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13 February 2012

Mr. John Traversy
Secretary General
Canadian Radio-television and
Telecommunications Commission
Ottawa, ON K1A 0N2

RE : Application by Quebecor Media Inc., on behalf of itself and its affiliate Videotron G.P., to review and vary Telecom Regulatory Policy CRTC 2011-703, *Billing practices for wholesale residential high-speed access services*, 15 November 2011

Dear Mr. Traversy,

1. Pursuant to section 62 of the *Telecommunications Act* and section 22 of the *Canadian Radio-television and Telecommunications Rules of Practice and Procedure*, please find enclosed the above-noted application.

2. Trusting this is satisfactory, we remain,

Yours truly,

Dennis Béland

Dennis Béland
Senior Director, Regulatory Affairs
Telecommunications

cc : List of interested parties to TNC 2011-77

Enclosure

BEFORE THE CANADIAN RADIO-TELEVISION AND TELECOMMUNICATIONS COMMISSION

APPLICATION OF QUEBECOR MEDIA INC.,
ON BEHALF OF ITSELF AND ITS AFFILIATE
VIDEOTRON G.P., TO REVIEW AND VARY
TELECOM REGULATORY POLICY CRTC 2011-703,
BILLING PRACTICES FOR WHOLESALE
RESIDENTIAL HIGH-SPEED ACCESS SERVICES

13 FEBRUARY 2012

1. Quebecor Media Inc. (Quebecor Media), on behalf of itself and its affiliate Videotron G.P. (Videotron), files this application pursuant to section 62 of the *Telecommunications Act* (the Act) and section 22 of the *Canadian Radio-television and Telecommunications Commission Rules of Practice and Procedure* (the Rules) to review and vary Telecom Regulatory Policy CRTC 2011-703, *Billing practices for wholesale residential high-speed access services*, 15 November 2011 (TRP 2011-703).

2. We submit that there is substantial doubt as to the correctness of TRP 2011-703 due to the Commission's failure to consider a basic principle which had been raised in the original proceeding, namely the principle that the cost of providing high-speed capacity is not constant over time. As relief, we request that the Commission vary TRP 2011-703 by replacing the fixed capacity rate for each network provider[1] by a declining capacity rate determined in such a manner that the weighted average of the declining rate over the study period equals the fixed rate determined in TRP 2011-703.

3. Failure to grant the requested relief will leave in place a situation where network providers are forced to confer substantial subsidies on their wholesale customers in the early years of the study period, with little likelihood of recuperating these subsidies in the later years. Such a situation denies network providers a reasonable opportunity to earn a fair return on their network investments, in contravention of the Commission's obligation under section 27(1) of the Act to ensure that rates charged for telecommunications services are just and reasonable and the Commission's obligation under section 1(b)(ii) of the Policy Direction[2] to ensure that regulatory measures do not promote economically inefficient entry.

Background

4. TRP 2011-703 was the culmination of a regulatory proceeding that began with the issuance of Telecom Notice of Consultation CRTC 2011-77, *Review of billing practices for wholesale residential high-speed access services*, 08 February 2011 (TNC 2011-77). The purpose of the TNC 2011-77 proceeding was to review the regulatory approach with regard to the terms upon which large incumbent telephone and cable carriers provide their services to wholesalers in order to, among other things, ensure that smaller Internet Service Providers (ISPs) continue to be in a position to offer competitive and innovative alternatives to their retail residential customers.

5. From the perspective of a cable network provider like Videotron, the most significant policy change to emerge from TRP 2011-703 was the Commission's decision to replace network providers' prior authority to charge for network usage on a per wholesale end-user basis (measured in GB consumed per wholesale end-user) with a

[1] It should be noted that the approved wholesale tariffs for certain network providers, namely Bell Aliant in Atlantic Canada, SaskTel, Shaw and TCC, do not currently include a capacity rate. Our requested relief would not affect these network providers, unless they avail themselves of the opportunity to file capacity rate models, as permitted at paragraph 63 of TRP 2011-703.

[2] *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

new authority to charge for network usage on an aggregate capacity basis (measured in 100 Mbps capacity increments ordered by the wholesale ISP).

6. The purpose of the current application is not to challenge the aggregate capacity billing model in principle. Rather, it is to ensure that the capacity rates approved under this model satisfy the Commission's obligations under the Act and the Policy Direction.

7. As will be demonstrated further below, fixed capacity rates for each network provider for the duration of the study period, as set out in Appendix 1 to TRP 2011-703, do not satisfy the Commission's obligations under either section 27(1) of the Act or section 1(b)(ii) of the Policy Direction.

Review and Vary Applications Filed by Shaw and Rogers

8. Before proceeding, we wish to note that Shaw Cablesystems G.P. (Shaw), on 03 February 2012, and Rogers Communication Partnership (Rogers), on 13 February 2012, have filed applications to review and vary TRP 2011-703. Both applications address matters that, among other things, affect the absolute magnitude of the fixed capacity rates set out in Appendix 1 to TRP 2011-703.

9. Quebecor Media considers that elements of the Shaw and Rogers applications have merit and will provide detailed comments within the timeframes afforded by the Rules. Silence on these matters at this time should not be interpreted as disagreement with the positions put forward by Shaw and Rogers.

10. The relief requested in the current Quebecor Media application can and should be granted regardless of any adjustments the Commission might ultimately bring to network providers' capacity rates as a result of the Shaw and Rogers applications.

Failure to Consider a Basic Principle – The Cost of Internet Capacity is Not Constant Over Time

11. To understand the Commission's error in approving a fixed capacity rate for each network provider for the duration of the study period, it is important to first understand the process by which cost-based wholesale high-speed rates are set.

12. At its simplest expression, the rate setting process consists of determining the absolute costs to be recovered for a given service, then distributing these absolute costs over one or more measures of demand (e.g. end-users, circuits, capacity, etc.). Depending on the importance of the service being studied, an elaborate series of Commission and third party interrogatories is used to test the service provider's assumptions regarding cost categorizations, cost drivers and anticipated demand. In the end, the Commission rules on the aggregate costs, the aggregate demand, and the cost per unit of demand (i.e. the tariff rate). In the course of the analysis, both costs and demand are discounted to reflect the time value of money, and a Commission-approved mark-up is added to the service provider's raw underlying costs.

13. In the wholesale high-speed proceeding, each network provider's total costs of providing service were split into fixed costs (apportioned among the network provider's different service speeds) and variable costs (to be allocated to a capacity charge). It is the latter group of costs, and more specifically the Commission's mechanism for allocating these costs to its chosen unit of demand, that are the subject of the current application.

14. It is trite to state that the variable cost of providing a unit of high-speed network usage declines over time. This is true whether the high-speed network usage is measured in units of consumption (GB) or units of traffic (Mbps). Numerous parties made arguments to this effect throughout the TNC 2011-77 proceeding. The fact that the Commission directed network providers to employ significant productivity improvement factors in their cost studies also lends direct concurrence to this statement.

15. In the course of the TNC 2011-77 proceeding, the Cable Carriers[3] raised on several occasions the desirability of ensuring that variable service costs are recovered based on a declining rate schedule over time. For example, at paragraph 7 of our 12 July 2011 opening remarks to the TNC 2011-77 public hearing[4], we stated that such an approach would provide wholesalers with the benefit of cost savings from increased traffic volumes. In addition, at Appendix A to the Cable Carriers' 29 July 2011 final argument, each Cable Carrier proposed a 10-year declining schedule of rates for each of the $/GB scenario and the $/Mbps scenario. We further stated at paragraph 35 of our final argument that such an approach would help to protect against the highly speculative nature of later year traffic estimates.

16. At paragraph 169 of TRP 2011-703, the Commission chose to reject the Cable Carriers' proposal. In doing so, the Commission focused solely on the alleged administrative burden and uncertainty that would flow from capacity rates that decline over time. The Commission did not address the inequity that would arise from setting near-term rates based on speculative long-term projections, nor did it consider the evident efficiency benefits of the Cable Carriers' proposal to have wholesalers benefit from cost savings <u>as they arise</u> rather than <u>before they arise</u>.

<u>Impact on Network Providers – No Reasonable Opportunity to Earn a Fair Return</u>

17. The inequity in the Commission's ruling can be seen in Figure 1 below. For the sake of argument, we assume that Videotron's total variable costs of providing wholesale high-speed services over the course of the study period, as established by the Commission in TRP 2011-703, are accurate[5]. We then examine the capacity rates that would recover these costs, based upon two rating scenarios. The first scenario (depicted by the red line) shows the capacity rate if the Commission's fixed rate approach is maintained. The second scenario (depicted by the green line) shows the capacity rate

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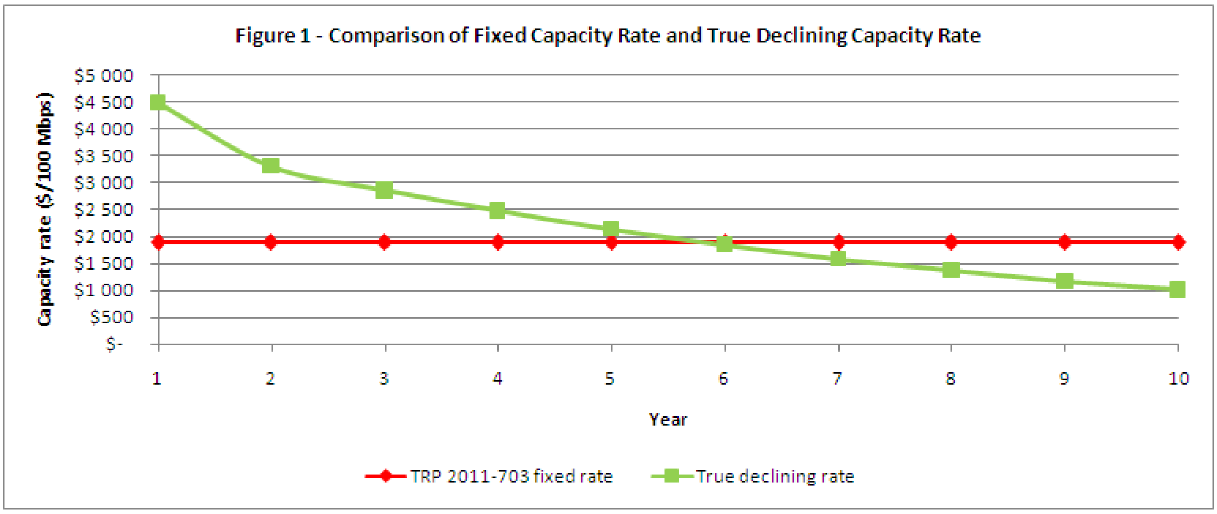
[3] Cogeco Cable Inc., Quebecor Media on behalf of Videotron, and Rogers.
[4] See also the hearing transcript, volume 2, at paragraph 1883.
[5] As noted earlier, these costs may change as a result of the Commission's determinations on the Shaw and Rogers applications.

if the rate declines annually in accordance with anticipated cost savings[6]. We emphasize that the total variable costs projected to be recovered under each scenario (roughly depicted by the area under each line) are the same, provided of course that the respective tariff arrangements remain in place for the full duration of the study period. The difference between the two scenarios is that the second tracks the true declining cost trajectory, while the first tracks an artificial fixed cost trajectory imposed by the Commission.



18. As can be seen in Figure 1, for the first several years of the cost study period, the capacity rate paid by wholesalers under the Commission's fixed rate approach is well below the true rate they should be paying if they were not benefiting prematurely from outer year cost savings. In year one, for example, the Commission-mandated fixed capacity rate is a full 58% below the true capacity rate ($1890/Mbps versus $4480/Mbps).

19. This substantial early-year subsidy from network providers to wholesalers is inequitable and offensive from several perspectives. First, by artificially lowering the retail rates that wholesalers are able to charge in the near term, it risks causing considerable disruption in the already intensely competitive high-speed marketplace. Second, it

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[6] The year-by-year rates have been calculated using the same methodology as was employed in deriving the rates in Appendix A to the Cable Carriers' 29 July 2011 final argument. Specifically, the total variable cost per end-user per month for the study period plus markup, as calculated after having incorporated all of the Commission's adjustments to Videotron's cost model, is divided by the total forecast monthly GB consumption per end-user for each year of the study. The resulting $/GB rate is then converted into a $/100 Mbps rate using the conversion factor approved by the Commission in TRP 2011-703. The derived rates are as follows :

Year 1 - $4480/100 Mbps	Year 6 - $1847/100 Mbps
Year 2 - $3305/100 Mbps	Year 7 - $1590/100 Mbps
Year 3 - $2861/100 Mbps	Year 8 - $1367/100 Mbps
Year 4 - $2474/100 Mbps	Year 9 - $1174/100 Mbps
Year 5 - $2142/100 Mbps	Year 10 - $1007/100 Mbps

creates a situation whereby the only way a network provider can have a reasonable opportunity to earn a fair rate of return on its network investments over the course of the entire study period is by maintaining artificially high capacity rates in the outer years. We refer specifically to the years where the green declining rate line crosses below the red fixed rate line.

20. Quebecor Media has serious doubts whether this crossover will ever happen. Having benefited from artificial subsidies in the early years, it is extremely difficult to believe that wholesalers will refrain from clamouring for urgent relief once the tap runs dry, let alone once it starts running in the opposite direction. In all likelihood, the Commission will order new ten-year cost studies to be conducted well before the current cost study period ends, thereby permanently depriving network providers of the opportunity to earn a fair overall return.

Contravention of the Act and the Policy Direction

21. Section 27(1) of the Act requires that:

> *Every rate charged by a Canadian carrier for a telecommunications service shall be just and reasonable.*

22. Section 1(b) of the Policy Direction further requires that:

> *The Commission, when relying on regulation, should use measures that satisfy the following criteria, namely, those that*
> *…*
> *(ii) if they are of an economic nature, neither deter economically efficient competitive entry into the market not promote economically inefficient entry,*
> *…*

23. By setting a wholesale high-speed capacity rate that is fixed for ten years in a context of declining real costs, the Commission has created a situation where network providers will be forced to subsidize their wholesale competitors for an initial period of several years, with little likelihood of recuperating these subsidies in the later years. This denies network providers a reasonable opportunity to earn a fair return on their network investments. The fixed capacity rate so established is not just and reasonable and it promotes inefficient entry. By approving the fixed rate, we respectfully submit that the Commission has acted counter to both section 27(1) of the Act and section 1(b) of the Policy Direction.

24. Videotron and the other network providers have invested billions of dollars in their high-speed networks, and continue to invest hundreds of millions of dollars annually to increase capacity and reliability, most notably by splitting nodes and pushing optical fibre further and further into neighbourhoods. Wholesalers make no comparable infrastructure investments.

25. Quebecor Media calls upon the Commission to correct the current inequity by varying TRP 2011-703 so as to replace the fixed capacity rate for each network provider by a

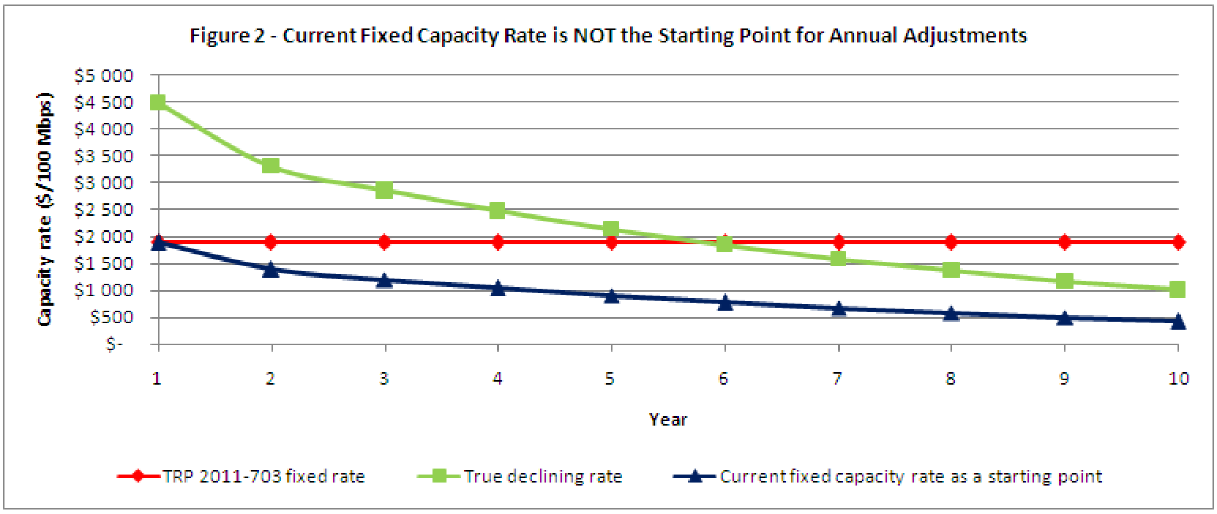
declining capacity rate determined in such a manner that the weighted average of the declining rate over the study period equals the fixed rate determined in TRP 2011-703.

The Current Fixed Capacity Rate is **NOT** the Starting Point for Annual Adjustments

26. To avoid any confusion that may arise during consideration of this application, Quebecor Media wishes to emphasize to the Commission that the fixed capacity rate set for each network provider in Appendix 1 to TRP 2011-703 is **NOT** the starting point for annual adjustments to the capacity rate over the course of the study period.

27. As shown in Figure 1 above, the fixed capacity rate set in Appendix 1 to TRP 2011-703 is already a weighted average of the true declining capacity rate over the course of the study period. It is already below the true capacity rate that should properly exist in the early years of the study period. To allow capacity rates to decline even further from this already artificially low benchmark would only worsen the competitive harm done to network providers.

28. To see why this is the case, refer to Figure 2 below. A blue line has been added, which is a hypothetical line depicting what might happen if the Commission were to erroneously use the current fixed capacity rate as the starting point for annual capacity rate reductions. We recall that the total variable costs to be recovered under the red and green lines (roughly depicted by the area under each line) are the same and are equal to the Videotron's total variable costs over the study period, as determined by the Commission. In stark contrast, the total variable costs to be recovered under the blue line (roughly depicted by the area under the blue line) are dramatically below the total variable costs to be recovered under the red or green lines. There is no possible way the network provider can recover its investments under the scenario depicted by the blue line.



29. The scenario depicted by the blue line in Figure 2 above is also the scenario that would emerge if the Commission were to order network providers to redo their cost studies every year, each time calculating a new fixed capacity rate for the duration of the study period. Network providers would find themselves in a perpetual first year of their study period, always subsidizing their wholesale competitors, and never reaching the elusive outer years when the subsidies will end.

30. The fundamental flaw in the Commission's fixed capacity rate ruling derives from the fact that capacity costs per unit of demand are not fixed over the course of the study period. The only way to correct this flaw is by eliminating the artificial fixed capacity rate and replacing it by a capacity rate that declines over the course of the study period.

31. This declining rate schedule need not be a source of uncertainty or administrative inconvenience. The entire rate schedule, for the duration of the study period, could be set now. It would certainly constitute a truer reflection of underlying cost trends than the artificial and competitively inequitable fixed capacity rates currently found in Appendix 1 to TRP 2011-703.

Conclusion and Requested Relief

32. Quebecor Media submits that there is substantial doubt as to the correctness of TRP 2011-703 due to the Commission's failure to consider a basic principle which had been raised in the original proceeding, namely the principle that the cost of providing high-speed capacity is not constant over time. As relief, we request that the Commission vary TRP 2011-703 by replacing the fixed capacity rate for each network provider by a declining capacity rate determined in such a manner that the weighted average of the declining rate over the study period equals the fixed rate determined in TRP 2011-703.

33. Failure to grant the requested relief will leave in place a situation where network providers are forced to confer substantial subsidies on their wholesale customers in the early years of the study period, with little likelihood of recuperating these subsidies in the later years. Such a situation denies network providers a reasonable opportunity to earn a fair return on their network investments, in contravention of the Commission's obligation under section 27(1) of the Act to ensure that rates charged for telecommunications services are just and reasonable and the Commission's obligation under section 1(b)(ii) of the Policy Direction to ensure that regulatory measures do not promote economically inefficient entry.

34. All of which is respectfully submitted.

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