gc.ca/cmb/welcomeic.nsf/ffc979db07de58e6852564e400603639/85256a5d006b972085257165006d7603!OpenDocument

[7] Industry Canada Press release, 15 Nov 2006, Canada's New Government Calls on the CRTC to Deregulate Certain VoIP Services,
http://www.ic.gc.ca/cmb/welcomeic.nsf/cdd9dc973c4bf6bc852564ca006418a0/85256a5d006b972085257227004c0829!OpenDocument; to link to the CRTC decisions, see Telecom Circular CRTC 2006-10, http://www.crtc.gc.ca/archive/ENG/Circulars/2006/ct2006-10.htm.

[8] See http://www.competitionbureau.gc.ca/internet/index.cfm?itemID=2180&lg=e

[9] The refusal to deal provision (s. 75) does allow the Tribunal to order the owner of a facility to provide access to it under certain circumstances. Arguably, this is a codification of the essential facilities doctrine.

[10] *Verizon Communications Inc. v. Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 124 S.Ct. 872 (2004).

[11] See for instance *Canada (Commissioner of Competition) v. Air Canada* (2003), 26 C.P.R. (4th) 476 (Comp. Trib.).

[12] See
http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=2578106&Language=e&Mode=1.

[13] S.C. 1993, c. 38, s. 2(1): http://laws.justice.gc.ca/en/T-3.4/279911.html#rid-279915

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[14] This is because a telecommunications service provider is a "person who provides basic telecommunications services"; telecommunications services include "a service provided by means of telecommunications facilities"; a telecommunications facility is "any facility, apparatus or other thing that is used or is capable of being used for telecommunications"; telecommunications is "the emission, transmission or reception of intelligence by any wire, cable [etc]"; and intelligence is "signs, signals, writing, images, sounds or intelligence of any nature". So a person who provides basic services using a facility for the transmission or reception of signs, signals, writing, sounds, etc, by wire, cable, etc, is a telecommunications service provider. ("Basic" is not defined.)

[15] To be more precise, the maximum AMPs that can be imposed on corporations under the deceptive marketing practices provisions are $100,000 for a first order and $200,000 for a second order.

[16] *Re Cartaway Resources Corp.*, [2004] 1 S.C.R. 672.

[17] Telecom Decision CRTC 2006-15, Forbearance from the regulation of retail local exchange services, http://www.crtc.gc.ca/archive/ENG/Decisions/2006/dt2006-15.htm

[18] The government thus appears to view wireless telephony as substitutable for, and in the same product market as, landline telephony.

[19] Vancouver, Calgary, Edmonton, Winnipeg, London, Hamilton, Toronto, Ottawa-Gatineau, Montreal, and Quebec City.

[20] Speaking points for the Hon. Maxime Bernier, 11 Dec 2006, http://www.ic.gc.ca/cmb/welcomeic.nsf/ddb0aecf65375eb685256a870050319e/85256a5d006b972085257241007482f7!OpenDocument

[21] Most of the cities identified are served by three (or more) independent facilities-based providers: two landline (ILEC and cable) and at least one wireless (there are three national wireless providers in Canada, but each is affiliated with a landline telephone or cable network in certain areas).