Canadian Radio-television and Telecommunications Commission
Conseil de la radiodiffusion et des télécommunications canadiennes

Telecom Decision CRTC 2005-27

Ottawa, 29 April 2005

Review of price floor safeguards for retail tariffed services and related issues

Reference: 8663-C12-200318130 and 8622-R4-200308115

In this Decision, the Commission:

(1) modifies existing pricing safeguards as follows:

a) modifications to the imputation test for stand-alone services:

(i) costs of all Category I Competitor Services are to be determined by imputing the applicable tariffed rates

b) modifications to the imputation test for general tariff bundles:

(i) costs of Category I Competitor Services in a general tariff bundle are to be determined by imputing the applicable tariffed rates

(ii) costs of residential local exchange service in a general tariff bundle are to be determined by imputing the applicable tariffed rates;

c) modifications to the pricing rules for term and volume contracts:

(i) the lowest rate in a rate grid must pass the imputation test

(2) restates the definition of a tariffable bundle;

(3) denies an application by Rogers Communications Inc. to prohibit incumbent local exchange carriers (ILECs) from bundling residential local exchange services with forborne services;

(4) denies a proposal by TELUS to delay the application of any price floor rule changes to TELUS Communications (Québec) Inc.; and

(5) denies a request by TELUS to allow ILECs to price services below the imputation test price floor.

I. INTRODUCTION

1. In *Amendments to Telecom Public Notice CRTC 2003-8, Review of price floor safeguards for retail tariffed services and related issues,* Telecom Public Notice CRTC 2003-10, 8 December 2003 (Public Notice 2003-10), the Commission invited submissions on proposed modifications to the imputation test and service bundle pricing rules, as well as on the

introduction of a new pricing safeguard for term and volume contracts for retail tariffed services. The Commission also invited submissions on any other aspect of the current regulatory framework regarding the imputation test and bundling rules and any other related tariffed service pricing safeguards.

2. In exercising its powers and duties under the *Telecommunications Act* (the Act), the Commission has developed a regulatory framework that attempts to balance the interests of the three principal stakeholder groups: customers, incumbent local exchange carriers (ILECs), and competitors. That regulatory framework comprises a number of key mechanisms, including constraints on price decreases.

3. The Commission expressed the preliminary view, in Public Notice 2003-10, that the current price floor mechanisms may not provide for a reasonable balance between the interests of customers, ILECs and competitors. In particular, the Commission expressed concern that the downward pricing flexibility granted the large ILECs (Aliant Telecom Inc. (Aliant Telecom), Bell Canada, MTS Communications Inc. (MTS), Saskatchewan Telecommunications (SaskTel), TELUS Communications Inc., TELUS Communications (Québec) Inc. (TELUS Québec) and Société en commandite Télébec (Télébec)) under the current mechanisms might have allowed the large ILECs to engage in targeted pricing in response to competitive entry. Such targeted pricing could impede the development of competition, as well as constitute unjust discrimination as between customers.

4. In light of these concerns, the Commission proposed changes to the current price floor mechanisms. In addition, the Commission proposed a new pricing safeguard to address its concern that the ILECs may have an excessive degree of pricing flexibility with respect to term and volume contracts for tariffed services. In particular, such contracts may allow the large ILECs to skew the distribution of price benefits under a contract in a manner that may raise concerns about unjust discrimination between customers or anti-competitive pricing.

5. On 27 June 2003, Rogers Communications Inc. (Rogers) submitted an application asking the Commission to prohibit the bundling of any ILEC monopoly residential telephone services with competitive services. In particular, Rogers requested that the Commission prohibit the ILECs from bundling residential local exchange services or local optional services with any forborne or non-telecommunications service provided by the ILEC or through an affiliated company. In response to this application, comments were filed by the Competition Bureau (the Bureau), Bell Canada (on behalf of itself and MTS, SaskTel and Télébec), Aliant Telecom, MTS, SaskTel, FCI Broadband, a division of Futureway Communications Inc. (FCI Broadband), TELUS Communications Inc., Call-Net Enterprises Inc. (Call-Net), the Canadian Cable Television Association (the CCTA), Independent Members of the Canadian Association of Internet Providers (IMCAIP) and Vidéotron Ltée (Vidéotron). Rogers filed a reply to these comments.

6. In Public Notice 2003-10, the Commission stated that it intended to address the relief requested by Rogers in the context of this proceeding. Accordingly, the record of Rogers' application was made part of the record of this proceeding.

7. The procedure set out in Public Notice 2003-10 provided for the filing of initial submissions, as well as an interrogatory process. The Commission indicated that after the completion of the interrogatory process, a decision would be made as to the nature of the remaining procedure.

8. The Commission received initial submissions on 30 January 2004 from the following parties: the Canadian Bankers Association (the CBA), the CCTA, the Coalition for Competitive Telecommunications Pricing (the Coalition), LondonConnect Inc. (LCI), Rogers, TELUS Communications Inc. (on behalf of itself and TELUS Québec[1] (collectively, TELUS)), Bell Canada (on behalf of itself and Aliant Telecom, MTS, SaskTel and Télébec (collectively, the Companies)), Allstream Corp. (Allstream) and Call-Net (collectively, the Competitors), the Public Interest Advocacy Centre (on behalf of Consumers' Association of Canada, National Anti-Poverty Organization and Union de consommateurs (collectively, the Consumer Groups)), Johnston & Buchan (on behalf of Telecom Ottawa, Hydro One Telecom, Utilities Kingston, SCBN Telecommunications, Fibretech Telecommunications, Blink Communications, Fibrewired Hamilton and Enersource Telecom (collectively, the Telecom Utilities)), Xit Télécom (Xit), the Canadian Cable Systems Alliance Inc., Quebecor Média inc., the Investment Dealers' Association of Canada, and the Canadian Chamber of Commerce.

9. In letters dated 27 April 2004 and 13 May 2004, the Commission set out the remaining procedure for the present proceeding. Final comments were filed on 11 June 2004 by the CBA, the CCTA, the Coalition, LCI, Rogers, TELUS, the Companies[2], the Competitors[3], the Consumer Groups, SaskTel, the Telecom Utilities and Xit. With the exception of the CBA and Xit, all parties that filed comments on 11 June 2004 filed reply comments on 25 June 2004.

10. The issues raised in Public Notice 2003-10 are discussed below, under the following headings:

Section II - The state of competition

Section III - The imputation test for stand-alone services

Section IV - The definition of a tariffable bundle

Section V - Rogers' application for a moratorium

Section VI - Pricing safeguards for general tariff bundles

Section VII - Pricing safeguards for Type 2 customer-specific arrangements

Section VIII - Pricing safeguards for term and volume contracts

Section IX - Other issues

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[1] Effective 1 July 2004, TELUS Communications Inc. assumed all rights, entitlements, liabilities, and obligations relating to the provision of telecommunications services in the territories previously served by TELUS Communications (Québec) Inc.

[2] In submissions dated 11 June 2004 and 25 June 2004, the group of parties collectively referred to as the Companies no longer included MTS.

[3] In comments dated 25 June 2004, the parties collectively referred to as the Competitors include MTS Allstream Inc. and Call-Net.

II. THE STATE OF COMPETITION

11. In Public Notice 2003-10, the Commission noted that the 2002 and 2003 versions of the Commission's annual *Report to the Governor in Council: Status of Competition in Canadian Telecommunications Markets* (the Competition Report) indicated that competition was weak in the Canadian local exchange market.

12. The Commission stated its preliminary view that the degree of downward pricing flexibility granted to the large ILECs under the current price floor mechanisms had contributed to the weakened state of competition. In particular, that flexibility appeared to have allowed the large ILECs to engage in targeted pricing in response to competitive entry, to the detriment of the development of competition.

Positions of parties

13. The Companies disagreed with the Commission's preliminary view of the state of competition and argued that the state of competition in residential and business markets was not weak. In support of their claims, the Companies submitted a Decima Research Inc. report conducted for Bell Canada entitled "Canadians' Usage and Views Regarding Telecommunications."

14. Similarly, TELUS argued that the state of local competition was not weak and submitted a survey conducted by Ipsos Reid entitled "Telecommunications Sector Competition." TELUS argued that although the 2003 Competition Report indicated that ILECs held over 95 percent of local loops on a national basis, competitors had made significant gains in urban areas. TELUS claimed that in larger urban areas, competitors had 10 to 20 percent of business lines and one to 13 percent of residential lines.

15. The Companies and TELUS both argued that the Commission took too narrow an approach to assessing competition. The Companies submitted that the Competition Reports and Public Notice 2003-10 did not adequately reflect the emergence of other services that constitute alternatives to wireline residential local exchange service.

16. TELUS submitted that competitive developments such as Voice over Internet Protocol (VoIP) services, the integrated provision of voice, data, and video services over high-speed access, and wireless substitution indicated that market forces were producing increased competition.

17. The Companies submitted that there was vigorous competition in the business market in particular, with several competitors generally responding to requests for proposals. The Companies also submitted that the wholesale market (other than for essential facilities) was extremely competitive and that Bell Canada's competitors were successful in winning business accounting for almost 50 percent of the incremental revenues associated with new wholesale opportunities in 2003. The Companies submitted that the 2003 Competition Report confirmed strong competitive presence in business markets in major cities across Canada, citing competitor market share of local business lines as 23 percent in London, 19 percent in Hamilton, 18 percent in Toronto, 17 percent in Québec City, 12 percent in Vancouver, and 10 percent in St. John's. The Companies also submitted that competition was thriving in the market for competitive digital network access (DNA) and fibre-based services.

18. Finally, the Companies argued that data from the 2003 Competition Report was out of date as it only reflected data to the end of 2002.

19. The Coalition and the CBA also disagreed with the Commission's preliminary view that there existed a weak state of competition in the business market. The Coalition submitted that it was doubtful as to whether the business telecommunications market required any regulatory intervention, let alone the intrusive measures proposed by the Commission in Public Notice 2003-10. In support of its argument, the Coalition stated that the 2003 Competition Report provided ample evidence that competition to provide wireline voice, data, local, long distance, and private line services was sustained and vibrant, particularly for business services.

20. The Coalition and the CBA submitted that competition for contracts among telecommunications service providers was intense. The Coalition stated that, as indicated by the experience of its members, usually three to five service providers bid on any large national contract. The CBA stated that it had been its members' experience that the telecommunications market was very competitive, with multiple vendors bidding on contracts put to tender.

21. The Coalition stated that spending by Canadian business customers was well distributed among competing suppliers and that competitors were sustaining market share and rates of growth in all sub-markets of the business telecommunications market, including that for business local access services. The Coalition submitted that, from the perspective of customers, there was no evidence that competition was dwindling in the business telecommunications market.

22. The Competitors argued that competitors had not gained a significant, let alone a substantial, market share in key telecommunications markets, primarily the market for local access services. The Competitors also argued that in those markets where competitors had gained a substantial market share, that market share was declining. The Competitors submitted that the central, simple fact among all of the statistics was that the ILECs continued to dominate the market for local access services.

23. Concerning the business market, the Competitors argued that the ILECs were able to use term and volume discounts to tie up large, high-volume customers. They submitted that competition for these large customers was weak, with competitors having a lower market share of those customers' combined local, long distance and private line revenues than for any other group of business customers.

24. Rogers and the CCTA submitted that competition in the local telephone market was weak, particularly in the residential local exchange services market. Rogers argued that the likelihood of entry in the future was not the determinative factor regarding market power and indeed, played only a small role in its assessment. Both Rogers and the CCTA argued that many years after the release of *Local Competition*, Telecom Decision CRTC 97-8, 1 May 1997 (Decision 97-8), the ILECs continued to dominate the residential local exchange services market with a 98 percent market share.

25. The Telecom Utilities submitted that it was widely recognized that competitive market forces were not yet sufficient to discipline the ILECs' pricing of residential local exchange services and that was why these services remained subject to price cap regulation.

26. The Consumer Groups argued that it seemed obvious that for the ordinary residential or small volume users of telecommunications, the existence of a workable competitive market for many telecommunications services, and particularly local service, was a long way off.

Commission analysis and determination

27. The Companies and TELUS argued that the Competition Reports do not adequately reflect the emergence of other services that are providing alternatives to local wireline telephone service. In the Commission's view, these parties did not provide compelling evidence to support this claim. The Ipsos Reid survey entitled "Telecommunications Sector Competition" and the Decima Research report entitled "Canadians' Usage and Views Regarding Telecommunications" measured consumer opinion. They did not provide data on actual service substitutions or market share statistics. The Commission does not consider it as appropriate to base a determination regarding the state of competition on expressions of opinion, as it is to rely upon factual data on the entire market relating to competitive activity and market shares where, as in the present case, such evidence is available.

28. Concerning the timeliness of the data set out in the 2002 and 2003 Competition Reports, the Commission notes that the 2004 Competition Report has now been released and there has been no substantial change in the state of competition over the past year. Accordingly, the 2004 Report lends support to the data on the record.

29. The 2003 and 2004 Competition Reports suggest that wireless has not yet achieved the status of a substitute for wireline service to a significant degree. Neither the Companies nor TELUS filed evidence that would render inappropriate this inference.

30. Similarly, there was no evidence on the record indicating that Canadians are using other technologies, such as e-mail or instant messaging as substitutes for wireline telephone service. The Commission considers that it is insufficient to argue that some usage of one service has been replaced by some usage of another service.

31. As far as the business market is concerned, the Commission is of the view that the existence of multiple bids in a bidding process on large contracts does not, in and of itself, demonstrate that the market is effectively competitive. A better indication would be the percentage of contracts won. In this regard, it appears that the ILECs are consistently winning such contracts, suggesting that the price floor mechanisms may not be sufficiently effective to produce a robust level of competition.

32. In this regard, the Commission notes the comments of the Competitors that they have a lower market share among large business customers than any other group of business customers. This evidence is confirmed by the 2003 Competition Report, which indicates that the ILECs are dominant in the large business local market, with a 98 percent market share. The Commission notes that this number remained unchanged in the 2004 Competition Report.

33. Concerning residential local exchange service, the Commission notes that the 2003 and 2004 Competition Reports indicate that ILECs likewise dominate, with a 98 percent market share.

34. In light of the evidence before it, the Commission remains of the view that the state of competition in local markets remains weak. The Commission considers it important to ensure that appropriate pricing safeguards are in place to ensure that rates are just and reasonable and to protect against unjust discrimination and undue preference or advantage.

III. THE IMPUTATION TEST FOR STAND-ALONE SERVICES

A. Introduction

35. The Commission first introduced the imputation test in *Review of regulatory framework - Targeted pricing, anti-competitive pricing and imputation test for telephone company toll filings*, Telecom Decision CRTC 94-13, 13 July 1994 (Decision 94-13). The price floor mechanism set out in Decision 94-13 was applicable to interexchange voice services and required that, when proposing a new service or a price reduction for an existing service, an ILEC would have to demonstrate that, in general, the proposed rate or rates for the service would be sufficient to recover the costs of the service, where those costs were defined as the Phase II costs of the service plus an imputed contribution amount or cost. In light of this latter component, the Decision 94-13 price floor mechanism was referred to as the "imputation test." Legitimate market trials and promotions of limited duration were not required to satisfy the imputation test. The primary purpose of introducing the imputation test in Decision 94-13 was to protect against unjust pricing in the interexchange voice market.

36. In *Review of regulatory framework*, Telecom Decision CRTC 94-19, 16 September 1994 (Decision 94-19), the Commission modified the imputation test to reflect the implementation of the new Carrier Access Tariff and extended the application of the test to Competitive Network services. In Decision 94-19, the Commission also addressed the situation where an ILEC provides a customized service to a single customer (referred to in Decision 94-19 as a Type 1 customer-specific arrangement (CSA)) by requiring that the imputation test be satisfied in those circumstances.

37. In Decision 94-19, the Commission also extended and modified the imputation test to make it applicable to Competitive Network services, and modified the imputation test to require the ILEC to impute Carrier Access Tariff rates for their own use of their bottleneck services.

38. In Decision 97-8, the Commission extended the imputation test to local exchange services. The Commission determined that the ILECs' use of essential facilities and services should be imputed at tariffed rates, and that the test should apply on a band-specific basis. Below-cost residential local exchange services were exempted from the imputation test on the grounds that they were generally priced below cost as a matter of public policy. In addition, the exemption for legitimate market trials and promotions of limited duration continued to apply.

39. In a letter dated 27 November 1998, The Imputation Test Methodology for Local Services (the 27 November 1998 letter), the Commission stated that the imputation test was to be provided with all tariff applications for services in the local market that proposed the introduction of a new service, or implicit or explicit price decreases to an existing service.

40. In *Issues related to imputation test methodology - Rebanding decision follow-up*, Decision CRTC 2001-737, 29 November 2001 (Decision 2001-737), the Commission further modified the imputation test for local exchange services because of concerns that the use of service-specific Phase II unbundled loop costs permitted ILECs to de-average loop costs within a rate band when providing service to individual customers. Accordingly, the Commission required the ILECs to use, for each non-essential rate band, the per-band average unbundled loop Phase II costs in place of service-specific Phase II unbundled loop costs.

41. In sum, the imputation test in its present form requires an ILEC to demonstrate that the revenues from retail local exchange services will equal or exceed the cost of the service where that cost is defined as the sum of:

    a) the tariffed rates for essential service components (i.e. the unbundled loop rate reflecting Phase II costs, plus a 15 percent mark-up in essential rate bands);

    b) the per-band average unbundled loop Phase II cost, with no mark-up, in non-essential rate bands; and

    c) the Phase II cost of other service components, with no mark-up.

42. In Public Notice 2003-10, the Commission expressed the view that the application of a 15 percent mark-up on the Phase II costs of certain service components and no mark-up on other components may set a price floor that is too low. In this regard, the Commission noted that the large ILECs have indicated in the past that, on average, a mark-up of approximately 25 percent is required for retail tariffed services in order to ensure the financial integrity of an ILEC. Accordingly, the Commission proposed a modification to the imputation test that would raise the mark-up required on Phase II costs of service components.

43. Specifically, the Commission proposed that the imputation test be modified to require that when a large ILEC wishes to introduce a new retail tariffed service or reduce the price of an existing retail tariffed service, the ILEC must demonstrate that the revenues derived from the service will equal or exceed the sum of the costs of providing the service, determined in the following manner:

    a) if the service incorporates a component that is already available on a retail tariffed basis, either as a stand-alone service or as a rate element of another retail tariffed service provided under comparable terms and conditions, then that component must be imputed at the pre-existing tariffed rate;

    b) if the service incorporates a component that is already available as a tariffed service that is classified as a Competitor Service, then the cost of that component shall be deemed to be the greater of the tariffed rate of the component as a Competitor Service or the Phase II cost of the component plus a 25 percent mark-up. In accordance with Decision 2001-737, the Phase II cost of unbundled loops would be taken as the average per rate band Phase II loop costs, where applicable; and

c) other components of the service would be imputed at their Phase II cost plus a mark-up of 25 percent.

B. Components available under the general tariff

Background

44. At the present time, costs of service components available under the general tariff, other than essential components within Category I Competitor Services[4], discussed in the next section, are included in the imputation test at their Phase II costs.

45. In Public Notice 2003-10, the Commission proposed that the costs of service components available on a retail tariffed basis, either as a stand-alone service or as a rate element of another retail tariffed service provided under comparable terms and conditions, be included in the imputation test at the pre-existing tariffed rate.

Positions of parties

46. The Telecom Utilities agreed with the Commission's proposal to impute the tariffed rate for service components available under the general tariff.

47. The Companies stated that imputing components available under general tariff at tariffed rates would be contrary to the Commission's previous policies, and that the harm caused by such a rule would outweigh the benefit, except in the case of customer-specific bundles. The Companies stated that, in 1994, the Commission's view was that a price floor based on underlying costs would facilitate the introduction of economically viable new services while maintaining competitive equity. The Companies emphasized that, at that time, the Commission rejected the notion of an imputation test where all the service elements were incorporated at tariffed rates, adopting in its place a test in which only essential facilities would be incorporated at tariffed rates.

48. The Companies submitted that such reasoning is even more relevant today as the telecommunications industry seeks to develop innovative next generation services to meet customer needs. The Companies stated that to hamstring the ILECs by requiring that they impute prices for existing tariffed service components, and even prices of forborne components in the case of bundles, would set the clock back 10 years and would undoubtedly slow the development and uptake of new services. They stated that this could not only damage the Canadian communications industry but also other industries in Canada that rely on the availability of leading-edge services at competitive prices for their global competitiveness. The Companies argued that the current test is consistent with competition law and economic principles.

49. The Companies also indicated that there could be several rates for related functionalities and it is not clear which rate should be used for the imputation test.

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[4] In *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 20 May 2002, the Commission established Category I Competitor Services to comprise those services which are in the nature of an essential service.

50. LCI submitted that while the proposal made by the Commission in Public Notice 2003-10 might in theory improve the competitive environment for entrants, consideration of how these proposals might be implemented in practice raises concerns of both a practical and policy nature.

51. LCI submitted that there has not been a general requirement that every rate component in a service or rate band, or that rates for any particular contract term, be compensatory or pass the imputation test. LCI submitted that the imputation test has generally been applied at the level of the rate band (in the case of exchange services using loops) or at the level of the aggregate service (in the case of most other local services). Thus, ILEC rate components do not always align perfectly with cost components, and may be driven in part by marketing considerations.

52. LCI submitted that it is quite likely that, for services with more than one rate component, there will be rate components which, on their own, may not recover causal Phase II costs, let alone pass either the existing imputation test or the proposed imputation test. LCI stated that using these low retail-rate elements for imputation to the price floor for some service components or functionality would be clearly inappropriate.

53. LCI also submitted that there are likely to be cases in which multiple rates exist for a service functionality. In these cases, even if any potential alternative rates that were to be imputed already met the imputation test on their own, the question arises as to which rate or rates should be imputed. LCI submitted that the Commission, in implementing the imputation process for components available under tariff, will need to recognize that situations may arise in which multiple approved retail rates currently exist for comparable functionalities.

54. LCI also stated that it is not clear what the Commission's proposal would entail in situations in which a new retail service or rate reduction was approved based on an imputation test price floor which included a rate component from another service. Similarly, uncertainty might arise where, immediately upon approval, an ILEC proposed an increase in the rate component used in the imputation. LCI stated that the initial logic of the test would suggest that any time an imputed rate is increased, all imputation tests in which it has been used should be re-filed, in order to ensure that rates whose appropriateness was contingent upon the imputation of the original rate level continued to exceed the price floor with the new imputed rate level.

55. LCI also stated its concern that the requirement to impute retail rates may have the unintended effect of providing the ILECs with an incentive to maintain rates for certain retail services at a level below that otherwise dictated by market conditions and regulatory requirements. According to LCI, the incentive would be to keep low the levels of such rates, which, when imputed, would result in an imputation test price floor which compromises the desired levels of other key rates. LCI stated that, although the practical impact of any such incentive is uncertain, as a general rule, a mechanism designed to be a competitive safeguard should not have the effect of placing artificial downward pressure on any retail rates. LCI submitted that, at a bare minimum, the Commission's proposal creates a linkage between various retail rates by making the approval of levels of rates for one service potentially contingent on the levels of rates for other retail services.

56. LCI suggested that if this proposal is implemented, the ILECs should be required to identify all currently approved rate elements for comparable functionalities and to justify in detail the particular rate elements chosen from among the various options identified.

Commission analysis and determination

57. The Commission considers reasonable the submissions of LCI and the Companies that there could often be multiple rate elements that could correspond to some service components or functionalities. The Commission considers that allowing the ILECs to choose which particular rate elements to impute would be complex to administer and might lead to inconsistencies in the imputation test results.

58. The Commission also considers that in the case of a service with multiple rate elements, while the overall service is required to pass the imputation test, the individual rate elements need not do so. Thus, the rates of certain service components listed in the tariff may not be compensatory, and their use for the imputation of new services may therefore not be appropriate.

59. Finally, the Commission notes that mark-ups for general tariff retail services are generally quite high. Using these tariffed rates for developing rates of new services may create an unwarranted upward pressure on rates.

60. Accordingly, the Commission maintains the existing rule applicable to the imputation tests of stand-alone services with respect to service components available on a retail tariffed basis. The costs of these components are to be included in the imputation test at their Phase II costs. Category I Competitor Services constitute an exception, and are dealt with next.

C. Category I and Category II Competitor Services

Background

61. In Decision 97-8, the Commission established the definition of essential facilities. The Commission concluded that, to be essential, a facility, function, or service must meet all three of the following criteria:

a) it is monopoly controlled;

b) a competitive local exchange carrier (CLEC) requires it as an input to provide services; and

c) a CLEC cannot duplicate it economically or technically.

62. Facilities that meet this definition are subject to mandatory unbundling and mandated pricing. As well, the costs of these facilities for the purpose of the imputation test are determined by imputing the applicable tariffed rates.

63. In Decision 97-8, the Commission determined that the following are essential facilities:

a) central office codes (NXXs);

b) subscriber listings; and

c) local loops in certain rate bands.

64. The Commission also stated that there was competitive supply of local loops in other rate bands, but that it was very limited and that CLECs would not be able to provide a significant number of these loops in the early stages of competition. The Commission concluded that CLECs also required the use of these ILEC loops at reduced rates if they were to compete effectively in the short term and made them available to competitors for a five-year period at Category I rates.

65. In *Local competition: Sunset clause for near-essential facilities*, Order CRTC 2001-184, 1 March 2001 (Order 2001-184), the Commission referred to these unbundled loops as near-essential services as they were critical inputs required by entrants and of very limited competitive supply. The Commission considered that entrants in the local market faced substantial barriers to entry that limited their ability to expand their networks and acquire customers through self-supply of the facilities in question. The Commission also considered that the development of competition in the local exchange services market would be limited significantly if it did not continue to require the provision of these services at mandated rates.

66. In *Implementation of price cap regulation and related issues*, Telecom Decision CRTC 98-2, 4 March 1998 (Decision 98-2), the Commission concluded that it was appropriate to assign an ILEC service to the Competitor Services category if the service was in the nature of an essential service or was primarily used by telecommunications service providers. Since Decision 98-2, the Commission has added a number of new services to the Competitor Services category, such as trunk-side wireless access interconnection service and call forward busy/no answer service (for example, *Internet Call Manager Service & amalgamation of the two companies' Calling Features tariffs*, Telecom Order CRTC 99-269, 23 March 1999).

67. In *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002 (Decision 2002-34), the Commission established two categories of Competitor Services in order to clarify the pricing treatment of these services:

a) Category I Competitor Services comprise those services which are in the nature of an essential service. Services in the nature of an essential service comprise interconnection and ancillary services required by Canadian carriers and resellers interconnecting to the ILEC's networks, including essential services as defined in Decision 97-8; and near-essential services, such as those that were the subject of Order 2001-184. The Commission stated that Category I Competitor Services constitute critical inputs required by competitors in light of the very limited competitive supply for these services. Category I Competitor Services are generally priced on the basis of Phase II costs plus the required mark-up of 15 percent; and

b) Category II Competitor Services are those services developed for use by telecommunications service providers, other than services in the nature of an essential service. The pricing of Category II Competitor Services is determined on a case-by-case basis.

68. In Public Notice 2003-10, the Commission expressed its preliminary view that Category I and Category II Competitor Services, without distinction, should be treated for the purpose of the imputation test in the same manner, namely, imputed at the higher of either the tariffed rate or Phase II cost plus a 25 percent mark-up. Under the current rules, only the subset of Category I Competitor Services classified as essential is imputed at tariff; the costs for the remainder of Category I Competitor Services and all Category II Competitor Services are included in the imputation test at their Phase II costs.

Positions of parties

69. The Companies and TELUS objected to the imputation of any costs in addition to Phase II, whether a 15 percent or a 25 percent mark-up, for Competitor Services, other than for essential services. The ILECs argued that, on the basis of economic principles, only essential services should be imputed at tariffed rates (at Phase II plus 15 percent for most services in that category). They argued that the imputation of rates for only essential services achieves competitive equity, since competitors are able to self-supply other competitor services or obtain them from other suppliers. They considered that if the other Category I Competitor Services were imputed at tariffed rates, ILECs would be at a competitive disadvantage as competition would not take place on the basis of relative efficiencies.

70. The Companies and TELUS further stated that a mark-up of 25 percent over Phase II cost would provide a pricing umbrella for competitors who would price their own services at just below the 25 percent mark-up. Further, they pointed to the resulting harm of such a measure, such as a lack of competitive pressure on prices to go below that threshold, even in the long run.

71. The Companies and TELUS also indicated that putting a mark-up of 25 percent over Phase II cost would remove the ILECs' pricing flexibility to put high or low mark-ups on services, depending on market conditions.

72. TELUS also argued that the proposed imputation test renders meaningless the Commission's essential facilities approach, which it described as the cornerstone element of the Commission's competition policy. In TELUS' view, by requiring the imputation of rates paid for all inputs purchased by competitors, not just the rates paid for essential facilities, the Commission would be encouraging resale, rather than facilities construction.

73. The Companies further argued that a change to the definition of essentiality contained in Decision 97-8, or the current classification of certain services as "essential" cannot be undertaken in this proceeding, as it would be outside the scope of Public Notice 2003-10.

74. LCI argued that the economic and sustainable use by CLECs of unbundled loops is a pre-condition to the continued development of facilities-based competition, which also extends to other near-essential services. LCI also argued that the imputation of rates for both essential and near-essential Category I Competitor Services is required in the anti-competitive price floor. LCI further stated that interconnection services of a carrier cannot generally be avoided if another carrier wishes to originate traffic from or terminate traffic to the first carrier's end-customers. LCI noted, however, that there may be Category I Competitor Services

elements for which imputation may not be practical or desirable, and suggested an alternative approach for those service elements. LCI specifically identified the near-essential and interconnection elements as ones that should be imputed.

75. The Competitors argued that it is a matter of competitive equity that Category I Competitor Services be imputed by the ILEC at the tariffed rates paid by a competitor, as these are necessary inputs competitors will be required to purchase from the ILECs for the foreseeable future. They stated that, at best, there are only very limited competitive alternatives to ILEC Category I Competitor Services. The Competitors further stated that there is not a clear line between facilities that are essential and those that are not.

76. The Competitors stated that the Commission has seen fit on numerous occasions to establish other categories of services, specifically "near-essential" and "services in the nature of essential facilities." They argued that the Commission's reasoning in establishing these types of facilities is straightforward: although it cannot be said that these facilities are subject to monopoly supply and thus may not fit strictly with the Commission's definition of essential facilities, they are necessary inputs that competitors will be required to purchase from the ILECs for the foreseeable future.

77. In their final argument, the Competitors indicated that as long as services for competitors are unbundled and all Category I Competitor Services are imputed at tariffed rates, it would not be necessary for the Commission to require the imputation of the higher of the tariffed rate or Phase II cost plus a mark-up of 25 percent.

78. The Telecom Utilities supported the imputation test proposal in Public Notice 2003-10. They submitted that the Phase II methodology was designed to identify the long-run incremental costs of providing a new service. The Telecom Utilities maintained that, accordingly, only those costs that are causal to the provision of a new service are included in the cost study, and thus long-run fixed costs, such as fixed corporate overhead, are generally excluded.

79. The Telecom Utilities also stated that, over the years, the ILECs have pointed out that it is not economically viable for them in the long run to simply recover their Phase II costs when providing access services or other services to their competitors. They submitted that it is for this reason that the ILECs have generally been permitted to charge a mark-up of 25 percent over and above their Phase II costs of providing a service.

80. The Telecom Utilities further indicated that the imputation test was one of the measures introduced by the Commission to limit the ILECs' targeted pricing practices, but that it has failed to achieve its intended goal. The Telecom Utilities submitted that one of the reasons for this failure has been that the test has set the minimum price bar too low.

Commission analysis and determination

81. The Commission proposed that all Competitor Services be imputed at the greater of the tariffed rate or Phase II cost plus a mark-up of 25 percent. There are two aspects to this proposal. The first is the imposition of the minimum 25 percent mark-up which in some cases,

would represent a higher cost than what the competitors would pay for the services. The second is the extension of the imputation test rules that currently apply to essential services to near-essential and interconnection services, as well as to all Category II Competitor Services.

82. The Commission notes that none of the competitors, other than the Telecom Utilities, supported the first proposal to impute the higher amount of Phase II cost plus a mark-up of 25 percent. The Competitors stated that their competitive equity concerns in relation to the imputation of Category I Competitor Services would be adequately addressed if ILECs were required to impute the same rates as the competitors are required to pay, provided that the services they need are unbundled and available under tariff. In essence, they argued that ILECs should be required to impute tariffed rates for all Category I Competitor Services.

83. At present, near-essential facilities are treated in the same manner as essential facilities for rating purposes and in terms of mandatory unbundling, but they are not imputed on the same basis as essential facilities. Whereas the costs of essential services are reflected in the imputation test by imputing the applicable tariffed rates, the costs of near-essential services are reflected by including the associated Phase II cost without mark-up.

84. As a result, the Commission considers that the current imputation test provides an undue advantage to the ILECs in terms of pricing for services containing near-essential components. ILECs are able to provide these services to competitors at Phase II cost plus a mark-up of 15 percent, but may provide these same services to end-customers at the level of Phase II cost, without a mark-up. Thus, just to match an ILEC's price to an end-customer, a competitor must absorb the 15 percent mark-up differential that it pays to the ILEC for such services, as well as any operating expenses incurred to administer services bought from the ILEC, thereby further raising the ILEC's advantage.

85. The Commission considers that for the purpose of the imputation test, competitive equity requires that the costs of near-essential services required by competitors interconnecting to the ILECs' networks be determined by imputing the applicable tariffed rates for the same reasons that the costs of essential services are determined by imputing the applicable tariffed rates.

86. The Commission is of the view that the record does not support the proposal to impute, at this time, a rate for Competitor Services that exceeds the applicable tariffed rate in order to address competitive equity concerns. The Commission considers that ensuring that the ILECs impute the same rate in the imputation test that competitors pay for Category I Competitor Services given that they are at best limited to competitive supply would be adequate to address competitive equity concerns at this time.

87. The Commission accordingly confirms that the costs of Category I Competitor Services should be reflected in the imputation test by imputing the applicable tariffed rates. The Commission notes that Category I Competitor Services are generally tariffed at Phase II cost plus a 15 percent mark-up. The Commission further notes that, pursuant to Decision 2002-34, Category I Competitor Services include essential, near-essential and interconnection services required by carriers and resellers interconnecting to the ILEC's networks.

88. As regards Category II Competitor Services, although they are, by definition, developed for use by competitors, they can also be supplied by other parties, and by the competitors themselves. The Commission accordingly considers that, from a competitive equity perspective, ILECs should not be required to reflect in the imputation test more than their Phase II costs for these services. To the extent, however, that Category II Competitor Services include Category I Competitor Services elements, the Commission considers it appropriate that the costs of such elements be reflected in the imputation test by imputing the applicable Category I Competitor Services rates.

89. Accordingly, for the purpose of the imputation test, the Commission finds as follows:

a) the costs of all Category I Competitor Services are to be reflected by imputing the applicable tariffed rates; and

b) the costs of Category II Competitor Services are to be included at the associated Phase II cost. However, in the costing of Category II Competitor Services themselves, if a component is a Category I Competitor Service, the costs of the Category I Competitor Services component will be determined by imputing the applicable tariffed rates.

D. Other components

Background

90. This section deals with rules for the costing of other service components or functionalities to be included in the imputation tests of stand-alone services. These components are neither Competitor Services nor service components available on a retail tariffed basis.

91. Under the current imputation test for stand-alone services, the costs of these components or functionalities are included at the associated Phase II costs, as established in Decision 94-13.

92. In Public Notice 2003-10, the Commission proposed that in the imputation test for a stand-alone service, other components or functionalities would be imputed at Phase II cost plus 25 percent. At that time, the Commission stated that such a rule should protect against both unjust discrimination and anti-competitive pricing, while protecting the financial integrity of the large ILECs.

Positions of parties

93. The Companies and TELUS submitted that it is not efficient to have any mark-up over Phase II cost on these other non-tariffed elements. They argued that any mark-up would artificially inflate the ILECs' costs and give equally efficient competitors a pricing advantage of 25 percent for non-essential service components. They also submitted analysis from economic experts that argued that as long as non-essential services are imputed at Phase II cost, equally efficient competitors should be able to compete as they have the option of producing the components themselves or obtaining them from alternate sources.

94. Additionally, the Companies and TELUS argued that the Commission's rationale that a 25 percent mark-up would protect the ILECs' financial integrity is illogical as artificially high price floors for competitive ILEC services can only harm the ILECs' competitive position and thus their financial integrity.

95. The Telecom Utilities stated that they supported a 25 percent mark-up as proposed in Public Notice 2003-10. They submitted that the current test has failed to protect against targeted pricing practices, as the minimum price bar has been set too low. The Telecom Utilities further stated that they cannot match the ILECs' prices on residential local exchange services when they are required to purchase underlying services from the ILECs at higher rates than the ILECs are quoting to their own customers.

Commission analysis and determination

96. The Commission notes that other service components or functionalities are not in the nature of essential services, and are generally available in a competitive market.

97. The Commission accepts the argument that reflecting the higher amount of Phase II costs plus a 25 percent mark-up for such components in the imputation test would not be competitively equitable. The Commission considers that, as long as services available on a competitive basis reflect the associated Phase II cost, competitors should be able to offer appropriate price points to customers by producing the components themselves, or by obtaining them from alternate sources.

98. At this time, the Commission does not consider it appropriate to apply a mark-up of 25 percent on the costs of other service components or functionalities, as proposed. Thus, in an imputation test for stand-alone services, the costs of these other service components or functionalities will continue to reflect the associated Phase II costs.

E. Conclusion

99. The Commission concludes that the existing imputation test rules for stand-alone services are to be maintained with the exception of the costs of Category I Competitor Services which are to be reflected in the imputation test at the applicable tariffed rates. The Commission also determines that the revised imputation test rules should also apply for new Type 1 CSAs, whenever required.

IV. THE DEFINITION OF A TARIFFABLE BUNDLE

Background

100. This section addresses the basic question of what constitutes a bundle that requires the filing of tariffs and Commission approval. Various parties to this proceeding requested that the Commission clarify the definition.

101. The Commission's current definition of a bundle has been developed through multiple decisions. In section III of *Joint marketing and bundling*, Telecom Decision CRTC 98-4, 24 March 1998 (Decision 98-4), the Commission described bundling as follows:

> The Commission in Decision 94-19 stated that "the term bundling generally refers to a situation where one rate covers a number of service elements," and that bundling includes "situations where there may be separate rate elements for each service element, but a number of service elements are aggregated for purposes of applying volume discounts, with the result that the discount available is greater than it would be were the service elements not aggregated." In *Forbearance – Regulation of Toll Services Provided by Incumbent Telephone Companies*, Telecom Decision CRTC 97-19, 18 December 1997 (Decision 97-19) and *Stentor Resource Centre Inc. – Forbearance From Regulation of Interexchange Private Line Services*, Telecom Decision CRTC 97-20, 18 December 1997 (Decision 97-20), the Commission also described bundling as the inclusion of different services or service elements under a rate structure. The Commission noted that this rate structure may be a single rate, a set of rates for various service elements, and/or rates for one or more service elements which are dependent on the usage of other services.

102. In *Call-Net Enterprises Inc. - Request to lift restrictions on the provision of retail digital subscriber line Internet services*, Telecom Decision CRTC 2003-49, 21 July 2003 (Decision 2003-49), the Commission referred to the description of bundling in Decision 98-4 and stated that it generally considers that bundling exists where a customer derives a financial benefit from acquiring more than one service from an ILEC that is greater than the benefit that would be available to the customer if the services were bought separately from the ILEC.

103. In *Shaw Communications G.P. v. TELUS Communications Inc. - Violation of bundling safeguards*, Telecom Decision CRTC 2004-23, 2 April 2004 (Decision 2004-23), the Commission considered that, to constitute a bundle, there must not only be a single rate or single rate structure, but also a benefit, financial or otherwise, arising from the aggregation of the services.

Positions of parties

104. The Companies stated that it is important to establish whether a particular offering involving forborne or non-telecommunications services is a tariffable bundle. They stated that if the offering meets the Commission definition of a bundle, and encompasses at least one tariffed service component, the bundle must be filed for the Commission's approval and must pass the Commission's current imputation test for generally available bundles, or the CSA test, if applicable. The Companies submitted that if it does not meet the definition, and assuming all tariffable components of the offering are already tariffed, no new tariff is required. The Companies stated that, for example, the offer of two tariffed services for a single price equal to the sum of the two tariffed prices should not require a separate tariff filing.

105. The Companies submitted that the Commission should adopt an approach in which any bundle to include forborne services, or unregulated non-telecommunications services, priced at a level at least as high as the sum of stand-alone prices of the tariffed elements, would not have to be filed for tariff approval.

106. The CCTA, the Competitors and LCI proposed using a definition whereby tariffable bundles would include situations where some benefit is provided to a customer, but which is not limited to a financial benefit. In response, the Companies argued that the definition of a tariffable bundle should not rely on the term "benefit," as that term is simply too broad. For example, "one-stop shopping," even where the purchase of the services are not contingent upon one another, could be interpreted as a benefit. The Companies stated that a definition of a tariffable bundle that relies on financial benefits is clearly superior because it would avoid debates as to the meaning of benefit.

107. The CCTA submitted that narrowing a definition to avoid debates, as argued by the Companies, does not necessarily lead to a superior result if a broader definition would more appropriately address the concerns regarding ILEC bundling practices. The CCTA submitted that there are numerous instances where both the Commission and parties have to apply judgment to assess whether a particular practice, undertaking or service meets an established criteria or definition.

108. The CCTA stated that the Companies' proposal would permit the pricing and offering of bundles without *ex ante* consideration and would be tantamount to granting forbearance. The Competitors also submitted that this approach would violate the requirement for prior approval of rates as set out in section 25 of the Act.

109. The CCTA submitted that unless the definition of a bundle is cast wide enough so that all offerings including local access service are subject to the Commission's *ex ante* scrutiny as part of a tariffing process, the Commission will be faced with endless *ex post facto* disputes over whether certain arrangements which do not meet the Commission's definition of a "bundle" nonetheless violate the provisions of subsection 27(2) of the Act.

110. The Competitors cited Decision 2003-49 in which the Commission determined that the ILEC practice of requiring a customer to subscribe to ILEC residential local exchange service in order to receive digital subscriber line (DSL) Internet service did not constitute a bundle but nonetheless constituted a violation of subsection 27(2) of the Act. The Competitors submitted that had this offering met a broader definition of a bundle, this offering would have been subject to the Commission's prior approval process, for rendering unnecessary the Call-Net application filed after much harm had already occurred.

111. The Competitors argued that the ILECs use techniques to get around the Commission's narrow definition. They provided three examples of such activity:

a) "bundles within a bundle," where Aliant Telecom offered local service in a bundle with no discount on the local service;

b) "packaged but not bundled," where TELUS packaged forborne services offered at a discount "plus the cost of your local residential line"; and

c) "one bill but not bundled," where Bell Canada promoted one bill benefits along with its local-excluded bundles.

112. LCI submitted that the definition of a tariffable bundle should include those arrangements where a service element is contingent on the consumption of another service element, whether or not such arrangements involve a benefit as compared to the provision of the services on a stand-alone basis. In LCI's view, tariffable bundles should include, for example, arrangements where a flat-rate price is changed to a usage sensitive pricing structure, with no discount for the average customer. In LCI's view, changes in the terms and conditions should amount to a change in the nature of the tariffed service element triggering the requirement of a new tariff.

113. TELUS stated that the Competitors and LCI, supported by the CCTA, set out an argument which seeks to have the Commission review and vary three of its recent rulings, specifically: Decision 2003-49, Decision 2004-23 and *Application from Call-Net seeking relief from TCI's alleged non-compliance with bundling rules*, Telecom Decision CRTC 2004-38, 9 June 2004. TELUS noted that in these rulings, the Commission set out the requirement that, in order to be considered a bundle, a joint offering of services must confer a benefit greater than that derived by subscribing to the same services on a stand-alone basis.

114. TELUS indicated that the Commission stated that it generally considers that a bundle exists where a customer derives a financial or other benefit from acquiring more than one service from an ILEC that is greater than the benefit that would be available to the customer if the services were bought separately from the ILEC. In TELUS' view, a modification to the definition of a bundle is not within the scope of this proceeding; rather, it is only the service bundle pricing rules that are under review.

Commission analysis and determination

115. The Commission considers that, since the current definition of a tariffable bundle has evolved over a number of decisions, it would be helpful to consolidate the various elements into one definition. The Commission intends to analyze future filings closely through the prism of this consolidated definition.

116. Concerning the Companies' proposal to define a tariffable bundle to exclude circumstances where the price of the bundle is at least as high as the sum of the prices of the tariffed elements, the Commission considers that any individual element of the rate charged for a bundle cannot properly be attributed to any particular service within that bundle. The Commission notes that the adoption of this proposal would, in effect, allow the Companies to price forborne or non-telecommunications services down to zero. The Commission considers that the Companies' proposal would therefore create the potential to price below cost, leading to unjust discrimination in the provision of tariffed service elements in the bundle. The Commission's bundling rules seek to ensure that the bundling of tariffed and non-tariffed services cannot be used as a means to circumvent the obligations of the ILECs to provide telecommunications services in accordance

with the Act. The Commission specifies that a tariffable bundle would not include the offering of two or more tariffed services for a single price equal to the sum of the tariffed prices, where all other terms and conditions are identical.

117. The Commission notes the concerns expressed by the parties regarding future debates about whether a benefit is present. The Commission confirms that a benefit must be financial or readily measurable. Thus, the Commission reiterates that, pursuant to its determinations in *Application to Review and Vary Telecom Decision CRTC 98-4: Joint Marketing and Bundling*, Telecom Decision CRTC 98-20, 6 November 1998 (Decision 98-20), the Commission does not consider a single bill a benefit that would, in and of itself, trigger the requirement to file a proposed tariff under the definition of a tariffable bundle. Similarly, the Commission does not consider the availability of "one-stop shopping" in and of itself to be a benefit.

118. Concerning Decision 2003-49, the Commission notes that retail DSL and residential local exchange services were not being offered in that case under a single rate structure. The Commission considers that the existence of a tie does not itself constitute a bundle, and that concerns about tying are best dealt with on a case-by-case basis. Since no financial benefit was available to customers for subscribing to both services, the Commission considers that it would not be appropriate to extend the definition of a bundle to include such situations.

119. LCI appeared to suggest that the current definition of a tariffable bundle was narrowed in Decision 2003-49 to exclude a bundle that involved, for example, a change from a monthly flat-rate pricing structure to a usage-sensitive pricing structure that did not yield a discount for the average customer.

120. The Commission considers that there is no requirement that the benefit be assessed at the level of the average customer. The Commission requires that a tariffable bundle such as that described by LCI be filed for approval if the change in the rate structure results in a discount to any customer or identifiable group of customers.

121. Having considered the comments of the parties, the Commission restates the definition of a tariffable bundle as follows:

> A tariffable bundle is an arrangement under which a subscriber is provided two or more service elements, at least one of which is a tariffed service element, under a single rate, a set of rates or other rate structure, and which provides a financial or other readily measurable benefit to any customer or identifiable group of customers that is contingent on the use, consumption of, or subscription to any or all service elements.

V. ROGERS' APPLICATION FOR A MORATORIUM

The application

122. On 27 June 2003, Rogers filed an application requesting that the Commission issue an order directing that all ILECs be prohibited from offering any ILEC tariffed residential local exchange service in a bundle with any forborne service or non-telecommunications service provided by the ILECs or through an affiliated company. Rogers' proposed prohibition on bundling would apply to:

a) all promotional offers that bundle tariffed residential local exchange service;

b) any offer that is contingent on or limited to a customer subscribing to residential local exchange service, even for technical reasons;

c) any offer that bundles tariffed residential optional local services with any competitive service (e.g. call waiting/caller ID and long distance services);

d) any discounted package that includes residential local exchange service; and

e) any calculation of savings or discounts that include residential local exchange service.

123. Rogers submitted that such a prohibition is necessary to both sustain and foster competitive markets. Rogers stated that the current rules and practices, whereby ILECs offer bundles that include residential local exchange service, allow the ILECs to leverage their dominant position in the residential local market to the detriment of competition in this and adjacent markets. Rogers submitted that the bundling of these services hinders the development of competition, and constitutes an undue preference contrary to subsection 27(2) of the Act.

124. Rogers submitted that the current regulatory safeguards were predicated on the assumption that there would be competition in the local service market. Rogers stated that this assumption is incorrect, and that the safeguards must be tightened, as the public policy established by the Commission is disconnected from the reality of the market. Rogers submitted that the technical and financial barriers to entry into the local service market are compounded when ILECs have the means of preventing a reasonable payback on entry by engaging in anti-competitive conduct.

125. Rogers stated that bundles can be viewed in the same way as winback promotions that were prohibited by the Commission in *Follow-up to Telecom Decision CRTC 2002-37 - Adoption of digital subscriber line winback rules*, Telecom Decision CRTC 2003-1, 17 January 2003 (Decision 2003-1). Rogers submitted that bundles meet the definition of winbacks provided by the Commission in Decision 2003-1, as they include price breaks on one or more services in the bundle if the customer either retains or reverts to the ILEC's residential local exchange service. Rogers also submitted that ILEC bundles including local service undermine competition in adjacent markets by allowing an ILEC to leverage its dominant position to offer bundles of services that its competitors in other market segments cannot offer. Rogers suggested that the same public policy that led to a prohibition on promotions speaks strongly to the disallowance of ILEC bundles that include residential local exchange service.

126. Rogers submitted that the Commission should retain the prohibition on monopoly bundling until there is effective and sustainable competition in the residential local exchange services market and other service providers are able to offer comparable bundles on a sufficient scale. Rogers further submitted that once the Commission determines that any local service is sufficiently competitive to forbear from regulation, the ILECs should be permitted to include such service on a bundled basis.

127. In Public Notice 2003-10, Rogers' application was incorporated into this proceeding, in which Rogers reiterated its request for a moratorium. Rogers indicated that it did not seek to prohibit bundles of residential services for which all service elements are tariffed, such as residential local and optional local services. Rogers argued that the low rates for residential local exchange services make it very hard for competitors to market a service which will be attractive to customers. Rogers submitted that the main reason for the dismal state of residential local competition in Canada is the low prices charged by incumbents, and that if the Commission wants to have local telephone competition, it cannot permit the incumbents to reduce local telephone rates by combining residential local exchange service with competitive services in a discounted bundle.

Positions of parties

128. The CCTA, the Bureau, FCI Broadband, Vidéotron, and IMCAIP supported Rogers' application or rules similar to those sought by Rogers.

129. Vidéotron submitted that, as the incumbent telephone company, Bell Canada knows when a customer is moving, as he or she must inform Bell Canada of a new address. Vidéotron stated that this allows Bell Canada to be the first competitor to offer the customer a suite of local and competitive services.

130. The CCTA submitted that the prohibition proposed by Rogers is needed to both sustain and foster competitive markets and should apply to all ILECs. The CCTA submitted that the prohibition should remain in place until there is effective sustainable competition in the local market.

131. The CCTA submitted that the ILECs have advantages in terms of revenues, reputation, customer information, and reach that cannot be duplicated. They stated that bundling local and competitive services gives ILECs an undue preference that will reduce the benefits of competition in other markets, including high-speed Internet and broadcast distribution.

132. The CCTA submitted that entering the local market requires significant financial resources and competitors will not seek to either enter or expand in the local market unless and until the rules required to foster and encourage competition are in place. The CCTA submitted that bundles can lock in customers before competitors can establish an effective market presence.

133. The Bureau submitted that while bundling normally does not raise concerns, when done by a dominant firm it can become anti-competitive and prevent or lessen competition substantially in relevant markets. The Bureau stated that bundling gives ILECs an unfair advantage in selling competitive products such as wireless, video, Internet and long distance. The Bureau submitted that competitors who do not have the ability to bundle local telephone service with their competitive offerings are put at a competitive disadvantage and that bundling with monopoly services, therefore, puts competitive markets at risk.

134. The Bureau submitted that such bundling raises the entry costs of entering the local market and impedes entry or expansion, citing as an example Call-Net's complaint regarding the ILECs' policy of tying high-speed Internet to local service.

135. The Bureau submitted that the Commission should:

a) implement an immediate ban on ILECs bundling residential local exchange service with competitive services until such a time that there is effective competition in local markets; and

b) allow for resale, on an avoidable cost basis, of services required by competitors to compete with the ILECs for residential local exchange service.

136. The Competitors stated that they generally do not oppose the ILECs' retention of their flexibility to meet their customers' demands legitimately through the provision of generally available bundles of tariffed and non-tariffed services, provided that the definition of a tariffable bundle is clarified and broadened.

137. The Consumer Groups stated that if the Commission's desire is to simply provide an initial leg-up for competitors, it is far preferable that it be done in an exclusionary way, similar to the bundling restrictions advanced by Rogers in this proceeding, rather than through an artificial juggling of ILEC costs. The Consumer Groups further stated that they did not support this measure, but that it did have the advantage of being driven by demand side rationale, based on the market supremacy in residential local exchange services of the ILECs.

138. The Companies argued that the relief requested by Rogers is anti-competitive, as it appears designed to entrench the cable companies' dominance in cable television service and leadership in high-speed Internet service. TELUS submitted that Rogers' application is an attempt to put in place an asymmetrical regime that would allow Rogers to engage in bundling wireless and Internet services while preventing the ILECs, who compete with Rogers, to engage in bundling. TELUS submitted that this would ensure that Rogers would face less competition should it enter the residential local exchange services market.

139. The Companies noted that in Decision 98-20, the Commission addressed an application to review and vary a portion of Decision 98-4, which sought relief similar to that requested in the Rogers' application to prohibit bundles. TELUS also noted that Rogers sought the precise result in its application that it was denied in the review and vary application.

140. The Companies stated that, while strongly disagreeing with Rogers' current characterization of alleged barriers to entry, the nature and extent of any such barriers is not relevant to the bundling rules established by the Commission. The Companies noted that in the review and vary application that led to Decision 98-20, the applicants sought a prohibition on bundling until at least certain conditions were met. The Companies submitted that if the review and vary application had been approved, rather than denied, bundling would be permitted today, as all the proposed conditions have now been satisfied. The Companies also stated that in Decision 98-20, the Commission indicated that the bundling rules established by the Commission were not related to the state of competition.

141. The Companies argued that concerns that competitors are unable to duplicate bundles offered by the ILECs are unwarranted, as demonstrated by the example of the successful marketing of bundles by EastLink. The Companies further stated that under the current rules, competitors have the ability to offer bundles of local telephone service and other services.

142. The Companies also argued that it was difficult to see how ILEC bundling could provide any unfair advantage in the provision of video and Internet services, since the cable companies are dominant in these markets.

143. The Companies and TELUS disputed the views of Rogers and the CCTA that the proposed moratorium would have a minimal impact on ILEC subscribers.

Commission analysis and determination

144. In evaluating the proposal for a moratorium, the Commission has considered the objectives of the moratorium, its potential effectiveness, and its likely impact on consumers.

145. The Commission notes that many of the reasons cited by Rogers and the CCTA in support of a moratorium relate to the incumbency advantages of the ILECs, such as brand recognition, customer reach and retention of customer information. Based on the record, the Commission cannot conclude that a moratorium on residential local exchange service bundles would address these incumbency advantages enjoyed by the ILECs.

146. In the Commission's view, these advantages stem from decades of incumbency, not the ability to bundle. Regardless of whether the ILECs can offer bundles of services, they will continue to enjoy the advantages they possess as the incumbents.

147. The Commission notes that even if the proposed moratorium were imposed, ILECs would still be able to bundle forborne services and other non-tariffed services. Accordingly, the ILECs would still be in a position to match competitors' prices by lowering their prices for these bundles and offering them in conjunction with tariffed residential local exchange service.

148. The Commission notes that in requesting the prohibition on bundles, one of Rogers' concerns was that discounting local exchange services when they are in a bundle will inhibit the development of local telephone competition. Given the ILECs' dominant market share in residential local exchange services, and the significant technical and financial barriers to entry, the Commission also considers that discounted local exchange services can inhibit competitive entry.

149. At the same time, the Commission considers that consumers benefit from bundles. Moreover, the Commission is of the view that competitors will likely bundle residential local exchange service with other services, rather than offer it on a stand-alone basis. Indeed, Call-Net, for example, is currently bundling local service with optional services.

150. The Commission notes that the Competitors do not seek to remove the ability of the ILECs to offer bundles of tariffed and non-tariffed services, but rather seek that they file tariffs for any such bundles.

151. Having balanced the various considerations noted above, the Commission concludes that allowing ILECs to offer bundles on a tariffed basis, at prices subject to the safeguards set out in this Decision, will better balance the interests of the stakeholders than would a moratorium as proposed by Rogers.

152. Accordingly, Rogers' application is denied.

VI. PRICING SAFEGUARDS FOR GENERAL TARIFF BUNDLES

Background

153. In Decision 94-19, the Commission considered the bundling of tariffed services. In doing so, it began by examining the circumstances under which such services should be permitted to be bundled, taking into account the possibility that by bundling, an ILEC could leverage its dominant position in one market to gain or retain market share in another, more competitive, telecommunications market. While acknowledging the seriousness of this concern, the Commission concluded, as has been confirmed in this Decision, that bundling provides benefits to customers, and that certain types of service bundles should accordingly be permitted.

154. The Commission identified two types of service bundles that could be offered on a tariffed basis, subject to certain service bundling rules: (a) bundles offered on a general tariff basis to all customers; and (b) CSAs, primarily involving elements available from the general tariff best tailored to a particular customer's needs for the purpose of customizing the offering in terms of rate structure or levels.

155. For bundles offered to all customers on a general tariff basis, the Commission specified three service bundling rules:

a) the service bundle must satisfy a pricing rule;

b) competitors must be able to offer their own bundled service through the use of stand-alone tariffed bottleneck components in combination with their own competitive elements; and

c) resale of the bundled service must be permitted.

156. Separate rules were developed for CSAs, and those will be addressed in the next section of this Decision. The rules outlined in this section apply only to general tariff bundles.

157. The Commission established a service bundle price floor in Decision 94-19 that required an ILEC to demonstrate that the revenues from the bundle would equal or exceed the cost, where the costs of the service components of the bundle would be based on:

a) the tariffed rates for bottleneck components (including, as applicable, start-up cost recovery and contribution charges); and

b) the Phase II costs for all other service components.

158. In Decision 97-8, the Commission modified the service bundle price floor by directing that the costs of residential local exchange service and forborne service components were to be reflected at their associated Phase II costs, except in the case of essential facilities and below-cost single line residential local exchange services, which were to be imputed at their tariffed rates.

159. In Decision 97-20, the service bundling rules were further modified to permit the bundling of non-forborne interexchange private line (IXPL) services with forborne services. The Commission determined that the costs of non-forborne IXPL services were to be reflected by imputing the applicable tariffed rates if offered in a bundle which encompasses such services.

160. In Decision 98-4, the Commission permitted additional types of bundles to encompass one or more tariffed services with one or more services of an affiliated company or a non-affiliated company, or with non-telecommunications services. The Commission established the following rules for the costs to be included in the imputation tests for such bundles:

a) tariffed rates for essential services, including services referred to as "bottleneck" services in Decision 94-19;

b) tariffed rates for non-forborne IXPL services;

c) tariffed rates for below-cost single line residential local exchange services;

d) Phase II costs for other ILEC-provided components; and

e) acquisition costs for service elements obtained from an affiliate, or a non-affiliated company.

161. The Commission, in the 27 November 1998 letter, set out more detailed rules for the price floor for a service bundle that includes a local service. In that letter, the Commission approved a methodology proposed by the Stentor companies, which was reflective of the price floor determined in Decision 98-4, but required certain modifications to the proposed methodology. The Commission stated that for bundled services these companies were to also:

a) identify with supporting rationale, as appropriate, the assumed levels and types of revenue discounts;

b) provide separate Phase II costs of major forborne services and non-forborne services;

c) provide separate tariffed rates for essential services, below-cost single-line residence service, bottleneck services, contribution charges and IXPL services; and

d) include separately the associated revenue and cost summaries for each major forborne service and for each major non-forborne service.

162. In *Bundling terminal equipment with network service elements*, Telecom Order CRTC 99-1203, 22 December 1999, the Commission removed the remaining restriction on bundling terminal equipment with network elements. In this order, the Commission also determined that bundles which include terminal equipment with one or more tariffed network service elements must receive prior Commission approval, and must satisfy the imputation test consistent with the Commission's practice for other bundled services.

163. In Decision 2001-737, the Commission modified the imputation test for a bundle that encompasses a residential local exchange service by requiring the use of the per-band average loop Phase II costs in the costing of the residential local exchange service.

164. In Public Notice 2003-10, the Commission proposed that the existing bundling rules (outlined at paragraph 160) be replaced with a safeguard where general tariff bundles should satisfy the following service bundle pricing rule:

> The revenues from the service bundle would be required to equal or exceed the sum of the stand-alone retail prices of the services included in the bundle, less 10 percent. When demonstrating that this pricing requirement is met, a large ILEC seeking tariff approval of such a service bundle would be required to provide satisfactory evidence that the individual service components are available on a stand-alone retail basis, at the retail price identified in the application.

Positions of parties

165. The Companies stated that the Commission's proposed rules for general tariff bundles are arbitrary, do not protect against anti-competitive pricing, and will harm customers by causing prices to rise. They argued that the Commission proposes constraints that would make it practically impossible to offer bundles to consumers.

166. The Companies expressed the view that the current pricing tests for bundles already more than meet the objectives of safeguarding against anti-competitive pricing and unjust discrimination. The Companies submitted that these concerns would be alleviated if the Commission adopted an approach in which any bundle to include forborne services, or unregulated non-telecommunications services, priced at a level at least as high as the sum of stand-alone prices of the tariffed elements, would not have to be filed for tariff approval.

167. The Companies argued that by requiring the filing of a tariff whenever a particular price or discount on a non-tariffed service is made conditional on the customer's purchase of a tariffed service, the Commission is, in practice, regulating the price of the non-tariffed service at least when offered in that fashion. The Companies argued that this approach requires an assessment of the reasonableness of the unregulated price, and that this amounts to a form of price regulation of a non-tariffed service, which is beyond the scope of the Commission's powers under the Act.

168. The Companies argued that additional jurisdictional concerns would arise if the bundling rules were to apply where a third party, whether or not affiliated with the ILEC, provides a discount or benefit subject to the condition that the customer purchase a tariffed service from the ILEC.

169. The Companies stated that there is no unique bundle discount that can achieve the objectives of both service suppliers and customers. The Companies indicated that their customers are currently benefiting from discounts of between 3 percent and 51 percent with a weighted average of 35 percent when purchasing tariffed bundles. The Companies noted, by way of comparison, that Call-Net filed information on consumer bundles offered by Sprint Canada showing discounts ranging from 10 percent (plus a free $30 telephone) to 47 percent, in comparison to stand-alone prices. Allstream filed information showing discounts on Internet packages for small and medium business customers ranging from 12 percent to 24 percent. Bragg Communications Inc. (EastLink) provided information on bundles including residential local exchange service showing discounts ranging from 10 percent to 16 percent for residential customers, and from 32.5 percent to 36 percent for small business customers.

170. The Companies also indicated that, as a practical matter, the Commission's proposals rely on the availability of unique stand-alone prices for both tariffed and non-tariffed services. The Companies argued that it would be difficult to determine unique stand-alone prices for forborne services in bundles and to monitor those prices for changes on an ongoing basis.

171. In regard to bundled components obtained from affiliates, the Companies emphasized that the ILECs have no incentive to forego profits by selling any of their products below cost, and that affiliates themselves could reasonably be expected to resist pressure to sell below cost. They submitted that, in the event that an ILEC did purchase a product from an affiliate for resale below cost and competitors were disinclined to respond in kind, it would be open to them to complain, and the Commission could require that the average incremental cost and average avoidable cost tests be applied at that time.

172. The arguments of the Companies stemmed from the views of Drs. Mathewson, Quigley, and McFetridge that, absent legitimate business explanations for below-cost pricing, the correct cost to use for a service acquired from an affiliated company included in a tariffable bundle is the affiliate's average incremental cost of producing the service.

173. The Companies therefore submitted that the Commission's current approach of using acquisition cost for the treatment of service elements obtained from affiliates and third-party suppliers is appropriate. They stated that it is a more expedient alternative to one that would require the Commission to examine the costs of suppliers which it does not regulate and which may have no costing experience or expertise.

174. TELUS submitted that the Commission's proposed bundle pricing rules are at odds with fundamental economic principles for reasons which include the following:

a) they are arbitrary and are not based on any economic rationale;

b) the regulator would limit how much of the cost savings gained by providing services as a bundle ILECs would be permitted to pass on to customers;

c) inefficient entry would occur in response to artificial incentives;

d) competitive local exchange carriers would price their bundles just below the price for the ILEC bundles, thus ensuring that the cost savings passed on to customers would be limited by regulation;

e) the proposed rules are harmful to customers because prices for bundled services would rise; and

f) a select number of competitors would be subsidized by all Canadian customers who subscribe to bundled local services.

175. TELUS argued that, in Public Notice 2003-10, the Commission incorrectly interpreted and applied subsection 27(2) of the Act, and that subsection 27(2) does not provide a jurisdictional foundation for the Commission's proposals to modify the current imputation test and the service bundle pricing rules. In TELUS' view, subsection 27(2) of the Act applies only where: (1) two persons or classes of persons being compared receive the same or substantially the same service; and (2) such persons are being treated differently. Accordingly, TELUS argued that the Commission cannot find unjust discrimination against competitors in relation to the rates charged by ILECs for its retail services.

176. TELUS stated that in establishing its existing price floor rules for bundles, the Commission has correctly identified the acquisition cost as the correct amount to be included for bundled components obtained from third parties and that there is no economic incentive for a company to price its services below cost in the price floor for the bundle.

177. TELUS argued that it would be unreasonable and burdensome to expect affiliates, in the event they do not use Phase II costing, to incur the time and expense of developing Phase II costing methodologies for services provided to TELUS for no other reason than compliance with a price floor requirement. TELUS stated that this process would also burden the Commission with the potential responsibility of examining and approving Phase II costing of non-tariffed services from non-regulated companies. TELUS further stated that the current price floor that uses the prices that the ILEC actually pays for services acquired from affiliates or third parties is reasonable and easily verifiable.

178. The CCTA recommended, as an alternative to the moratorium proposal, that the safeguard for service bundles that include residential local exchange service be amended as follows:

a) no discount should be applied to residential local exchange service included in a service bundle;

b) the revenues associated with residential local exchange service included in a service bundle be determined using the standard tariffed retail rate of the residential local exchange service; and

c) the total revenues associated with any non-residential local telephone or non-tariffed services in a bundle should equal or exceed the sum of the highest non-promotional stand-alone retail prices of these services, less a 10 percent discount.

179. Rogers objected to the Commission's proposal on the basis that it would permit a 10 percent reduction in residential telephone rates, which, in Rogers' view could eliminate local telephone entry. Rogers expressed the view that the main reason for the dismal state of residential local competition in Canada is the low prices charged by the incumbents. Rogers and the CCTA also submitted that the investment on network and equipment to enter the local service market is high. In the alternative to its proposed prohibition on bundling of monopoly residential local exchange services with competitive services, Rogers argued that the rule proposed for customer-specific bundles should apply to all bundles containing monopoly residential local exchange services. Rogers argued that if the Commission truly desires local telephone competition, it cannot permit the incumbents to reduce local telephone rates by combining the local telephone service with competitive service in a discounted bundle.

180. Rogers submitted that the existing bundling price floor must be changed for components obtained from ILEC affiliates, since the costs of services obtained from affiliates are assessed at the acquisition cost, and this could be far less than the long-run incremental costs.

181. LCI submitted that the proposed bundle pricing rule is arbitrary and that the proposed safeguard would not guarantee that the bundled service revenues or prices would exceed either the existing or proposed imputation test price floor, or even Phase II costs without a mark-up.

182. LCI stated that it is quite likely that, for tariffed services with more than one rate component, there will be rate components that, on their own, may not recover causal Phase II costs, let alone pass an imputation test. In addition, there is no guarantee that the imputed prices for forborne elements of the bundle would exceed an imputation test price floor, since no price floor applies to stand-alone forborne elements.

183. LCI submitted that, even in cases in which the bundled service makes use of a number of elements of each stand-alone tariffed service included in the bundle, there is no guarantee that the use by the bundled service of the stand-alone service would have a pattern of demand across various rate elements that was similar to that underlying the original imputation test filed in support of the stand-alone service. There would thus be no guarantee that this use of the stand-alone service, priced at retail rates, would pass an imputation test. Furthermore, a 10 percent reduction might be sufficient to take the service below an imputation test price floor.

184. LCI submitted that the proposed price floors provide an incentive not present in the existing bundling price floors for ILECs to reduce prices for stand-alone forborne services or to establish forborne services rate elements strategically for the purpose of imputing in the new price floors.

185. LCI also submitted that the proposed bundling rules provide an opportunity for the ILECs to circumvent the imputation test proposed for stand-alone services. This would occur when there is ambiguity as to whether a service is classified as a stand-alone service with multiple elements, or as a bundle of those service elements. LCI gave the example of residential local exchange service with various calling features being classified as either Centrex (a stand-alone service) or a bundle of residential local exchange service and optional features. LCI argued that the Commission's proposed rules provide opportunities for regulatory gaming because,

in the case of general tariff services consisting entirely of non-forborne local elements, a different price floor applies to a service considered to be a general tariff stand-alone service than to a service considered to be a general tariff bundled service.

186. LCI recommended that the Commission keep its existing bundling safeguards, but modify them to reflect any changes made to the imputation test.

187. LCI stated that the continued use of acquisition cost for the imputation test for components obtained from non-affiliated companies is appropriate as these costs are reflective of market values.

188. LCI submitted that acquisition costs are not sufficient for price floor purposes in cases where an affiliate is wholly or partially owned by the ILEC.

189. LCI argued that the price floor for service elements obtained from an affiliate or from a non-affiliated company should also include the Phase II costs associated with incorporating these service elements into a bundle, such as modifications to billing systems and procedures.

190. The Consumer Groups also expressed concern about the Commission's proposed bundling rules. They stated that, if implemented, more than one million consumers who subscribe to bundles of optional local services, such as Call Answer and Call Display, would face significant rate increases. The Consumer Groups submitted that consumers should not be required to subsidize the ILECs' competitors: if competitors cannot compete against the ILECs when their prices are compensatory, competitive entry is not desirable.

191. The Coalition and the CBA argued that the proposed rules would raise the prices paid by its members.

192. The Telecom Utilities supported the Commission's proposed bundle pricing rules, but added that they also believe that the ILECs should not be permitted to provide any discounts on residential local exchange services included in general tariff bundles. The Telecom Utilities also queried how the Commission would determine the retail price of the ILECs' non-tariffed services.

Commission analysis and determination

193. The key difference between the existing bundle pricing rules and the rules proposed in Public Notice 2003-10 is that the existing rules are based on costs, while the proposed rules are based on retail rates.

194. The Commission notes that parties including the Companies, the CCTA, and the Telecom Utilities specified a number of cases where there are a variety of retail rates for a forborne service within a rate band. Several parties demonstrated that it would be difficult to use the approach of retail prices to set price floors for general tariff bundles, particularly for non-tariffed items.

195. By contrast, the Commission has significant experience with costing, and has a well-recognized costing approach based on Phase II. For these reasons, the Commission determines that it will continue to use a cost-based approach for bundles that include one or more general tariff services.

196. With regard to the 10 percent discount proposed in Public Notice 2003-10, the Commission accepts that there is no single bundle discount that can achieve the objectives of both service providers and customers.

197. Consistent with the Commission's determination with regard to the imputation test for stand-alone services, the Commission finds that Category I Competitor Services should be included at tariffed rates in the imputation test for a general tariff bundle.

198. With regard to non-forborne IXPL services, the Commission stated the following in Decision 97-20:

> Consistent with the Local Competition Decision, the Commission finds that, should Stentor companies desire to bundle tariffed IXPL services with forborne services, the rates, terms and conditions for the bundled service must receive prior Commission approval. The Phase II costs of the forborne service elements are to be filed as part of the imputation test, and tariffed rates are to be used to cost the tariffed IXPL service element as well as any interconnection or contribution elements. The Commission considers these requirements to be necessary to ensure that there is no undue preference with respect to the charging for tariffed service elements.

199. The Commission considers that the reasons set out in Decision 97-20 remain valid today. Accordingly, it determines that the costs of non-forborne IXPL services be determined by imputing the applicable tariffed rates in the imputation test of a general tariff bundle.

200. As regards below-cost residential local exchange services, the Commission stated the following in Decision 97-8:

> If the Stentor member companies bundle below-cost single line residential exchange services with other telecommunications services, the Commission will deem that the cost of the residential exchange services is equal to the tariffed rate for the purposes of the imputation test.

201. The Commission considers that it remains appropriate to impute below-cost single line residential local exchange services at tariffed rates in the imputation test of a general tariff bundle.

202. Concerning above-cost basic residential local exchange services, the Commission notes the Telecom Utilities submitted that the ILECs should not be permitted to provide any discounts on local exchange services in bundles. The CCTA and Rogers also argued that, as an alternative to their moratorium proposal, the Commission should require that the ILECs impute residential local exchange services at tariffed rates when offered as part of a bundle.

203. The Commission concluded above that allowing ILECs to offer bundles on a tariffed basis, at prices subject to the safeguards set out in this Decision, will better balance the interests of the stakeholders than would a moratorium as proposed by Rogers. Permitting the ILECs to bundle residential local exchange services with competitive service offerings thus raises the question as to what are the appropriate pricing safeguards to ensure that the rates are just and reasonable and that these telecommunications services are provided without unjust discrimination, undue preference or disadvantage.

204. The Commission notes that the 2003 Competition Report found that competitors earned 1.1 percent of local revenues, with a penetration rate of 1.4 percent of residential lines. The 2004 Report shows increases in the market shares of competitors to 1.9 percent of residential local revenues and 2.0 percent of residential lines. Nonetheless, the Commission considers these data demonstrate that competition in the residential local exchange services market remains weak.

205. The Commission notes that Rogers argued that the main reason for the current weak state of competition is the low price of residential local exchange services. The Commission is persuaded that the costs of facilities-based entry may act as a significant barrier to entry in the residential local market. Further, given the high costs of facilities-based entry, the low price of residential local exchange services may act as an additional barrier to entry.

206. The Commission finds that discounts on the already low price of residential local exchange services, potentially down to Phase II cost would have the effect of further extending the period of time that it takes a competitor to recover its costs of entry, as suggested by Rogers, and otherwise creating an additional barrier to entry into the market. Therefore, the Commission finds that it is necessary and appropriate to prohibit the ILECs from discounting residential local exchange service when offered as part of a bundle in order to prevent the ILECs from conferring upon themselves an undue preference and subjecting competitors to an undue and unreasonable disadvantage.

207. Accordingly, the Commission considers that the revenues associated with above-cost residential local exchange service included in a service bundle should be determined using the tariffed rate of the retail service, exclusive of any promotions, rather than the tariffed rates of the underlying wholesale components. The Commission considers that, in light of the significant mark-ups that characterize optional local services, it remains appropriate to reflect in the imputation test of a general tariff bundle the costs of these services at their Phase II costs.

208. Based on the Commission's 2003 Competition Report, the Commission considers that the business local market, though still in development, is more competitive than the residential local market. The Commission notes that the statistics in its 2004 Competition Report reveal no material change from the previous year's figures.

209. The Commission also notes that the price of business local exchange services is higher than residential local exchange services, so that a wider price window is available to competitors entering the business market.

210. In light of these considerations, the Commission determines that the costs of business local exchange services should continue to reflect the associated Phase II costs in the imputation test of a general tariff bundle.

211. The Commission accepts the arguments of Rogers, LCI and the ILECs that the cost imputed for services obtained from an affiliated and non-affiliated third party included in a general tariff bundle should cover the long run incremental costs of the service element. Indeed, the Commission considers that the acquisition costs presented by the ILECs when filing an application for the approval of a tariffable bundle generally fully cover the Phase II costs of the service elements.

212. While all parties agreed that acquisition cost should reflect Phase II costs, there was less agreement on the issue whether an ILEC would have any incentive to price below cost. In the Commission's view, there could be instances where an affiliate might offer its services to the ILEC below cost, if such a transaction were in the best interests of the overall corporate family.

213. While requiring a Phase II study for all service elements from affiliates would ensure that the costs of all service elements obtained from affiliates reflect the associated Phase II costs, the Commission considers that such a requirement would be onerous both for the ILECs and for their affiliates. The Commission notes, moreover, that it would be able to question any costs filed by ILECs, if it believed that acquisition costs in a particular case were non-compensatory.

214. The Commission finds that the costs of service elements obtained from third parties, either affiliated or non-affiliated, to be included in the imputation test of a general tariff bundle are to reflect the acquisition costs, including the cost of incorporating the component into the bundle. Further, the Commission expects that the acquisition cost of a component obtained from an affiliate will cover the Phase II cost of the component. If it appears to the Commission that the acquisition cost of a component obtained from an affiliated company is less than the Phase II cost of the component, the Commission may require the ILEC to file further information, including a Phase II cost study for that component.

215. In summary, the Commission requires that, when filing applications for approval of general tariff bundles, the ILECs must demonstrate that the revenues from a bundle would equal or exceed the cost of the bundle, where the costs of service components are to be determined as follows:

a) the applicable tariffed rates of Category I Competitor Services, non-forborne IXPL services, and residential local exchange services;

b) acquisition costs of components obtained from affiliated or non-affiliated third parties including the associated costs of incorporating these components into the bundle; and

c) Phase II costs of all other services or other components.

216. The Commission considers that the pricing safeguards set out in this Decision are fully within its powers under the Act. These safeguards are necessary and appropriate to ensure that rates for telecommunications services are just and reasonable to prevent unjust discrimination and

undue or unreasonable preference or disadvantage in the provision of a telecommunications service, and that telecommunications services are otherwise provided in accordance with the provisions of the Act.

VII. PRICING SAFEGUARDS FOR TYPE 2 CUSTOMER-SPECIFIC ARRANGEMENTS

Background

217. In Decision 94-19, the Commission permitted Type 2 CSAs, defined as those arrangements providing a bundle of services tailored to a particular customer's needs, primarily involving elements available from the general tariff, where the purpose is to customize the offering in terms of rate structure or levels. The Commission found that such offerings are subject to the following four service bundling rules:

a) the service bundle must satisfy a pricing rule in the form of a price floor;

b) the ILEC must demonstrate that there is not sufficient demand to offer any customer-specific elements of the service through the general tariff;

c) in order that there be no unjust discrimination or undue preference, the service package and the associated rates, terms and conditions provided under the CSA must be generally available to other customers; and

d) resale must be permitted.

218. The Commission determined the price floor rule as follows. The present worth of revenues under the customer-specific contract must equal or exceed the sum of:

a) the present worth of revenues under general tariff rates for those service components available under the general tariff over the duration of the customer-specific contract; and

b) the present worth of Phase II causal costs for those components not covered by the general tariff rates.

219. In *Bundling rules for customer-specific arrangements*, Order CRTC 2000-425, 19 May 2000, the Commission determined that permitting CSA bundles to include tariffed services with forborne services and services of affiliated and non-affiliated companies and non-telecommunications services would be consistent with the Commission's regulatory framework for bundling. In that order, the Commission extended to such CSAs the four service bundling rules established for Type 2 CSAs in Decision 94-19, but modified the pricing rule to reflect the additional service components permitted by that order. Accordingly, the present worth of revenues under a CSA must equal or exceed the sum of:

i) the present worth of revenues under general tariff rates for those service components available under the general tariff over the duration of the customer-specific contract;

ii) the present worth of causal costs for those components not covered by the general tariff rates; and

iii) the present worth of acquisition costs of any service elements in the bundle acquired from an affiliated or non-affiliated company.

Public Notice proposal

220. In light of the greater risk of unjust discrimination which the Commission perceived to be associated with Type 2 CSAs, the Commission was of the preliminary view in this proceeding that it would be inappropriate to permit any discount to be applied to the tariffed services included in such bundles. Accordingly, the Commission proposed in Public Notice 2003-10 that a large ILEC seeking tariff approval of a customer-specific bundle would be required to demonstrate that the revenues from the service bundle would equal or exceed the sum of the stand-alone retail prices of the services included in the bundle, less a 10 percent discount on the non-tariffed services.

221. As in the case of a service bundle offered on a general tariff basis, a large ILEC seeking tariff approval of a customer-specific bundle would be required to provide satisfactory evidence that the individual service components were available on a stand-alone retail basis, at the retail price identified in the application. As an exception to this pricing rule, in the case of an incidental feature, such as training or enhanced support that was not available on a stand-alone retail basis, the Commission proposed that the ILEC be permitted to include the feature in a customer-specific bundle priced at or above the Phase II costs of the feature, plus a mark-up of 25 percent, without discount. An ILEC wishing to include such a feature in a customer-specific bundle would be required to provide satisfactory evidence of the Phase II costs of this feature, as well as to demonstrate that the inclusion of the feature would not result in unjust discrimination.

Positions of parties

222. The Competitors proposed a moratorium on Type 2 CSAs. The Telecom Utilities also objected to Type 2 CSAs.

223. The Competitors noted that their proposed moratorium would not impede the ability of customers to obtain non-tariffed services from the ILECs pursuant to individually contracted rates, terms and conditions, provided these were not bundled with tariffed services. Furthermore, a moratorium would not prevent customers from having their specific technological or service configuration needs met by the ILECs, as this would still be permitted through Type 1 CSAs, or special facilities tariffs. Finally, a moratorium would not prevent the ILECs from offering legitimate term or volume discounts on tariffed services, provided these were offered through generally available bundles and general tariffs.

224. The Competitors stated that it was not clear what legitimate customer benefits of Type 2 CSAs could not be achieved through the use of transparent rate structures in the companies' general tariffs. Similarly, the Telecom Utilities argued that the ILECs have been given far too much leeway to designate a service as "customer-specific" simply because a customer has requested that several service elements be arranged in a package or offered at multiple locations, when all elements of the package can be found in the published general tariffs.

225. The Competitors stated that the ILECs use Type 2 CSAs in an unjustly discriminatory and anti-competitive manner, and that in many instances the ILECs have failed to respect the existing rules. The Competitors cited, as examples, Bell Canada's use of its affiliate, Bell Nexxia, to offer illegally targeted bundles; Bell Canada's optical fibre arrangements, which the Commission approved on the basis of public interest considerations in spite of a failure to meet the Type 2 CSA price floors; and services offered by TELUS, and the former MTS, that the Commission found were not in compliance with the Commission's bundling rules.

226. The Companies and TELUS submitted that the current rules already more than meet the objectives of safeguards against anti-competitive pricing and unjust discrimination. They stated that by requiring the imputation of tariffs for tariffed services, the current test for Type 2 CSAs might prevent normal competitive pricing activity which, they suggested, enhances customer welfare.

227. The Companies argued that the Commission should reject the request for a prohibition on Type 2 CSAs.

228. The Companies stated that the current rules for Type 2 CSAs protect against the potential for abuse by requiring the imputation of tariffs for tariffed services. With respect to the Bell Nexxia CSAs, the Companies stated that these were not found to violate current rules; rather, the Commission found, for the first time, that agency arrangements between Bell Canada and Bell Nexxia constituted a "bundle" within the meaning of Decision 98-4. Regarding the optical fibre arrangements, the Companies noted that the Commission can approve tariffs that do not meet the test for Type 2 CSAs, where it finds that to do so is in the public interest.

229. The Companies submitted that the same problems noted concerning the proposed general tariff bundle rules exist in the proposed CSA rules, such as providing satisfactory evidence that the service components are available on a stand-alone basis. In their view, the ILECs would have to determine the appropriate benchmark for the price floor to support proposed pricing for a CSA that contains a forborne service. This process would necessitate finding a customer with the same forborne service provided on a stand-alone basis, with the same service requirements in all material respects, including contract term, volume or revenue commitment, and usage or network profile. The Companies doubted that a customer would exist who could provide an appropriate reference point for many of the large national customers, and that, as a consequence, the ILEC would be unable to demonstrate that it provides a particular price level for a customer of that nature.

230. The Coalition and the CBA supported the use of the current CSA pricing rules, stating that adopting the proposed rules would cause prices for business services to increase.

231. LCI stated that, at the time the Commission released Decision 94-19, there was a relative lack of competition, the rules established for Type 2 CSAs were confined to the interexchange market, and all wireline network components were subject to tariff regulation. LCI considered that these conditions no longer hold and, consequently, the current Type 2 CSA price floor no longer guarantees that Type 2 CSAs are priced above costs.

Commission analysis and determination

232. The Commission notes that progress is being made towards more robust competition in the business market, and that business customers support the continued use of Type 2 CSAs. Further, the Commission is of the view that it would be inappropriate to ban CSAs for all ILECs simply as a result of certain past questionable practices of some ILECs.

233. Accordingly, in balancing the interests of all stakeholders, the Commission will continue to permit the filing of proposed Type 2 CSAs by ILECs.

234. Having considered the positions of the parties, the Commission agrees that it would be difficult to identify the correct retail rate to use in an imputation test, and that a framework based on Phase II costs remains a more practical approach. Reliance on Phase II costing also draws on the Commission's expertise and experience with respect to costing. Accordingly, and consistent with the determination above for general tariff bundles, the Commission maintains its existing Type 2 CSA rules, with the modification that components from third parties are to be imputed at acquisition cost plus the Phase II cost of incorporating the component into the CSA.

235. The Commission notes that its determination that components from third parties be imputed at acquisition cost presupposes that the acquisition cost of components from affiliates recovers the Phase II cost of the component. The Commission may, of course, question any costs filed by an ILEC if it believes that the acquisition cost for an item obtained from an affiliate may be too low.

236. In summary, in the imputation tests for Type 2 CSAs, the costs of service components are to be reflected as follows:

a) tariffed services are to be imputed at tariffed rates;

b) other telecommunications services, such as those non-tariffed services provided by the ILECs are to reflect the associated Phase II costs; and

c) components obtained from third parties, either affiliated or non-affiliated, are to reflect the associated acquisition costs, including the associated costs of incorporating the component into the bundle.

237. The Commission also directs that ILECs must provide sufficient costing information in support of a Type 2 CSA application, and, specifically, in the format required by the Commission. Failure to do so will, in future, result in the denial of the application.

238. Finally, the Commission cautions that any violation of this Type 2 CSA regime could lead the Commission to require the ILEC in question to show cause why it should be allowed to continue to file Type 2 CSAs in the future.

VIII. PRICING SAFEGUARDS FOR TERM AND VOLUME CONTRACTS

Background

239. At present, the large ILECs can provide retail tariffed services pursuant to contracts which provide pricing advantages that depend on volume or length of the contract period.

240. For imputation test purposes, access service rates must pass the imputation test at the rate band level and at the service level. At the rate band level, the revenues for each rate band must exceed the costs associated with that rate band. At the service level, the total revenues must exceed all the costs, including corporate level costs that are causal to the service, but not causal to any particular rate band.

241. The Commission notes that there are other services that are offered on long-term and volume contracts that are not access services. These include, for example, voice mailboxes. For non-access services, only the imputation test at the service level is required.

242. At the present time, there is no requirement that every rate in the rate grid must pass the imputation test.

Public Notice proposal

243. In Public Notice 2003-10, the Commission noted that long term and volume contracts are currently not subject to pricing safeguards beyond the application of the imputation test. The Commission expressed concern that the pricing flexibility available to the large ILECs in connection with such contracts may provide them with an opportunity to skew the distribution of price benefits under a contract in a manner that may raise concerns about unjust discrimination as between customers, or about pricing below cost.

244. The Commission proposed that if a large ILEC wishes to modify the manner in which a tariffed service is provided pursuant to a contract that offers price advantages that depend on volume or length of contract period, it must do so in a way that, within a rate band, preserves the existing approved rate differentials.

245. The Commission also proposed that if a large ILEC wishes to introduce new contract periods for a new or existing tariffed service, the ILEC would be required to demonstrate that the proposed arrangements satisfy the imputation test, and that they embody rate differentials for volume or length of contract commitments that are just and reasonable. This requirement could be fulfilled, for example, by drawing a comparison with rate differentials that have already been approved by the Commission for another tariffed service.

Positions of parties

246. The Telecom Utilities submitted that term and volume discounts are another tool at the disposal of the ILECs to target price reductions in market segments where they face competition. These mechanisms not only enable the ILECs to target rate decreases to larger users at the expense of smaller users, but also have the effect of foreclosing markets to competition for extended periods of time.

247. Nonetheless, the Telecom Utilities expressed concern about the reasonableness of using existing rate relationships for ILEC tariffed services as a precedent for appropriate rating of term and volume discounts for other services. According to the Telecom Utilities, these existing rate relationships were established in an era when the Commission was less focused on the discriminatory nature of term and volume discounts. They stated that it may be unwise to look to these rate relationships as a precedent for new services or new discounts without first reviewing their validity.

248. The Competitors submitted that long term and volume contracts permit the large ILECs to provide disproportionate benefits to specific customers, with anti-competitive effects.

249. The CBA, the Coalition, the Companies and TELUS opposed the proposed rules for term and volume contracts. The CBA and the Coalition, representing the interests of business users, cited, among other concerns, the potential harm to business users that will ensue from higher prices if the proposed pricing rules are implemented. The Companies and TELUS opposed the proposed pricing rules for similar reasons.

250. TELUS stated that the assertions of the Telecom Utilities ignore the fact that term and volume discounting is a perfectly normal feature and an acceptable practice in a competitive marketplace, as well as a practice followed by the members of the Telecom Utilities themselves. TELUS submitted that the Telecom Utilities provided no evidence that term and volume contracts offered by the ILECs enable them to target rate decreases to larger users at the expense of smaller users.

251. TELUS submitted that, in fact, any discount from a long term or volume contract must be made available by the ILEC to any customer willing to commit to the term or volume. This is a regulatory obligation that the members of the Telecom Utilities are not themselves required to meet. TELUS further stated that the Telecom Utilities provided no evidence that term and volume contracts have the effect of foreclosing markets to competition for extended periods of time.

252. Citing concerns with the current method and the proposals in Public Notice 2003-10, LCI suggested that the Commission set the lowest rate in a rate grid to pass the imputation test at the required level of disaggregation.

253. In support of its proposal, LCI indicated that pricing-related concerns associated with discounts for term and volume commitments stem largely from the fact that, under current imputation policies, there is no explicit requirement that rates for any particular contract term or volume commitment pass an imputation test applied other than at the level of the service or rate band.

254. According to LCI, there are two underlying concerns with the current approach. First, it may be possible for the incumbent to charge low rates for long contract terms to target the largest, most attractive customers, even though those rates would not pass the imputation test on their own. LCI submitted that the incumbent then might recover the foregone revenues with high mark-ups on rates to customers whom it may not yet be practical for entrants to serve, or who are not as attractive to new entrants. Under the current rules, as long as the imputation test is passed at the required level of aggregation, the service is approved.

255. Secondly, LCI stated that even a determination that the imputation test is passed at the overall service level is contingent on the validity of a demand forecast for each of the various contract periods and volume commitments. LCI argued that these demand weights could be open to manipulation by an incumbent.

256. In this regard, LCI noted support from the work of two economists on the record of this proceeding for the proposition that, in the presence of differential pricing, in addition to a requirement that total incremental revenue equal or exceed total incremental cost for the service as a whole, revenues for the lowest-priced units must also cover the combined incremental cost of the units sold at the lowest price.

257. LCI also commented on TELUS' submissions that a problem with the implementation of sub-service imputation tests is the practicality of determining costs on a sub-service basis. LCI noted that Phase II costs have frequently been estimated at the sub-service level.

258. LCI added that the ability of Phase II to produce estimates at the sub-service or rate element level should not be surprising because Phase II costs are typically built up using estimates of disaggregated network characteristics, demand drivers and cost inputs.

259. In reply, TELUS argued that the evidence on the record of this proceeding demonstrates that all parties offer long term and volume contracts, including LCI, and that the ILECs are not able to lock in customers for these types of arrangements.

Commission analysis and determination

260. The Commission notes that the current requirement to pass the imputation test at the rate band and service levels recognizes the following considerations:

a) imputation at the rate band level takes into account the fact that costs for identical services may differ in different rate bands; and

b) imputation at the service level takes into account the fact that costs at the rate band level do not capture the costs that are associated with the overall service, such as costs causal to the service.

261. Currently, as long as the ILEC satisfies the imputation test at the rate band level and at the overall service level for local exchange service rates, they are able to set the individual rates within a rating grid as they see fit.

262. This flexibility could result in an undue preference conferred upon those specific customers, since the rates for the large customers might not be compensatory. Accordingly, the Commission considers that the current imputation test is insufficient to prevent unjust discrimination or undue preference and to ensure that rates are just and reasonable.

263. The Commission considers that the modification to the rate band test proposed by LCI would be a valuable enhancement to the current methodology. Further, the Commission expects that all rates on the rate grid for the rate band should also pass the imputation test.

264. Accordingly, the Commission modifies the tests for term and volume rates to require that, in their cost studies, the large ILECs must demonstrate not only that the proposed service offering passes the imputation test at the service and rate band levels for the service, but also that the lowest per-unit rate (explicit or implicit) in a grid meets the imputation test.

IX. OTHER ISSUES

A. Existing contracts

265. In Public Notice 2003-10, the Commission invited comments on whether the large ILECs should be required to undo approved service bundles which do not conform with the service bundle pricing rules to be established in this Decision.

Positions of parties

266. The Telecom Utilities stated that the ILECs should be required to undo approved service bundles which do not conform with the service bundle pricing rules to be established in this Decision. They submitted that it would be contrary to the intent of the Act for the Commission to allow the ILECs to honour long-term contracts that were inconsistent with its regulatory safeguards. They argued that to do so would merely perpetuate the discrimination between the ILECs' customers and the foreclosure of market segments to competition.

267. The CCTA proposed that any new safeguards be applied to existing as well as future pricing actions.

268. TELUS noted that the Commission approved existing service bundles based on the regulatory regime in place at the time. TELUS argued that, consistent with the Commission's general policy of only introducing changes to the regulatory framework on a prospective basis, any changes resulting from this proceeding should also apply only on a prospective basis, to new service bundles. TELUS argued that applying the proposed pricing safeguards to previously approved service bundles would be extremely disruptive for customers and would constitute a dangerous policy precedent.

269. The Coalition argued that there is neither any justification nor any fairness in retroactively amending pre-existing contracts which were fully compliant with the rules that existed at the time of the contract.

Commission analysis and determination

270. The Commission considers that, in the circumstances, to undo approved service bundles would be too disruptive for existing customers.

271. Accordingly, the Commission finds that changes made to the regulatory framework in this proceeding will apply on a prospective basis, effective the date of this Decision.

B. Annual percent limit reduction

272. In Public Notice 2003-10, the Commission asked whether it would be appropriate to establish an annual percentage limit for price reductions for certain retail services. If parties thought such a limit would be appropriate, they were asked which services should be subject to such a limit and what level of price limit should be applied.

Positions of parties

273. The Companies responded that no annual percent limit was required. They stated that the current requirements for tariff filings preclude the possibility of anti-competitive pricing, independent of the magnitude or frequency of price proposals, and that any additional concerns of unjust discrimination should necessarily be dealt with on a case-by-case basis. The Companies stated that they could not foresee any circumstances whereby setting an annual limit on price reductions for certain tariffed services or bundles would be a satisfactory means of addressing concerns related to unjust discrimination.

274. The Companies further stated that imposing such a limit would hamper the ability of the ILECs to compete on the basis of price in the markets for the services in question. They stated that this would harm customers because they could be deprived of price reductions that would benefit them. The Companies added that it would also weaken price competition because an important service provider, the ILEC, would be hamstrung in its ability to compete.

275. TELUS submitted that it would only be appropriate to review the pricing rules as part of the overall review of the price cap regulatory framework for the next price cap period. TELUS stated that it would not be appropriate to establish an annual percent limit for price reductions for certain retail services, other than those limits already established by the Commission's price caps framework and the imputation test. It submitted that there is no justification for further price constraints, and that new prescribed annual limits on price reductions will merely ensure that competitors set their prices just below the known price floor, thereby harming consumers. TELUS emphasized that pricing rules in the current framework should not be changed at the midpoint of the price cap period.

276. The CBA stated that it does not support the establishment of an annual price reduction limit, as it would effectively create a contract that is renewed on an annual basis and does not provide certainty beyond that time period. It added that such a modification would have an impact on long-term business decisions.

277. The Telecom Utilities submitted that the ILECs should be prohibited from offering any price reductions on residential local exchange services for as long as the ILECs are considered dominant in this market. They stated that this prohibition should apply to service bundles, term contracts and large volume contracts. The Telecom Utilities submitted that as long as the ILECs remain dominant in the local exchange services market, they are in a position to offer customers price advantages that no competitor can match. They argued that the ILECs can leverage this advantage through bundling and term and volume contracts in order to foreclose the development of competition.

Commission analysis and determination

278. The Commission is not persuaded, based on the record of this proceeding, that the ILECs should be prohibited from offering any price reductions on stand-alone residential local exchange services. The Commission notes that, under current price cap rules, ILECs are permitted to offer price reductions for residential local exchange services in non-high cost serving areas at the sub-basket level, as long as the imputation test is passed and there is no further de-averaging of rates within a rate band.

279. The Commission finds that it would not be appropriate to change price reduction limits, particularly as there is no record in this proceeding concerning what the percentage limit should be, or what the impact would be of implementing such a limit.

280. Accordingly, the Commission considers that any review of this mechanism, if necessary, should more properly be undertaken in a future proceeding.

C. TELUS Québec

281. TELUS suggested that the Commission should delay the implementation of any price floor rule changes that may result from Public Notice 2003-10 for TELUS Québec until the Commission rules on *Implementation of competition in the local exchange and local payphone markets in the territories of Télébec and TELUS (Québec)*, Public Notice CRTC 2001-69, 14 June 2001 (Public Notice 2001-69). TELUS noted that TELUS Québec did not have company-specific approved Phase II costs, and thus would not be in a position to implement any rule changes which rely on company-specific Phase II costs.

282. TELUS also submitted that, as local competition was only introduced in TELUS Québec's territory on 1 September 2002, it would be premature to implement further significant changes to the regulatory framework for TELUS Québec.

Commission analysis and determination

283. The Commission notes that the Commission has now ruled on Public Notice 2001-69, in *Implementation of competition in the local exchange and local payphone markets in the territories of Société en commandite Télébec and the former TELUS Communications (Québec) Inc.*, Telecom Decision CRTC 2005-4, 31 January 2005.

284. In the Commission's view, the modifications in this Decision improve and strengthen the current pricing safeguards for all the large ILECs. These modifications, applied to TELUS Québec, would strengthen the regulatory environment in its operating territory. The fact that competition was only introduced in the operating territory of TELUS Québec in 2002 would not, in the Commission's view, adversely affect the enhancements specified in this Decision.

285. Accordingly, the Commission determines that all the safeguards established in this proceeding are to apply to all ILECs who are parties to this proceeding, including TELUS Québec.

D. TELUS proposal concerning price floors

286. In responding to the Commission's invitation to comment on other aspects of the current regulatory framework, TELUS proposed that the ILECs be permitted to price below the imputation and bundling price floors in order to meet competition from new services, such as wireless, cable companies, and VoIP. TELUS stated that, under this proposal, the ILECs would have to file an application with the Commission demonstrating that the market price for the service in question had dropped below the imputation test, or bundling price floor. TELUS stated that this application would be filed on an *ex parte* basis, consistent with the *ex parte* pricing rules adopted for long distance services in Decision 94-19.

287. In support of its proposal, TELUS argued that meaningful local entry is likely to come from wireless and fixed-wire (such as cable television) carriers who do not use incumbent facilities, essential or non-essential. TELUS maintained that, as entry from such sources begins to strand incumbents' facilities, the incumbents should be permitted to reduce prices to as low as short-run marginal cost.

288. TELUS stated that an ILEC would be responding to an entrant's price for a comparable, but not necessarily identical, service. TELUS specified that the burden would be on the ILEC to demonstrate that the entrant's service was a substitute for the ILEC service, and that the ILEC could request the lower price in the geographic areas in which the entrant was providing service.

289. The CCTA argued that diluting the current safeguards would not contribute to strengthening competition but would serve to reinforce the market power of the incumbent telephone companies.

290. LCI stated that there is no legitimate need for ILECs to be provided with the flexibility, in any circumstance, to price below the price floor. LCI argued that TELUS' proposal ignores the fundamental reality that the ILECs possess market power in those markets in which they are still regulated.

Commission analysis and determination

291. The Commission notes that ILECs' rates are regulated only for those services for which they possess market power. To permit ILECs to offer services at rates below cost, would, in the Commission's view, only serve to strengthen their market power and weaken the prospects of competition.

292. Accordingly, the Commission denies the TELUS proposal to price services below the imputation test and bundling price floors.

E. Rate de-averaging

Background

293. In *Restructured bands, revised loop rates and related issues,* Decision CRTC 2001-238, 27 April 2001, the Commission established a rate band structure that provided a reasonable degree of cost homogeneity within each of the rate bands. Pursuant to Decision 2001-737, costs are established on a per rate band basis, rather than on a geographic basis within a rate band.

294. In Decision 2002-34, the Commission determined that for residential local exchange services, residential optional services and bundles consisting of residential local exchange services or optional local services, single and multi-line business local exchange services and Other capped services, rates should not generally be de-averaged further within a rate band. The Commission further determined that should an ILEC seek to further de-average rates for Uncapped services, it should provide the rationale in its application.

Positions of parties

295. The Companies and TELUS made proposals that would change the policy on rate de-averaging within a rate band. In particular, they indicated that they should be allowed to de-average rates within a rate band to meet existing or anticipated competition.

296. The Companies submitted that in the event that competitive market conditions are different between different geographical regions of a rate band, the Companies should have the ability to respond to those conditions. The Companies argued that, as long as the services and service modifications developed in response to such differences meet the current imputation requirements, there can be no anti-competitive effects, and the services or service modifications should be allowed. The Companies submitted that tailoring service offerings to customers in recognition of market conditions is not unjustly discriminatory. Consequently, in the Companies' view, further rate de-averaging should not be prohibited.

297. TELUS submitted that the Commission should not prohibit rate de-averaging within a rate band, but rather should proceed on the assumption that de-averaging proposals are evidence of competition and, often, serve to better align rates with underlying costs. TELUS stated that rate de-averaging proposals should only be rejected if the application of established economics principles so requires.

298. LCI proposed that the Commission maintain its policy concerning geographic de-averaging within a rate band. LCI argued that limiting the availability of a bundle, or any other service, to only certain areas of a rate band would constitute geographic de-averaging. Rogers submitted that the Commission should clarify that ILECs will only be permitted to reduce rates for residential local wireline service across an entire rate band.

299. The CCTA submitted that the Commission should include in its determinations provisions that reinforce its existing rules against further rate de-averaging within a rate band. The CCTA argued that, absent appropriate safeguards, the ILECs would seek to lower the effective price of service components for only select geographic areas in response to, or in anticipation of, competition.

Commission analysis and determination

300. The Commission considers that its policy to preclude further rate de-averaging within a rate band provides a valuable additional safeguard to protect against targeted price reductions. The Commission notes that, should an ILEC wish to respond to existing or anticipated competition within a rate band, it is permitted, under existing pricing rules, to reduce rates, provided that the rate reduction applies throughout the rate band and the imputation test is satisfied. By contrast, existing rules do not permit an ILEC to target small geographic areas within a rate band, for this practice could deter entry into the local market, where the ILECs continue to be the dominant service provider.

301. The Commission is of the view that allowing the ILECs to respond to market forces within a geographic area of a rate band through rate de-averaging would allow for a degree of targeted pricing which could subject other customers in the rate band to an undue disadvantage, result in rates that are not just and reasonable, and slow the development of fair and sustainable competition.

302. Accordingly, the Commission reaffirms its policy, specified in Decision 2002-34, that for residential local exchange services, residential optional services and bundles consisting of residential local exchange services or optional local services, single and multi-line business local exchange services and Other capped services, rates should not be de-averaged further within a rate band. Furthermore, the Commission notes that, based on the applications that have been filed to date, it has consistently been inappropriate for rates of Uncapped services to be further de-averaged within a rate band.

Secretary General