Competition and Price Regulation in the Market for Public Long-Distance Telephone Services

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In 1992, the Canadian Radio-television and Telecommunications Commission decided to permit competition in the provision of public long-distance telephone services. The advent of competition has compelled the Commission to make sweeping changes to the manner in which it regulates the prices charged by the telephone companies and other telecommunications carriers under its jurisdiction.

The article begins with a brief overview of the regulatory regime as it stood prior to the introduction of competition. The author describes the new measures the C.R.T.C. has introduced to permit the incumbent telephone companies and their rivals increased flexibility in the pricing of the services they provide to the public.

The author then focuses on the Commission's approach to the special issues presented by the pricing of "access". The telephone companies own the local exchange and other access facilities to originate and terminate the calls carried over their long-distance networks. In order to ensure equality of treatment between the telephone companies and their new competitors, the Commission has instituted a form of accounting separation, under which the long-distance arm of the telephone companies will be forced to "purchase" access services in a manner similar to other long-distance carriers. This device will eliminate some of the current asymmetries in the treatment of telephone companies and their competitors in respect of access. At the same time, the Commission has moved to correct many of the problems that have undermined the confidence of competitors in the cost allocation scheme, called Phase III, which has been used to set access prices.

Finally, the author turns to the Commission's new policy on predatory pricing. He concludes that reliance on a pure incremental cost standard would be inappropriate because the telephone companies provide access and long-distance services on an integrated basis and because of the numerous barriers to the achievement of a workably competitive market which persist.

En 1992, le Conseil de la radiodiffusion et des télécommunications canadiennes a décidé de permettre la concurrence dans le domaine des services téléphoniques interurbains. L'avènement de cette concurrence a contraint le Conseil à effectuer des modifications radicales dans sa façon de réglementer les tarifs exigés par les compagnies de téléphone et par d'autres transporteurs en télécommunications sous sa juridiction.

L'article débute avec un bref survol du régime réglementaire en place avant l'introduction de la concurrence. L'auteur décrit les nouvelles mesures introduites par le C.R.T.C. afin de permettre aux compagnies de télépbones ainsi qu'à leurs rivales d'augmenter leur flexibilité dans la tarification des services qu'elles offrent au public.

L'auteur se penche ensuite sur l'approche du Conseil relativement aux questions particulières présentées par la tarification de l'«accès». Les compagnies de téléphone détiennent l'échange local ainsi que les autres services d'accès pour commencer et terminer les communications transportées par leurs réseaux interurbains. Afin d'assurer l'égalité de traitement entre les compagnies de téléphone et leurs nouveaux concurrents, le Conseil a institué une forme de séparation de comptabilité selon laquelle les départements des appels interurbains des compagnies de téléphone sont forcés d'«acheter» les services d'accès d'une manière semblable aux autres transporteurs d'interurbains. Co mécanisme permettra d'éliminer certaines asymétries dans le traitement des compagnies de téléphone et de leurs concurrents relativement à l'accès. De même, le Conseil a agi afin de corriger plusieurs problèmes qui ont miné la confiance des concurrents dans le schème d'allocation des coûts, aussi appelé la Phase III, utilisé afin de déterminer la tarification de l'accès.

Finalement, l'auteur analyse la nouvelle politique du Conseil concernant le *predatory pricing* et conclut que se fier à une norme de tarif purement marginale serait inappropriée étant donné que les compagnies de téléphone offrent un accès et des services d'interurbain de manière intégrée, et que plusieurs obstacles à l'accomplissement d'un marché compétitif persisteront.

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To be cited as: (1995) 41 McGill L.J. 169
Mode de référence : (1995) 41 R.D. McGill 169

Synopsis

Introduction

Prior to 1992, the provision of public long-distance telephone services in Canada was largely the preserve of Bell Canada and the eight other major telephone companies with which it is allied through the organisation called Stentor.[1] Each of the Stentor members provided service in its respective operating territory on a monopoly basis and collaborated with the other members to provide nation-wide service. In 1992, however, in a decision entitled *Competition in the Provision of Public Long Distance Voice Telephone Services and Related Resale and Sharing Issues*,[2] the Canadian Radio-television and Telecommunications Commission ("C.R.T.C." or "Commission"), the authority which regulates the members of Stentor[3] and other Canadian telecommunications carriers, approved an application by Unitel Communications Inc. ("Unitel") to provide a public long-distance telephone service to compete with the service provided by the Stentor members. The C.R.T.C. simultaneously declared its readiness to permit further new entry by other long-distance carriers , referred to in the industry as "interexchange carriers" ("I.X.C.s").[4] Several have since emerged. As of December 31, 1994, competitors, including so-called "resellers"[5], reportedly accounted for twelve percent of the market for Canadian public long-distance telephone traffic. The single largest competitor, Unitel, had a four and one-half percent market share.[6]

The advent of competition in the provision of Canadian public long-distance telephone services has compelled the C.R.T.C. to reconsider the methods it has traditionally followed in regulating prices charged by the Stentor members and to devise new rules that are better tailored to the new competitive environment. In a

[1] The eight other telephone companies that are members of Stentor are: AGT Limited, BC TEL, The Island Telephone Company Limited, Manitoba Telephone System, Maritime Tel & Tel Limited, The New Brunswick Telephone Company Limited ("N.B. Tel."), Newfoundland Telephone Company Limited and Saskatchewan Telecommunications ("SaskTel").

[2] (1992), Telecom. Decision C.R.T.C. 92-12 [hereinafter *Long Distance Competition*].

[3] The C.R.T.C. does not regulate SaskTel. The *Telecommunications Act*, S.C. 1993, c. 38, s. 133, provides that SaskTel shall not come under the jurisdiction of the C.R.T.C. until a date to be fixed for that purpose by the Governor in Council on or after October 25, 1998 (the fifth anniversary of the coming into force of the Act), unless the Government of Saskatchewan requests that an earlier date be fixed.

[4] An I.X.C. is a telecommunications carrier that provides long-distance services between local telephone exchanges but which does not itself own local exchanges. The term "telephone company" is typically reserved in industry usage for those carriers, such as the members of Stentor, that own local exchanges and provide both intra- and interexchange services. Interexchange ("I.X.") services include not only public long-distance telephone service and enhancements, such as 800 service, but private-line and data services, also. It is the former that has the most relevance to the discussion in this article.

[5] Resellers are companies which do not own their own transmission facilities and instead lease capacity from telephone companies and I.X.C.s. Resellers have been allowed to provide public long-distance telephone service since 1990.

[6] See letter of G. Pizante to the author (24 February 1995)

series of decisions that culminated in *Review of Regulatory Framework*,[7] released in September 1994, the C.R.T.C. has made sweeping changes to the regulatory regime. Among these changes is the abandonment of the system of "rate base/rate of return" regulation[8] — the foundation of telephone company regulation for several decades — for the telephone companies' competitive services. This has been replaced with a new scheme which will allow greater play to market forces in setting prices.

One of the criticisms levelled at the Unitel application in the *Long Distance Competition* proceeding was that it did not offer true competition but only "regulated competition" — a reference to the on-going role the C.R.T.C. would have in regulating carrier prices — and the Unitel proposal would, therefore, not deliver the benefits normally associated with competition.[9] The concept of regulated competition is an anathema to many economists — a "worst of both worlds" approach. Alfred Kahn has said that:

> [T]here [is] no rational halfway house between thorough regulation and free competition ... [R]egulation confronted with competition will have a systematic tendency either to suppress it ... or to orchestrate it and control the results it produces. Why? Because competition is unpredictable and messy, and the regulator prizes predictability and tidiness. Businesses move in and out of competitive markets. They are constantly changing their product and service offerings, schedules and prices. The regulator, in contrast, prefers continuity of serviee and stability and uniformity of prices and service offerings.[10]

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[7] (1994), Telecom. Decision C.R.T.C. 94-19 [hereinafter *Regulatory Framework*].

[8] Under rate base/rate of return regulation, the regulator establishes a rate base equal to the value of the capital invested (or the total value of the plant employed) in the enterprise and fixes a rate of return on that base. Rates are then set in such a way that the revenues they generate, minus permissible expenses, equal the allowed rate of return.

[9] Bell Canada, for instance, which was one of the respondents to the Unitel application, argued that

> the aberrant variants of competition [suggested by Unitel and its co-applicant in the case, BCRail/Lightel Inc.], would result in serious industry inefficiencies, would be detrimental to telecommunications users and would significantly increase the regulatory burden. Under regulated competition, competitors would not be subject to the discipline of competitive market forces and they could frequently gain more by focusing their efforts on the regulatory forum rather than on the marketplace, looking to the Commission to protect their inefficient operations. Consumers would not be well served under this market structure which would, through the regulatory process, delay the introduction of new services and innovations, retard price decreases and increase the costs of service (Argument of Bell Canada on the Issues raised in *CRTC Telecom. Public Notice 1990-73*, Technical Paper No. 11 (29 July 1991) at 1).

[10] A. Kahn, "The Uneasy Marriage of Regulation and Competition" (1984) 1 Telematics 1 at 8-9, quoted in W.T. Stanbury, *The Case for Competition in Public Long Distance Telephone Service in Canada* (Unitel, August 1990) at 47 [unpublished]. The Stanbury evidence was commissioned and filed by Unitel.

Still, as W. T. Stanbury noted in evidence filed in the *Long Distance Competition* proceeding, "[w]hile the concept of regulated competition is anomalous and the practice of regulated competition may be a temporary 'black art', it is an unavoidable step in getting from here to there."[11] This article proposes to examine the Commission's approach to price regulation in the newly-competitive market for public long-distance telephone services and the progress of the industry on the road from "here to there".

The analysis will proceed as follows: Part I provides a brief description of the regulatory regime as it stood prior to the *Regulatory Framework* decision and then details the new measures aimed at providing the telephone companies with increased pricing flexibility. This lays the groundwork for the discussion in Part II and Part III.

Part II is concerned with the Commission's approach to the pricing of the telephone companies' local exchange, or "access", facilities. The pricing of access has been rightly described as one of the most vexing issues facing telecommunications regulators.[12] Access facilities consist of the network of wires running between the local switch and customers' premises which are used by both the telephone companies and I.X.C.s to originate and terminate calls carried over their long-distance ("interexchange", or "I.X.") facilities.[13] The fact that ownership of these facilities is in the hands of the telephone companies creates the danger that they will charge competitors more for access than the cost that they themselves incur in providing their own services, thereby inflating competitors' cost structures and undermining their ability to price compete.

In 1985, the Commission introduced a cost-allocation scheme (called "Phase III") which was intended to combat this problem by identifying the relevant access costs.[14] The costing of telecommunications services is an extraordinarily complex matter, however, due in no small part to the large proportion of costs associated with the provision of facilities used in common by different services. There has been continual controversy over the accuracy and reliability of Phase III allocations, which competitors have claimed results in access charges being overstated by at least thirty-five percent.[15]

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[11] Stanbury, *ibid.* For a discussion of issues related to the regulation of competition in the Canadian telecommunications sector, see H.N. Janisch, "From Monopoly Towards Competition in Telecommunications: What Role for Competition Law?" (1994) 23 Can. Bus. L.J. 239.

[12] See W.J. Baumol & J.G. Sidak, "The Pricing of Inputs Sold to Competitors" (1994) 11 Yale J. on Reg. 171 at 172.

[13] See *supra* note 4 for an explanation of this terminology.

[14] See *Inquiry into Telecommunications Carriers' Costing and Accounting Procedures: Phase III — Costing of Existing Services* (1985), Telecom. Decision C.R.T.C. 85-10 [hereinafter *Phase III Decision*]. The impetus for the development of Phase III came from the Commission's decision a few years earlier to allow competition in the provision of private line voice and data services and terminal equipment.

[15] See Unitel, Final Argument (17 January 1994), filed in *Regulatory Framework*, at c. 4 [hereinafter

In the *Regulatory Framework* decision, the Commission attempted to escape the difficulties associated with costing by adopting a new scheme under which the telephone companies' rate base will be split into a "utility" segment, comprised of access and monopoly services, and a "competitive" segment. Under this scheme, the telephone companies' competitive services will be required to "purchase" access services from the utility segment at tariffed rates in the same manner as I.X.C.s. The net effect will be to increase the transparency of intra-telephone company dealings and to eliminate some of the asymmetries that currently exist in the way telephone companies and I.X.C.s are treated in respect of access charges. The new regime, however, inherits a vital weakness from the old: because the splitting of the telephone companies' rate bases will be accomplished using Phase III allocations, the existing problems with Phase III will be perpetuated rather than eliminated unless corrective action is taken. These matters are discussed more fully in Part II.

Part III focuses on a different subject. A key component of the new framework is a set of rules designed to check any attempt by the telephone companies to abuse their new pricing flexibility by pricing predatorily. Predation has been defined as "the deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition."[16] The risk of predatory behaviour is enhanced considerably in the situation of firms, like the Stentor telephone companies, which operate simultaneously in monopoly and competitive markets because of the potential which exists for such companies to use their monopoly services to fund price cuts in their competitive markets. As we shall see, the cost standard adopted by the Commission differs from that used, for instance, by the Director of Investigation and Research under the *Competition Act*[17] and is intended to recognize the particular characteristics of an industry that is still in a stage of transition from monopoly to competition. In Part III, the Commission's approach is compared with the cost standards used by the Director of Investigation and Research, the American civil courts in antitrust cases and the C.R.T.C.'s counterpart in the United States, the Federal Communications Commission ("F.C.C.").

I. The Regulatory Framework, Old and New

The mandate under which the C.R.T.C. operates requires it to ensure that the rates telephone companies charge for their services are "just and reasonable", and that they do not unjustly discriminate between customers or customer groups, or confer an undue preference on any particular customer or customer group in rela-

Unitel Final Argument].

[16] P. Areeda & D.F. Turner, *Antitrust Law: An Analysis of Antitrust Principles and their Application*, vol. 3, 3d ed. (Toronto: Little, Brown, 1978) at 151.

[17] R.S.C. 1985, c. C-34.

tion to the provision of services and facilities.[18] Compliance with these requirements has traditionally been enforced by requiring the telephone companies to file tariffs setting forth the terms and conditions on which their services and facilities are supplied and subjecting all changes in those tariffs to the prior approval of the C.R.T.C.

Over the years during which the telephone companies had a monopoly on the provision of public long-distance telephone services, the C.R.T.C. and its predecessors developed a complex, and often arcane, set of policies, rules and regulations designed to give substance to the legislative imperatives of justness, reasonableness and non-discrimination. Under this regime, telephone companies were subject to a particularly stringent form of rate regulation characterized by the following features: the establishment of an overall limit on the permitted return on the carrier's total capital investment (to prevent the earning of unreasonably high profits); a price structure that embodied an elaborate system of cross-subsidies flowing from long-distance to local services, urban to rural customers and central Canada to other regions of the country (principally in aid of the key policy objective of maintaining universal access to basic telephone services at affordable rates); and a cost-allocation scheme designed, *inter alia*, to detect any improper cross-subsidization by monopoly services of those limited services which, prior to the *Long Distance Competition* decision, were offered on a competitive basis (to ensure that monopoly subscribers did not bear the risk of such endeavours, and that telephone company competitors were not unfairly disadvantaged).[19]

To the extent that competition in the provision of services was allowed at all,[20] it took place under strictly regulated conditions. In 1983, the C.R.T.C. prescribed that prices charged by CNCP Telecommunications, a provider of interconnected private-line services, could not be more than five percent below those of the telephone companies in the case of bulk facilities and no more than ten percent below in the case of I.X. voice-grade facilities.[21] When the C.R.T.C. decided in 1987 to "detariff"

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[18] *Telecommunications Act*, *supra* note 3 at ss. 25, 27.

[19] These arrangements are described in more detail in M.H. Ryan, *Canadian Telecommunications Law and Regulation* (Scarborough: Carswell, 1993) at 6-32 to 6-52.

[20] CNCP Telecommunications, the precursor of Unitel, had been authorized to interconnect its private line voice and data services to the telephone company network in 1979 (see *CNCP Telecommunications: Interconnection with Bell Canada* (1979), Telecom. Decision C.R.T.C. 79-11). See also *CNCP Telecommunications: Interconnection with the British Columbia Telephone Company* (1981), Telecom. Decision C.R.T.C. 81-24. Interconnection was permitted subject to the express stipulation that the connections furnished not be used for the provision of public long-distance telephone service.

[21] See *CNCP Telecommunications — Rates for the Provision of Interconnected Private Line Voice Service* (1983), Telecom. Decision C.R.T.C. 83-10, application to review and vary den'd *Bell Canada and British Columbia Telephone Company — Applications to Review Telecom. Decision CRTC 83-10* (1984), Telecom. Decision C.R.T.C. 84-19. Indeed, the C.R.T.C. initially refused to permit any differential at all and was only persuaded to allow the five and ten percent differentials on the ground that they were necessary to compensate for the market perception that the CNCP services were inferior in quality to the corresponding telephone company services (see *CNCP Telecommunications — Special*

CNCP's services — a decision later overturned on jurisdictional grounds[22] — it expressly retained price regulation for private-line voice services, "because of the necessity of ensuring that appropriate rate relationships are maintained with directly competing services provided by the telephone companies and with [public long-distance telephone service]."[23]

The Commission's private-line pricing decisions may furnish a particularly vivid illustration of the regulatory obsession with predictability and tidiness (see Kahn, above). They were motivated, however, by a fundamental concern about the potentially de-stabilizing effect competition from private-line services might have on the existing system of cross-subsidies and, therefore, on local rates. The continuance of those subsidies depended on the maintenance of high prices for I.X. services which would not be sustainable if private-line rates were allowed to fall. This same concern about maintenance of low local rates led the Commission to deny an application by CNCP to provide a competing public long-distance telephone service in 1985.[24]

While endorsing the concept of new entry, the *Long Distance Competition* decision revealed a continuing ambivalence on the part of the Commission to the prospect of price competition for switched voice services. It agreed to "streamline" the tariff approval process governing Stentor's competitive services by allowing the filing of tariffs on an *ex parte* basis in certain circumstances,[25] thereby dispensing with the process of public comment that sometimes led to delays in the implementation of Stentor price initiatives. The C.R.T.C. also affirmed that "optional"[26] toll services would no longer be subject to the policy that rates should "maximize con-

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Tariffs Covering the Provision of Interconnected Private Line Voice Service (1982), Telecom. Decision C.R.T.C. 82-9). For related decisions, see: *CNCP Telecommunications — MACH III Service and Related Matters* (1988), Teleeom. Decision C.R.T.C. 88-17; *British Columbia Telephone Co.* v. *B.C. Rail Telecommunications — Rates for Interconnected Interexchange Voice Grade Services* (1991), Telecom. Decision C.R.T.C. 91-17.

[22] *CNCP Telecommunications — Application for Exemption from Certain Regulatory Requirements* (1987), Telecom. Deeision C.R.T.C. 87-12 [hereinafter *Application for Exemption*], rev'd (*sub nom. T.W.U.* v. *CRTC*) (1988), [1989] 2 F.C. 280, 98 N.R. 93 (C.A.).

[23] *Application for Exemption*, *ibid.* at 16-17.

[24] See *Interexchange Competition and Related Issues* (1985), Telecom. Decision C.R.T.C. 85-19. For a particularly vigorous critique of this decision, see W.T. Stanbury, "Decision Making in Telecommunications: The Interplay of Distributional and Efficiency Considerations" in W.T. Stanbury, ed., *Telecommunications Policy and Regulation: The Impact of Competition and Technological Change* (Montreal: Institute for Research on Public Policy, 1986) at 481.

While the concern about local rates was ultimately overcome in the *Long Distance Competition* decision — the Commission pronounced itself satisfied that the terms of entry it fixed obviated the need for any local-rate increase (see *Long Distance Competition*, *supra* note 2 at 13) — local rates continue to be a preoccupation of public policy (see *e.g.* text accompanying note 45ff, below).

[25] *Long Distance Competition*, *ibid.* at 139-40.

[26] An optional long-distance telephone service is a conventional (or "basic") long-distance telephone service offered under an alternative pricing plan; for example, by payment of a flat subscription fee for a specified number of hours of "free" calling.

tribution".[27] However, the Commission otherwise declined to take any measures to liberalize the rules governing Stentor member pricing.[28]

The telephone companies responded to the *Long Distance Competition* decision by launching a campaign for a move towards what Bell Canada's then C.E.O., Robert Kearney, termed "more natural markets" for telecommunications services.[29] Stentor filed a Petition with the Governor in Council seeking a modification of the *Long Distance Competition* decision.[30] In that document, Stentor claimed that "[t]he Commission [had] opted for wide open competition but without relieving the telephone companies from a regnlatory structure which increases their costs and impedes their progress." Stentor asked for a relaxation of what it described as a "heavy-handed" regnlatory process, so that its members would have "the flexibility to act quickly in the market".[31]

It seems probable that the Commission would have moved in the direction of regulatory reform of its own accord, but the Petition provided an impetus for doing so immediately. Within months of the *Long Distance Competition* decision, the Commission initiated the proceeding which led to the *Regulatory Framework* decision.[32] The Commission said that it intended to examine whether "the current regulatory framework is the most appropriate or effective [means] to serve the public interest" and invited submissions concerning, among other matters, the ways in which regulation might be streamlined or regulatory requirements eliminated "in light of changes in industry structure".[33] Parties were also asked to address what "regulatory safeguards may be necessary to protect against abuse of dominant power in competitive markets."[34]

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[27] *Long Distance Competition, supra* note 2 at 139. The policy of contribution maximization requires that rates for long-distance services be kept at high levels to generate the maximum contribution to the maintenance of the cross-subsidy to local service.

[28] The Commission said that it found it "appropriate that, in general, the present regulatory framework continue to apply" to the Stentor members, including rate of return regulation and the requirement to provide supporting information for proposed tariff revisions (*Long Distance Competition, ibid.*). I.X.C.s were at the same time freed of the obligation to cost justify their rates. With this requirement removed, I.X.C.s are now able to change their rates, largely at will, although the requirement to file tariffs remains in place (*ibid.* at 141).

[29] L. Surtees, "Bell Canada's new chief wants to end regulation" *The [Toronto] Globe and Mail* (8 March 1993) B4.

[30] Petition to the Governor in Council pursuant to section 67 of the *National Telecommunications Powers and Procedures Act* delivered by Stentor Telecom Policy Inc. (5 August 1992) [hereinafter Petition].

[31] Petition, *ibid.* at 1-5.

[32] With the announcement of the new proceeding, the Stentor Petition was withdrawn (see Stentor, News Release, "Regulatory Reform Initiatives Prompt Stentor to Withdraw Petition to Cabinet" (26 January 1993)).

[33] *Review of Regulatory Framework* (1992), Telecom. Public Notice C.R.T.C. 92-78 at 2.

[34] *Ibid.* at 4.

In the *Regulatory Framework* proceeding, the Commission recognized that the inflexibility of its traditional method of rate regulation would hinder the achievement of the benefits of competition, such as increased efficiency and more rapid innovation, which had motivated the *Long Distance Competition* decision. It concluded that some liberalizing of the telephone-company pricing regime was necessary to ensure that these companies had the incentive and the ability to act competitively. The Commission announced four new measures aimed at increasing the pricing flexibility available to the telephone companies:

(1) *Removal of the constraint on price increases for optional long-distance telephone services and 800 services.* The C.R.T.C. expressed the view that competition will provide sufficient protection against significant price rises for these services and, therefore, decided that there should be no regulatory controls over price increases.[35]

(2) *Relaxation of the rules governing prices for basic (that is, other than optional) long-distance telephone services to points within North America.* The Commission indicated that it will give expedited approval to rate revisions that do not result in an overall price increase for these services; that is, increases in, for example, peak-period prices must be offset by decreases in off-peak period prices so that the change will be "revenue neutral". Proposed departures from that requirement (as well as rates for overseas services) will continue to be examined on a case-by-case basis.

(3) *Relaxation of the rules relating to non-discrimination to enable carriers to introduce "customer-specific" arrangements.* According to the Commission, this change will allow telephone companies greater flexibility in packaging and pricing their services. Any such arrangement will remain, however, subject to a variety of conditions, including a test designed to prevent cross-subsidization. "Service packages" introduced under this measure must be made available to other customers on similar terms.

(4) *Imposition of a "price cap" on utility services.* Instead of regulating the price of individual services, price caps regulate the rate of change in the price of a "basket" of services. The permitted rate of change is typically fixed in relation to the annual rate of increase in the consumer-price index or some similar index of prices in the economy. So long as the aggregate change of prices for services in the basket observes the cap, approval of individual price changes is not required. The form the new price-cap regime will take is deferred to a separate proceeding to be initiated in the first half of 1996, with a view to implementation on January 1, 1998.

[35] For a description of the regime governing priee *decreases*, see Part III, below.

In certain market segments, the Commission has since gone further. In a series of decisions which reflects the liberalizing philosophy of the *Regulatory Framework* decision, the Commission has decided to forbear from rate regulation of wireless services,[36] the sale, lease and maintenance of terminal equipment[37] and the sale and lease of earth stations.[38]

On September 8, 1995 the Commission took another important step toward liberalizing telecommunications markets by deciding to forbear entirely from rate regulation of I.X.C.s.[39]

II. The Pricing of Access

Access service is one area in which competition has yet to establish itself and where the traditional rationale for rate regulation — to prevent the charging of excessively high rates and to prevent undue discrimination between customers — continues to apply.[40] Because access is an input to other services that are themselves furnished on a competitive basis, however, there is an additional rationale for regulatory intervention, namely, to ensure equality of treatment between telephone companies and their competitors. It is worth drawing attention to this point, in view of the criticisms of "regulated competition",[41] because it underscores the fact that regulation is, in this respect at least, not merely a relic of the former monopoly industry structure but is a product of the move toward competition.

Because of the way telephone tariffs are structured, customers do not pay any express charges for the use of access facilities. Instead, telephone companies recover their access costs through the charges their customers pay for local, I.X. and other services. The revenues the telephone companies earn in providing these services are, in each case, sufficient to cover the direct costs of those services plus a surplus. The surplus revenues generated by each service constitute that service's "contribution" to the recovery of total access costs. Historically, tariffs have been designed so that I.X. services make a far larger contribution than local services to access costs. It is in this sense that I.X. services are sometimes said to "subsidize" local services.

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[36] See *Regulation of Wireless Services* (1994), Telecom. Decision C.R.T.C. 94-15.

[37] See *Forbearance — Sale of Terminal Equipment by Canadian Carriers* (1994), Telecom. Decision C.R.T.C. 94-14 at 76ff.

[38] See *Telesat Canada — Forbearance for the Sale and Lease of Earth Stations* (1994), Telecom. Decision C.R.T.C. 94-23.

[39] *Forbearance — Services Provided by Non-Dominant Canadian Carriers* (1995), Telecom. Decision C.R.T.C. 95-19.

[40] It appears that access services, too, may ultimately become available from competitive sources of supply. The Commission expressed the view in the *Regulatory Framework* decision, that "the potential exists for meaningful local competition in basic telecommunications and in many of the information-based telecommunications markets" and its intention to encourage that potential (*Regulatory Framework*, *supra* note 7 at 33).

[41] See *supra* notes 9-11 and accompanying text.

In the *Long Distance Competition* decision, the C.R.T.C. determined that I.X.C.s utilizing telephone-company access facilities should make a contribution to the subsidy that matched the contribution generated by comparable telephone-company services.[42] There was a significant difference in the manner in which that contribution was calculated and collected from the telephone companies and I.X.C.s under this regime. Because the telephone companies provide I.X. and access services through the same corporate entity, their I.X. services' contribution to access was notional only; it could be calculated as the difference between I.X. revenues and costs on an *ex post facto* basis for a given accounting period but involved no actual payments. By way of contrast, the contribution paid by competitors takes the form of explicit payments.

The asymmetry inherent in this scheme of explicit charges for competitors and implicit charges for telephone companies provoked concerns on the part of competitors about the potential for unequal treatment. These concerns centred on the Phase III allocations. Under Phase III, telephone-company costs are allocated to a number of broad service categories, including "access" and two separate I.X. service categories, namely, "competitive toll" for switched voice services and "competitive network" for private-line voice and data services. It was alleged that the telephone companies had been mis-allocating costs to access that should have been allocated to one of the I.X. service categories, thereby overstating the contribution made by their own services and, by extension, the matching contribution due from competitors. These concerns were exacerbated because contribution payments represent a substantial percentage of I.X.C. revenue and a miscalculation could, therefore, have a devastating financial impact on the industry.

This decision to split the telephone companies' rate bases and impose a charge on all dealings between the utility side of the telephone companies' operations and I.X. service providers, including the I.X. side of the telephone company,[43] assures that, in future, there will be a formal symmetry[44] in the contribution arrangements as

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[42] Provision was made for a "contribution discount" during a transitional period which was designed to offset the advantages accruing to the telephone companies as a result of their control of local exchanges and their historically dominant positions (*Long Distance Competition*, *supra* note 2 at 84).

[43] Economists will see in the C.R.T.C.'s approach key elements of the efficient-component pricing rule articulated in Baumol & Sidak, *supra* note 12, and discussed in: A.E. Kahn & W.E. Taylor, "The Pricing of Inputs Sold to Competitors: A Comment" (1994) 11 Yale J. on Reg. 225; W.B. Tye, "The Pricing of Inputs Sold to Competitors: A Response" (1994) 11 Yale J. on Reg. 203. For a discussion of the application of the efficient-component pricing rule in the context of a suit alleging abuse of dominant position arising out of a disagreement over terms and conditions of interconnection, see *Telecom Corporation of New Zealand* v. *Clear Communications Ltd.*, [1995] 1 N.Z.L.R. 385 (P.C.).

[44] The rules governing coutribution that are now in place are not *completely* symmetrical. In the *Regulatory Framework* decision, the Commission determined that the access charge payable by both the telephone companies and I.X.C.s should take the form of a per-minute charge (*supra* note 7). The Commission has sinee decided to revert, however, for the time being, to the levy per interconnecting trunk origiually adopted for I.X.C. traffic in the *Long Distance Competition* decision (see *Applications by Unitel Communications Inc. and Sprint Canada Inc. to Review and Vary Part of Decision 94-*

they apply to telephone companies and competitors. This decision does nothing, however, in and of itself, to resolve concerns about the substantive problem of costing. This is because the division of the telephone companies' rate bases is to be effected by splitting these rate bases according to existing Phase III allocations. If, indeed, Phase III harbours significant cost misallocations that inflate access costs, these will inevitably be perpetuated in inflated contribution charges.

Not only competitors would be harmed in such a case. Rates for local service are also set with reference to total access costs. As part of the *Regulatory Framework* decision, the Commission announced that monthly local rates would be raised by six dollars in equal stages of two dollars in each of the next three years.[45] This decision was premised on the belief that there is a large revenue/cost imbalance in the access category, and that local service is therefore not making a sufficient contribution to the recovery of the revenue shortfall. If Phase III, in fact, overstates access costs, this local rate increase may not be warranted.

Unitel believed it found confirmation of its concerns about cost misallocations in a "benchmarking" exercise in which it compared the cost per minute of providing I.X. service reported by major long distance carriers in the United States — A.T.&T., MCI and Sprint — and Bell Canada's cost per minute calculated using Phase III allocation procedures. These comparisons suggested that the costs of the carriers in the United States were about double those of Bell Canada. Since the U.S. carriers all provide long-distance service on a stand-alone basis (that is, they do not provide access or local services), their cost data is not complicated by allocation issues. Unitel, supported by other I.X.C.s and consumer groups, argued that it was implausible that carriers in the United States could have I.X. costs that are so dramatically higher than Bell Canada's and alleged that Phase III was mis-allocating costs of providing I.X. services to the access category.

These allegations persuaded the Commission to appoint one of its members to conduct an inquiry into Phase III. As a result of the Inquiry, some significant modifications were made to Phase III[46] (the contribution rates payable by competitors fell by approximately ten percent), but these changes failed to address all of the concerns of the critics of Phase III. An alliance of industry competitors and other interested participants, grouped together in the Competitive Telecommunications Alliance, subsequently filed a Petition with the Governor in Council under the provisions of the *Telecommunications Act* asking the Governor in Council to institute an independent inquiry

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19 (1994), Telecom. Decision C.R.T.C. 94-27, announcing the change and explaining the reason for the decision to levy access charges on I.X.C. traffic on a per-trunk basis instead of the per-minute basis applied to telephone company traffic). See also *De-Averaged Per-Minute Contribution Mechanism* (1994), Telecom. Public Notice C.R.T.C. 94-59.

[45] See *Regulatory Framework, ibid.*

[46] See *Review of Phase III: Report of the Inquiry Officer* (1994), C.R.T.C. Telecom. Decisions, Letter Decisions and Public Notices, vol. 2, number 29. The recommendations contained in the Report were adopted by the Commission in *Review of Phase III of the Cost Inquiry* (1994), Telecom. Decision C.R.T.C. 94-24.

into the subject of cost allocations. In response to that Petition and a parallel Petition by consumer groups expressing concern about the local-rate increases proposed by the C.R.T.C. in the *Regulatory Framework* decision, the Governor in Council directed the C.R.T.C. to reconsider the proposed local-rate increases. It also indicated its view that it was material to the reconsideration that the Commission compare Phase III cost allocations to "external benchmarks".[47]

The Commission accordingly joined these issues to a new proceeding concerning implementation of the *Regulatory Framework* decision. During the course of that proceeding, it became clear that some of the discrepancies that Unitel believed it had found between the I.X. costs reported by carriers in the United States and Bell Canada's Phase III results were traceable to economies of scope that Bell Canada enjoyed because it provides access, local and I.X. services on an integrated basis. This integration allows Bell Canada to share costs for certain functions that are jointly used by all services (customer service; network planning, installation, operation and maintenance; computer and information systems; and general overhead and administration) across the whole range of its telecommunications services, while the United States I.X. carriers are, *per force*, required to allocate all of those costs to their I.X. services alone. In implementing Phase III, it became clear that Bell Canada (and the other Canadian telephone companies) had chosen to distribute these joint costs among their services in a manner that *maximized* the costs allocated to access and *minimized* those allocated to I.X. services.

I.X.C.s argued that, if competition is to take place on a fair basis, the telephone companies' Phase III allocations ought to resemble as closely as possible the costs incurred by stand-alone providers of I.X. services, and that joint costs should, therefore, be distributed so as to achieve this result. The Stentor telephone companies strenuously argued against this approach. They claimed that such proposals would effectively require them to share the cost advantages they derived from their integrated structure with competitors, and that this was both unjust and economically inefficient.

The Commission released its decision in this proceeding on October 31, 1995.[48] Although the Commission rejected the results of Unitel's benchmarking comparison, it accepted that certain (but not all) of the joint costs referred to by Unitel ought to be allocated differently. Specifically, the Commission directed that customer service costs should be allocated under the new split-rate base to the utility segment and the competitive segment equally. This will reduce contribution rates significantly. No explanation was provided as to why other joint costs should not be treated similarly. The Commission also decided to modify its plans for local rate increases. Local rates will increase by two dollars per month in each of the next two years, as originally contemplated by the *Regulatory Framework* decision, but a decision about the magnitude of the third increase will be deferred until a future date.

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[47] P.C. 1994-2036 (13 December 1994) at 2.

[48] See *Implementation of Regulatory Framework — Splitting of the Rate Base and Related Issues* (1995), Telecom. Decision C.R.T.C. 95-21 [hereinafter *Split Rate Base*].

At the present time, it is unclear what the reaction of I.X.C.s, telephone companies, consumer groups and other interested parties will be to the decision.

III. Predatory Pricing

Pricing which is below "cost" will normally be regarded as *prima facie* "predatory".[49] The measure of cost which is employed for this purpose is, of course, crucial since differing measures of cost can lead to radically different results. While the subject of the appropriate cost standard to use in judging whether a rate is predatory is one which has engendered a great deal of debate, it is now widely, but by no means universally, accepted that some measure of variable cost (marginal cost or average variable cost ("A.V.C."), long-run incremental cost ("L.R.I.C.") or avoidable cost)[50] is to be preferred to measures of total cost (average total costs or fully-distributed costs ("F.D.C.")).

The C.R.T.C. has crafted its own cost standard which differs materially from all of these. Though the Commission implicitly accepts that variable costs form a proper starting point for the analysis of predation, in order to ensure fairness to competitors it has decided that contribution should also be imputed to telephone company I.X. services, even though local-exchange costs are fixed in character.

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[49] There are circumstances where a price below cost will not be regarded as predatory; for example, where the vendor is merely minimizing losses iu a market where there is excess capacity or is selling off perishable inventory (see: Director of Investigatiou and Research, *Predatory Pricing Enforcement Guidelines* (Ottawa: Supply & Services Canada, 1992) at 10 [hereinafter *Predatory Pricing Enforcement Guidelines*]; *R.* v. *Consumer's Glass Co.* (1981), 33 O.R. (2d) 228, 124 D.L.R. (3d) 274 (H.C.J.) [hereinafter *Consumer's Glass*]).

[50] The first of these, marginal cost (*i.e.*, the cost of supplying one additional unit of the service in question) is usually accepted as the theoretical ideal, but since marginal cost cannot normally be derived from a firm's accounting records, a variety of proxies is used. The Director has indicated that a price below A.V.C. is likely to be regarded as in violation of the *Competition Act* requirement that prices not be "unreasonably low" (*Competition Act, supra* note 17 at s. 50(1)(c)). The Director has defined A.V.C. as inclusive of all costs that vary with the level of output (see *Predatory Pricing Enforcement Guidelines, ibid.* at 10-11). The A.V.C. standard was applied in *Consumer's Glass*. The Second and Seventh Circuit Courts of Appeal applied an L.R.I.C. standard in both *Northeastern Telephone Company* v. *A.T.&T.*, 497 F.Supp. 230 (D. Conn. 1980) [hereinafter *Northeastern (Trial)*], rev'd 651 F.2d 76 (2d Cir. 1981) [hereinafter *Northeastern*] and *MCI Communications Co.* v. *A.T.&T.*, 708 F.2d 1081 (7th Cir. 1983) [hereinafter *MCI*]. L.R.I.C. was defined in the latter case as the average additional cost of a large change in production of the service. Long-run avoidable cost, on the other hand, was the standard preferred in G. Myers, *Predatory Behaviour in UK Competition Policy: Research Paper* (London: Office of Fair Trading (U.K.), 1994). According to Myers, "long-run avoidable cost is closely related to 'incremental cost' ... There is a difference betweeu the two if there exist costs that are sunk in the long run and do not require replacement — these sunk costs are included in the incremental costs but excluded from the long-run avoidable costs" (Myers, *ibid.* at note 1, p. 20).

It is useful to an understanding of the C.R.T.C.'s approach to the issue of predation to preface our examination of it with a review of the two leading antitrust cases from the United States[51] on the issue of predatory pricing in the telecommunications industry. As we shall see, in both cases, the courts ultimately ruled in favour of an incremental cost standard. In each instance, however, the appellate court was required to overrule the lower court, which favoured F.D.C. Moreover, in one of the cases, there was a dissent in the appellate court that is germane to the cost-standard issue.

A. *The* Northeastern *Case*

The first of the two United States cases is *Northeastern Telephone Company* v. *A.T.&T.*[52] Northeastern was a small supplier of telephone terminal equipment, based in Connecticut, which sold private-branch exchanges ("P.B.X.s") and key telephones in competition with A.T.&T. and its affiliate, Southern New England Telephone Company ("S.N.E.T."). Northeastern, believing that the prices being charged by S.N.E.T. were predatorily low, commenced an action under the *Sherman Act*[53] seeking damages, *inter alia*, caused by the alleged attempt of the two defendants to monopolize the relevant markets. At trial, the jury returned a verdict for Northeastern and awarded damages which when trebled, as provided for by the Act, amounted to over sixteen and one-half million dollars. The defendants moved for judgment notwithstanding the verdict on the ground, *inter alia*, that the evidence put before the jury was legally insufficient to support that verdict.

Eginton D.J. set aside the verdict as it related to the pricing of key telephone systems but affirmed it with respect to P.B.X.s. The evidence had shown that, in setting its rates, S.N.E.T. took into account only the incremental costs attributable to the provision of P.B.X.s and did not attribute any portion of its indirect or common costs to that product. The court noted that, in previous decisions, several courts had accepted the proposition that if a price recovers the marginal or incremental costs of a product or service, it is not predatory; the court declined, however, to adopt that standard "on the particular circumstances of this case". "Instead," the court said, "defendant's pricing conduct will be viewed against a pricing floor of fully distributed cost." The court went on to explain:

> Fully distributed cost combines the marginal or incremental cost of supplying a particular good or service with some portion of the unattributable costs (i.e., indirect costs). Such a standard is particularly appropriate for a firm like [S.N.E.T.] which sits astride noncompetitive and competitive markets and has the potential to "undermine competition by supporting artificially low prices in the terminal-equipment market with revenues from intrastate monopoly services."

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[51] See also *Southern Pacific Communications Co.* v. *AT&T*, 556 F.Supp. 825 (D.C. 1983), aff'd 740 F.2d 980 (D.C. Cir. 1984) [hereinafter *Southern Pacific*].

[52] *Supra* note 50.

[53] 15 U.S.C. § 2 (1976).

> One of the indicia of predatory pricing posited by Areeda & Turner is whether a firm has engaged in the "deliberate sacrifice of present revenues for the purpose of driving rivals out of the market and then recouping the losses through higher profits earned in the absence of competition." Although such a test may be appropriate for the normal industrial firm which is in a competitive situation in all sectors of its business, it is not appropriate for an entity like [S.N.E.T.] which can support artificially low prices in the terminal equipment market with revenues from monopoly services. To permit [S.N.E.T.] to allocate all or a disproportionate percentage of its unattributable costs to the noncompetitive sector of its business — which defendants urge this Court to do under the guise of long-run incremental analysis ... — is to give defendants an improper pricing advantage over Northeastern and other single market competitors who must allocate all costs directly to their terminal equipment rates. A fully distributed cost standard, on the other hand, would require that the rates for [S.N.E.T.]'s competitive products and services reflect some portion of its unattributable costs, thus substantially curtailing potential subsidization. Under the particular circumstances of this case, a fully distributed cost pricing floor is the proper standard against which to measure defendants' pricing practices.[54]

The finding for Northeastern was reversed on appeal to the Second Circuit Court of Appeal.[55] The appellate court began its analysis by expressing its agreement with Areeda & Turner, whose article on predatory pricing had been cited by Eginton D.J.,[56] that the appropriate benchmark against which to judge whether a price is predatory is, generally, marginal cost. "Were this a run of the mill case," the court went on to say, it would proceed to apply the average variable cost rule to S.N.E.T.'s P.B.X.'s prices. "But as Northeastern rightly contends, this case is far from typical."[57] One of the "significant factors" which distinguished that case from the classic situation was the fact that the prices charged by S.N.E.T. were regulated by the Connecticut Department of Public Utility Control ("D.P.U.C.").[58]

The court characterized the trial judge's approach as "seriously flawed". First, it stated, the argument that a regulated utility can allocate all of its joint costs to the monopoly aspects of its business and, thereby, give itself a permanent advantage over its unregulated competitors "proves too much". This advantage, the court said, may be enjoyed by all diversified firms, whether regulated or unregulated. The Court continued:

> Second, this approach emphasizes the interests of single-market rivals over those of consumers and the competitive process. Marginal cost pricing maximizes short run consumer welfare. Fully distributed cost pricing, in contrast, requires some consumers to pay a higher price for the desired product, and forces others to do without that product entirely, although they are willing to

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[54] *Northeastern (Trial), supra* note 50 at 240-41 [citations omitted].

[55] See *Northeastern, supra* note 50.

[56] See P. Areeda & D. Turner, "Predatory Pricing and Related Practices Under Section 2 of the Sherman Act" (1975) 88 Harv. L. Rev. 697 at 698.

[57] *Northeastern, supra* note 50 at 90.

[58] *Ibid.* at 88.

> pay the costs of its production. Moreover, a fully distributed cost rule would have perverse consequences when the dominant firm's rival was itself diversified. In that case, presumably, both firms would have to set their prices above their fully distributed costs. So high a price floor might prevent the diversified rival from ever entering the market, thereby curtailing competition rather than promoting it.
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> Third, Northeastern's argument in favour of the fully distributed cost test is based on a misunderstanding of the economic notion of subsidization. Northeastern seems to believe that whenever a product's price fails to cover fully distributed costs, the enterprise must subsidize that product's revenues with revenues earned elsewhere. But when the price of an item exceeds the costs directly attributable to its production, that is, when price exceeds marginal or average variable cost, no subsidy is necessary. On the contrary, any surplus can be used to defray the firm's non-allocable expenses.
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> Finally, Northeastern's fear that [S.N.E.T.] will be able to allocate all of its overhead to its monopoly services rests on the premise that the [D.P.U.C.] is either asleep or incompetent. A key step in the long and complex business of rate regulation is the "cost allocation study," in which the regulatory agency distributes fixed costs against the revenues from the regulated and unregulated aspects of the utility's operations. If Northeastern believes that the [D.P.U.C.] is unable to perform these studies, its recourse is to intervene before that body and, if unsuccessful, to appeal to the state courts. If comity and federalism mean anything in this context, they require that we not create an exception to the general rule of marginal cost pricing on the basis of plaintiff's bald assertion that the [D.P.U.C.] cannot perform the duties delegated to it by the state.[59]

B. The MCI *Case*

There are many parallels between the facts in *Northeastern* and those in *MCI.*[60] MCI, which competed with A.T.&T. in the provision of private-line services, had brought suit against A.T.&T. under the *Sherman Act* alleging that it had attempted to monopolize the market for I.X. services through, *inter alia*, predatory pricing. The object of MCI's complaint was a service called "Telpak". In response to MCI's entry into the telecommunications field, A.T.&T. had formulated a plan known as the "Hi-Lo tariff" under which A.T.&T. "de-averaged" its Telpak service rates into two principal rate categories. On high-density routes (the target of MCI's activity), rates were lowered; while on low-density routes, rates were increased. The trial judge left to the jury the question of whether the appropriate cost standard for determining whether predation was occurring was F.D.C. or incremental costs. The

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[59] *Ibid.* at 90 [citations omitted].

[60] See *supra* note 50. See also *Southern Pacific, supra* note 51, a case brought by another A.T.&T. competitor which proceeded parallel to the MCI suit. Southern Pacific alleged that A.T.&T.'s Telpak, Hi-Lo and private line tariffs were predatory. The trial court found that A.T.&T. had priced these offerings above both L.R.I.C. and F.D.C. and dismissed the plaintiff's claims. On appeal, the Court of Appeals expressed "serious doubts" about the usefulness of F.D.C. as a measure of cost for use in the context of predatory pricing claims but held that it was unnecessary to decide what standard was appropriate in view of the trial court's findings of fact (*Southern Pacific, ibid.* at 1006).

jury found that the Hi-Lo tariff was priced below F.D.C. and was, therefore, predatory. MCI was awarded treble damages amounting to 1.8 billion dollars.[61]

The Seventh Circuit reversed this decision, holding not only that the choice of the cost standard was a question of law to be decided by the trial judge, but that the appropriate measure was L.R.I.C. The court characterized F.D.C. as not "an economically relevant definition of average total cost" in the antitrust context, elaborating as follows:

> First, [F.D.C.] is a quite arbitrary allocation of costs among different classes of service ... [which] cannot purport to identify those costs which are *caused* by a product or service, and this is fundamental to economic cost determination.
>
> [F.D.C.] also fails as an economically relevant measure of cost for antitrust purposes because it relies on historical or embedded costs. For it is current and anticipated cost, rather than historical cost that is relevant to business decisions to enter markets and price products. The business manager makes a decision to enter a new market by comparing anticipated additional revenues (at a particular price) with anticipated additional costs. If the expected revenues cover *all* the costs caused by the new product, then a rational business manager has sound business reasons to enter the new market. The historical costs associated with the plant already in place are essentially irrelevant to this decision since those costs are "sunk" and unavoidable and are unaffected by the new production decision. This factor may be particularly significant in industries such as telecommunications which depend heavily on technological innovation, and in which a firm's accounting, or sunk, costs may have little relation to current pricing decisions.
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> In particular, [F.D.C.] fails as a relevant measure of cost in a competitive market. [F.D.C.] is, at best, a rough indicator of an appropriate rate *ceiling* for regulatory purposes and should not be used as a measure of the minimum price permissible in a competitive market. The justifiable fear of monopoly, and the basis of section 2 of the Sherman Act, is that a firm enjoying monopoly power will not be constrained by market forces; it will raise prices and decrease output in such a manner that its own profit will be maximized but that consumers will be subject to higher prices and a less efficient allocation of resources than would be the case in a competitive market ... When a price floor is set substantially above marginal or incremental cost a price "umbrella" is created which allows less efficient rivals to remain in the market sheltered from full price competition. A fully distributed price floor may thus misallocate resources and force consumers to pay more for less production than competition would dictate.[62]

The court concluded by saying:

> Pricing at or above long-run incremental cost in a competitive market is a rational and profitable business practice. Because there are legitimate, and in fact compelling, business reasons for pricing products at or above their long-run in-

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[61] See *MCI*, *supra* note 50 at 1092.

[62] *Ibid.* at 1116-117 [footnotes and citations omitted].

> cremental cost, no predatory intent should be presumed or inferred from such conduct.[63]

One of the arguments that MCI had advanced in support of F.D.C. was a variant on the argument that had earlier been made by Northeastern; that is, that an F.D.C. methodology is required to prevent A.T.&T. from subsidising its competitive services with revenues derived from monopoly services. MCI pointed out that A.T.&T.'s Telpak and other private-line long-distance services, although they showed a positive rate of return, earned, on an allocated rate base, a lower rate of return than did certain other A.T.&T. long-distance services. The court rejected this argument:

> Such differing rates of return, however, even if correctly and meaningfully derived, do not support the imposition of antitrust liability. The fact that different services may earn different rates of return largely reflects the realities of a competitive market. Where a firm faces competition, demand is more elastic — that is, more sensitive to changes in prices — because of the presence of other firms producing substitute products to which buyers may turn. Lower returns on investment are to be expected in competitive markets because each firm, in accordance with classical competitive theory and practice, will be forced to lower prices toward marginal costs in order to maintain its market share.[64]

The criticisms of F.D.C. are justified. What is, nevertheless, unsatisfactory about the analyses of these appellate courts is their failure to address the threat to competition inherent in the special market positions occupied by the telephone companies. In effect, S.N.E.T. and A.T.&T.'s ability to disregard their indirect costs in the pricing of their competitive services was a consequence of the existence of a secure monopoly base from which these costs could ultimately be recovered. This was an entirely artificial advantage sustained by public policies favouring monopoly in the provision of local and switched voice services.

The consequence of the application of a strict L.R.I.C. cost standard might have been the virtual extinction of competition in the terminal-equipment and private-line markets had it not been for the results achieved in two other contemporary suits. In the first, MCI successfully challenged a decision by the F.C.C. prohibiting MCI from offering "Execunet" — a "switched private line service" which was the functional equivalent of public long-distance telephone service for many customers — in competition with A.T.&T.[65] In the second action, the Department of Justice

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[63] *Ibid.* at 1123.

[64] *Ibid.* [footnotes omitted].

[65] *MCI Telecommunications Corp.* v. *FCC*, 561 F.2d 365, 182 U.S. App. 367 (D.C. Cir. 1977), cert. denied 434 U.S. 1040, 98 S. Ct. 781 (1978). The F.C.C. had ruled in *MCI Telecommunications Corp.* v. *FCC*, 60 F.C.C.2d 25 (1976), that MCI was not authorised to provide Execunet service. The Court of Appeals reversed on the ground that the F.C.C. had made no formal finding that the preservation of A.T.&T.'s monopoly over public long-distance telephone service was in the public interest, or that MCI's existing facilities authorizations restricted it to the provision of non-switched services. For a discussion of the case and subsequent litigation, see G.W. Brock, *Telecommunication Policy for the*

brought suit against A.T.&T. alleging monopolization of the I.X. market. As a consequence of that suit's settlement, A.T.&T. was divested into separate local and I.X. companies.[66] The combined effect of these two measures was to deprive A.T.&T. of its monopoly base and, therefore, eliminate much of the problem which had led to the *Northeastern* and *MCI* cases.

One of the three appellate court judges who sat on the *MCI* case, Wood J., dissented in part on the ground that the simple application of an L.R.I.C. cost standard was an improper substitute for a full assessment of the defendant's conduct in making a determination as to whether predation had occurred. "The majority," the dissenting judge said, "accepts the proposition that the antitrust laws are concerned only with efficiency and thus concludes that arguably monopolistic practices which do not disturb efficiency should escape liability *pro tanto*."[67] He continued:

> While not uegating the value of policy arguments based on efficiency, I am hesitant to abandon the jurisprudence and historical texture of the antitrust laws in order to embrace a set of seemingly hard and fast efficiency rules which present an illusion of conceptual and empirical tidiness.[68]

He pointed, in particular, to the danger that

> [a] monopolist producing multiple products and services may arbitrarily and systematically shift its revenues and costs between and among competitive products and monopoly products, resulting in widely divergent rates of return between these two types of markets. Such a strategy is nothing more than a disguised price reduction and serves no purpose other than to eliminate or discipline troublesome competitors. A thinly financed competitor may be vulnerable, regardless of relative efficiency, when a monopolist is willing to tolerate rates of return which, although profitable, are nonetheless below his normal expectations and reflect a systematic marshalling of monopoly resources to eliminate a competitor.[69]

C. The F.C.C.'s Approach

There are echoes of the concerns expressed by Wood J. in the F.C.C.'s approach to predation. In 1985, for example, the F.C.C. established guidelines for the pricing of new optional calling plans ("O.C.P.s") offered by A.T.&T. and other carriers which it classified as "dominant".[70] In the proceedings that led to the establishment

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Information Age: From Monopoly to Competition (Cambridge, Mass.: Harvard University Press, 1994) at 135-39.

[66] The terms of the settlement were embodied in a consent decree, known as the Modification of Final Judgment ("M.F.J."). For a description of the events leading up to the M.F.J., see Brock, *ibid.* at 149-67.

[67] *MCI, supra* note 50 at 1177.

[68] *Ibid.* at 1179.

[69] *Ibid.* at 1181-182 [citations omitted].

[70] *Guidelines for Dominant Carriers' MTS Rates and Rate Structure Plans*, 50 FR 42945 (CC Docket No. 84-1235), F.C.C. 85-540 [hereinafter *O.C.P. Guidelines*].

of those guidelines, the F.C.C. examined a number of costing standards which could potentially serve as the test of just, reasonable and non-discriminatory rates in the context of O.C.P. offerings. One of these was F.D.C. The F.C.C. rejected this standard, citing the reasoning in Northeastern and MCI. At the same time, however, the F.C.C. declined to adopt a pure incremental cost standard, choosing instead a third option that would allow a carrier to price down to incremental cost, but only in cases where the carrier could demonstrate that its net revenues from the service would increase within a twelve-month period. "The rationale for this standard," the F.C.C. said, "is that, if the [O.C.P.] increases net [long-distance] revenues over a reasonable period, it would not create a revenue shortfall burdening non-[O.C.P.] customers and it would not, by definition, be receiving an anti-competitive subsidy from those customers."[71] As such, it would be more responsive to the F.C.C.'s "dual objectives" of "granting AT&T more pricing flexibility while continuing to protect against anti-competitive pricing".[72] The standard adopted in the O.C.P. Guidelines decision has since been expressly incorporated in the rules governing the pricing of new A.T.&T. service offerings established in the AT&T Price Cap Order.[73]

Local-exchange carriers ("L.E.C.s") in the United States were initially subject to the same net-revenue test. In their case, however, this test has since been replaced by a new rule which serves a very similar purpose. L.E.C.s must demonstrate that the revenues for any new service offering will cover all direct costs of the service plus a share of overhead costs. This share may vary from service-to-service in response to competitive conditions. In a similar vein, in its recent decision on Telephone Company — Cable Television Cross-Ownership Rules, the F.C.C. stipulated that L.E.C.s include in their calculation of the costs of new video dialtone offerings a "reasonable allocation" of the common costs of shared plant.[74]

D. The C.R.T.C.'s Approach

Since the private-line and terminal-equipment markets in Canada were first opened to competition in the late 1970s and early 1980s, competitors have pressed the case that the telephone companies have priced their offerings at levels designed to undermine competition. The C.R.T.C. has never expressly accepted these claims, though it has sometimes ordered an increase in the impugned rates on grounds which did not expressly recognize the validity of the predation claim.[75]

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[71] *Ibid.* at 42949.

[72] *Ibid.* at 42950.

[73] See *Policy and Rules Concerning Rates for Dominant Carriers*, 4 FCC Rcd. 2873 at 3123-124 (1989).

[74] *Opinion and Order on Reconsideration and Third Further Notice of Proposed Rule Making*, 10 FCC Rcd. 244 at 340ff (1994).

[75] See *e.g.*: *British Columbia Telephone Company — Interim Rate Changes and Revenue Requirement Proceeding for the Years 1988 and 1989* (1988), Telecom. Decision C.R.T.C. 88-2; *British Columbia Telephone Company — Revenue Requirement for the Years 1988 and 1989 and Revised Criteria for Extended Area Service* (1988), Telecom. Decision C.R.T.C. 88-21 at 122-39; *Association of Telecommunications Competitive Suppliers and CNCP Telecommunications* v. *Bell Canada and Brit-*

The controversy surrounding the telephone companies' pricing practices was heightened by the Long Distance Competition decision. The new difficulties stemmed from the fact that, as part of its decision to open the I.X. market to competition, the C.R.T.C. decided to loosen the rules governing the approval of rates for the telephone companies' I.X. services. Under the new rules, the C.R.T.C. undertook to grant interim ex parte approval to proposed rates for the telephone companies' public long-distance services where the Commission was satisfied that the proposed rates covered their costs and continued to make an acceptable level of contribution.[76]

Unitel and other competitors subsequently complained to the Commission that the telephone companies were availing themselves of the relaxed rules to reduce their rates for I.X. services to levels that brought them below their allowed (company-wide) rate of return, and seeking to recoup the lost revenues through increases in their rates for monopoly local services. Competitors characterized this process as unfair to them and to local subscribers. Thus, in the months following the release of the Long Distance Competition decision, Bell Canada proposed to lower rates for business services such as "Advantage Plus" and "WATS" by twenty-five percent and 21.3 percent respectively, and to lower 800 service rates by 10.7 percent. The initial impact of these proposals was a net reduction in I.X. revenues of about ninety-two million dollars annually.[77] Over the same period, Bell Canada asked the Commission to approve rate increases for a variety of monopoly local services, such as touch-tone calling and long-distance directory services, which would yield an additional 118 million dollars in annual revenues.[78]

In Re Information Requirements for Competitive Toll Filings by the Telephone Companies,[79] the Commission addressed this problem by identifying specific information that telephone companies would be required to file with their rate applications. This information would be used to establish that there was compliance with the conditions contemplated by the Long Distance Competition decision before interim *ex parte* approvals could be granted.[80]

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ish Columbia Telephone Company (1988), Telecom. Decision C.R.T.C. 88-9; *Application by Call-Net Telecommunications Ltd. to Review and Vary Telecom Orders CRTC 90-1000 and 90-1001 and Decisions dated 30 November 1990 and 24 December 1990* (1991), Telecom. Decision C.R.T.C. 91-3. See also the decisions *infra* note 82.

[76] See *Long Distance Competition*, *supra* note 2 at 139-40. The telephone companies were required to show that either the loss of contribution resulting from the change would not be significant, or where the loss of contribution would be significant, it would amount only to the elimination of "surplus" revenues — *i.e.*, revenues in excess of the amount of contribution expected from that service.

[77] See *Response to Interrogatory* Bell(CRTC)19Nov92-9 CC filed by Bell in the C.R.T.C.'s 1993 *Contribution Charges* proceeding. For the decision in that proceeding, see *Contribution Charges Effective April 1, 1993* (1993), Telecom. Decision C.R.T.C. 93-11.

[78] See letter of L.D. Hunt (Unitel) to G.G. Henter (C.R.T.C.) (4 November 1992) at 4. This letter commented on the *Bell Tariff Notice* 4562 (23 October 1992).

[79] (1993), Telecom. Letter Decision C.R.T.C. 93-12 [hereinafter *Letter Decision 93-12*].

[80] The C.R.T.C. applied *Letter Decision 93-12* to Bell Canada's subsequent application for approval

This measure increased protections against cross-subsidization but did not resolve a second, equally troubling aspect of the telephone companies' pricing strategy, namely, the targeted[81] nature of telephone-company price cuts. In order to understand the nature of the problem, it is necessary to recall that, prior to the Regulatory Framework decision, the telephone companies did not pay explicit contributions in respect of the use of access facilities by their I.X. services; their contribution was implicit in the I.X. rate. One consequence of this was that the telephone companies were relieved of any commercial constraint to recover contribution from any particular I.X. service at any particular level; they could average their contribution over all services or recover it from a particular sub-category of services. This situation, Unitel alleged in comments filed with the C.R.T.C. in 1993 and 1994[82] and expressed again in the Regulatory Framework proceeding,[83] gave the telephone companies a degree of pricing flexibility that was unavailable to their competitors. They used this flexibility to target price reductions on market segments where competitive entry had occurred while ignoring other market segments. It was Unitel's contention that the telephone companies could price below competitors and squeeze them out of the market unless the telephone companies were required to impute their average contribution to each service in determining the costs of that service and to price their services above the resulting cost floor.

One of the telephone-company filings attacked by Unitel on the basis that it did not meet this imputation test was Bell Canada's proposed "TeleCity" service,[84] an optional long-distance service that would have allowed subscribing customers within certain urban centres to pay a special reduced rate for up to twenty-five hours of calls to exchanges within forty miles of their home exchange. According to calculations performed by Unitel, the market targeted by TeleCity represented almost one-third of the market for long-distance calling within Bell Canada's operating territory. Unitel charged that the per-minute rate of five cents proposed by

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of a new optional calling scheme called the "Long Distance Plan". Utilizing the information provided pursuant to that decision, the Commission rejected Bell Canada's estimates of the contribution impact of the Plan. The Commission nevertheless approved the Plan, subject to the express condition that Bell Canada absorb the contribution impact as calculated by the Commission by deducting that amount from any increase in local revenues that the Commission might otherwise be prepared to grant (see (1994), Telecom. Order C.R.T.C. 94-612).

[81] "Targeted" pricing is a particular form of anti-competitive pricing which involves strategically reducing prices for selected services. A firm that operates in all service areas can pursue a strategy of reducing prices in the service area where competitors operate, while recovering the resulting losses in monopoly or limited-entry service areas. In such an environment, the firm that operates in all service areas can effectively cross-subsidize its prices in the competitive markets.

[82] These included the proceedings that led to: (1994), Telecom. Order C.R.T.C. 94-111 (revisions to rates for Virtual Corporate Network service); (1994), Telecom. Order C.R.T.C. 94-152 (revisions to rates for overseas telephone service); (1994), Telecom. Order C.R.T.C. 94-397 (revisions to rates for N.B. Tel's "Atlantic Business Pak" service); and (1994), Telecom. Order C.R.T.C. 94-691 (revisions to Bell Canada's rates for "Advantage Preferred" service).

[83] See Unitel Final Argument, *supra* note 15 at c. 2:4ff, c. 5:14ff, c. 7:1ff.

[84] See (1993), Telecom. Order C.R.T.C. 93-1090 [hereinafter *TeleCity Order 93-1090*].

Bell Canada was not compensatory. Unitel also pointed out that the payments competitors were required to make on account of contribution, traffic switching and aggregation functions performed by the telephone companies alone amounted to in excess of twelve cents per minute. The consequence was that, even if they faced no other costs of providing service, the competitors would lose approximately seven cents per minute if they attempted to match the TeleCity tariff. "This," as Unitel pointed out, "is because the price paid by Unitel and others for contribution and switching/aggregation are not reflected in the TeleCity rates."[85]

The C.R.T.C. had considered and rejected a proposal in 1979 similar to Unitel's imputation test during Phase II of the Cost Inquiry.[86] Phase II was concerned with identifying the requirements that should govern the approval of rates for new services introduced by telephone companies and other carriers. The Commission had proposed to use a "prospective incremental cost" standard for this purpose. The Consumers' Association of Canada ("C.A.C.") criticized the C.R.T.C.'s proposal to use this standard and advocated that a market price be charged to carriers' competitive services for use of the carriers' fixed common resources for costing purposes. In the view of the C.A.C., this was "fundamental for the prevention of predatory pricing and the encouragement of competition in telecommunications".[87] The Commission concluded, however, that the prospective incremental-cost approach was appropriate for the economic evaluation of a new service, and that no account should be taken of common costs since those costs "do not vary as a result of the introduction of the new service". The Commission determined, however, that "the proportion of these costs attributable to a new service should be identified on a memorandum basis."[88]

In the TeleCity case, Unitel referred the Commission to evidence filed by Alfred Kahn on behalf of a Stentor member, AGT Limited, in the Regulatory Framework proceeding. Dr. Kahn had said the following:

> A competitive system is one in which all actual and potential competitors, incumbents and new entrants, have the same opportunity to vie for the patronage of buyers on the basis solely of their relative efficiency in providing the contested service or services — with "efficiency" defined in terms of giving customers the best combination of service quality and cost. I have on occasion referred to this condition as the "principle of competitive parity."

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[85] Letter of L.D. Hunt (Unitel) to S. MacPherson (C.R.T.C.) (28 October 1993) at 12.

[86] *Inquiry into Telecommunications Carrier' Costing and Accounting Procedures: Phase II — Information Requirements for New Service Tariff Filings* (1979), Telecom. Decision C.R.T.C. 79-16 [hereinafter *Phase II Decision*].

[87] Quoted *ibid.* at 7.

[88] *Ibid.* The issue was raised again in the *Phase III Decision*, which was concerned with the pricing of existing services. The Commission determined, however, that the objectives of Phase III were "limited to the identification of costs in an empirical sense, based on the principle of cost causation, and do not include the development of rules to allocate any fixed common costs based on concepts of fairness" (*Phase III Decision*, *supra* note 14 at 35).

> Special problems are raised — whether under the antitrust laws or under regulation — in applying this principle to a situation where one or more of the competitors can obtain access to customers only by using facilities controlled by one of their rivals. Such a problem is presented here: the competition is over the provision of toll or interexchange telephone service and competitors can, for the most part, reach customers only via AGT for most of Alberta and by ED TEL in Edmonton. Manifestly, when one of the competitors controls access to or the supply of an input or a facility essential to its rivals, it becomes necessary to specify the terms of that access compatible with competitive parity.
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> The basic governing principle is simple — it is that there be no discrimination, overt or implicit, between the rivals and, specifically, between the division or affiliate of the company supplying the essential input and rivals requiring access to it. That discrimination may be in the price or quality of interconnection provided or other terms or conditions of supply, manipulation of any of which to the unfair advantage of competitors could thwart the achievement of competitive parity. For simplicity, I will confine my attention to price — i.e., the interconnection charge (as always, including contribution) — and to competition in toll market where AGT is the supplier of local exchange service.
>
> The requirements for competitive parity are two:
>
> ° AGT's own toll operations must be subject to the same access or interconnection charges as it imposes on its competitors, except to the extent that the (marginal) costs of providing that service to itself and to its competitors differ; and
>
> ° AGT's toll charges must recover both that access or interconnection charge and the incremental costs of its own operations.[89]

The Commission denied the TeleCity filing on the ground that the contribution impacts appeared to be "significantly underestimated"[90] but made no express reference to the Kahn evidence nor to the Unitel proposal to include contribution in determining the compensatory nature of telephone company rates.

The Commission returned to the subject, however, a few weeks later in *Review of Regulatory Framework — Targeted Pricing, Anti-Competitive Pricing and Imputation Test for Telephone Company Toll Filings*.[91] In that decision, the C.R.T.C. ruled that telephone companies should be required to impute contribution at the same levels as competitors to the cost of providing their services and to maintain their prices above the resulting cost floor. This approach was necessitated, in the Commission's view, by the imperfect state of competition in the market for I.X. services. It identified five specific factors which contributed to this situation:

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[89] A.E. Kahn, *Major Elements of a Competitive Telecommunications Policy* (New York: National Economic Research Associates, 1993) at 17-18.

[90] *TeleCity Order 93-1090*, *supra* note 84 at 4.

[91] (1994), Telecom. Decision C.R.T.C. 94-13 [hereinafter *Targeted Pricing*].

(1) domination of the I.X. market by members of Stentor, former monopoly providers of that service;

(2) the integrated character of the Stentor telephone companies that provide not only I.X. services but also own and operate the local exchanges used by them and their rivals to originate and terminate I.X. traffic;

(3) the persistence of entry barriers in some market segments, for example, 800-services;

(4) a rate structure under which local rates are maintained by regulatory policy below the levels necessary to cover the total costs of operating local exchanges, thereby giving rise to a need for a large contribution to the recovery of those costs by I.X. services;

(5) customer inertia, namely, the propensity of customers to remain with the incumbent carrier even when competitors offer more advantageous prices and other terms of service.

The Commission said the following:

> The Commission's approach to targeted pricing in [the *Long Distance Competition* decision] essentially relied on market forces. In other words, it relied on the assumption that, to the extent that the telephone companies targeted reductions at particular market segments, they would leave other non-targeted market segments exposed to price reductions by competitors and would make competitive entry in the non-targeted segments more attractive. The Commission's approach was also based on the assumption that contribution discounts would be sufficient to offset barriers to entry across market segments. Under such a scenario, competitors could duplicate the pattern of contribution across market segments implicit in the telephone companies' rates by generating a traffic mix similar to that of the telephone companies, or could take advantage of the telephone companies' targeting strategy by entering other, high contribution market segments left exposed by the targeting. In addition, over time, one would expect the telephone companies to respond to entry in the high contribution market segments, with the result that the difference in contribution across market segments would be moderated.
>
> However, based on an examination of the market as it has evolved since [the *Long Distance Competition* decision], the Commission considers that the contribution discounts established in that Decision, in conjunction with the current regime for the approval of telephone company tariff filings, are not sufficient to address concerns over targeted pricing, given barriers to entry and customer inertia in the non-targeted market segments. From the perspective of a competitor, contribution represents a tangible, albeit discounted, element of cost. Under a scenario of unrestrained targeted pricing by the telephone companies, competitors could be faced with a situation in which they must compete against telephone company prices that embody a contribution amount that is lower than the competitor contribution cost in that market segment, but where they

> are unable to generate sufficient contribution in the less competitive (and higher contribution) markets to offset the lower contribution markets.
>
> The Commission considers that, due to their previous status as monopoly toll providers, the telephone companies have an established and generally predominant share in all market segments. As a result, their traffic mix, the presence of barriers to entry and the existence of customer inertia would permit them, on a sustained basis, to recover contribution from the most highly contested market segments at a level below the contribution amount [required of competitors]. Further, the Commission is of the view that, until barriers to entry and customer inertia in all market segments have been reduced sufficiently to provide competitors with an opportunity to compete equally, or until contribution is reduced to levels where potential variations between high and low contribution market segments is minimal, recovery of contribution by the telephone companies in specific market segments that is below [the amount required of competitors] would be inconsistent with a fair competitive environment. Until such time, while recognizing that it will somewhat reduce telephone company pricing flexibility, the Commission considers it necessary in order to ensure such an environment that an imputation test be applied ...[92]

As a result of the Commission's subsequent decision in the *Regulatory Framework* proceeding to require telephone companies to "pay" an access charge, the contribution amount now imputed to the telephone companies in determining the compensatory nature of their rates will be that charge rather than the contribution charge calculated under the terms of the *Long Distance Competition* decision.[93]

Conclusion

The challenge facing the C.R.T.C. in the wake of the *Long Distance Competition* decision has been to find a formula which allows the telephone companies greater pricing flexibility while at the same time providing competitors with adequate protection against the exploitation by telephone companies of their dominant market position. In the *Regulatory Framework* decision, the Commission removed the constraint on price increases for optional long-distance telephone services and 800 services. It also relaxed the rules governing prices for basic (that is, other than optional) long-distance telephone services to points within North America through the adoption of an expedited approval process for rate revisions that do not result in an overall price increase. In addition the telephone companies have been promised greater flexibility in the packaging of customer-specific offerings.

At the same time, the C.R.T.C. has introduced two measures aimed at making competition fairer for competitors. Telephone-company contribution has been made

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[92] *Ibid.* at 7-9. Applying this test, the Commission has since rejected a number of telephone company filings (see *e.g.*: (1994), Telecom. Order C.R.T.C. 94-998; (1994), Telecom. Order C.R.T.C. 94-1142). The latter was a re-filing by Bell Canada of its TeleCity proposal, first denied in *TeleCity Order 93-1090.*

[93] *Regulatory Framework*, *supra* note 7 at 96.

explicit by splitting the telephone company rate base and by requiring the I.X. division to "pay" for use of utility services. The Commission hopes, thereby, to ensure equality of treatment as between the telephone companies and their competitors. The Commission has at the same time made a number of important modifications to its costing system, Phase III. In particular, it has decided to reallocate costs of jointly-used customer services equally between the telephone companies' utility and competitive segments. In doing so, it has opened the prospect of further, similar changes being made to the allocation of costs of other jointly-used services. Such measures would go a long way to correcting the inherent disadvantages I.X.C.s suffer in competing with the integrated telephone companies.

The second measure is a new policy on predatory pricing in which contribution charges are imputed to the telephone companies in determining whether or not their services are being provided below cost. The new policy takes account of the fact that numerous barriers to the achievement of a workably competitive market persist that would make it inappropriate to rely upon a pure incremental-cost standard. At the same time, the incentives to predate have been reduced. The splitting of the telephone companies' rate bases ensures that, if a telephone company lowers its I.X. rates, it will be unable to "recover" that lost revenue through increased rates for utility services, as it could in the past. In its decision of October 31, 1995, the Commission shows that it is prepared to go beyond the protection afforded by the imputation test to prevent telephone company targeting of price cuts on selected I.X. market segments. It has directed that increased revenues that the telephone companies will earn as a consequence of the planned increases in local rates are to be passed on to customers through across-the-board reductions in I.X. rates.[94]

The implementation of the process of reform mapped out in the *Regulatory Framework* decision will continue. The Commission has recently announced its decision to forbear from regulating services provided by I.X.C.s. The Commission will, undoubtedly, be considering applications from the telephone companies for forbearance for their I.X. services in the future. As to the remaining telephone company services, in its October 31 decision, the Commission repeated its intention to initiate a proceeding in 1996 to implement a price-cap scheme for the regulation of telephone-company utility rates.[95]

It has sometimes been suggested that, after a brief sunset period during which the dismantling of remaining barriers to competition could be completed, long distance markets should be completely "deregulated", and that any issues related to anti-competitive conduct by carriers should thereafter be left to the Director of Investigation and Research for action under the *Competition Act*. One of the conclusions that emerges from the discussion in this article is that such a move would be premature. Although significant progress has been made since the *Long Distance Competition* decision in 1992, Canadian telecommunications markets are not yet

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[94] See *Split Rate Base*, *supra* note 48 at 24.

[95] See *ibid.* at 30.

workably competitive. When competition is more firmly established in all market segments, the need for regulation will pass. However, until that stage is reached, transitional rules are required in order to ensure that competition is given a chance to develop.