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PHILIP B. LIND

VICE CHAIRMAN

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SUSTAINABLE COMPETITION ON THE INFORMATION HIGHWAY

Over the past year or so, the media have been full of stories about the growing number of users on the Internet and about the wide variety of new services which will be available on the "information highway".

The vast majority of these stories have been positive. They assume that the information highway will stimulate economic growth, generate new opportunities for Canadian expression and enhance Canada's education system.

I share this optimistic view, but I also want to add a strong note of caution.

This year, federal policy-makers and the CRTC will make a number of important decisions which will influence the pattern of the communications landscape for many years to come. The first of these came last Friday with a major report by the CRTC on competition and culture on Canada's information highway.

As was evident in last Friday's report by the CRTC and in the Order in Council which initiated it, there is now a very deep commitment to the concept of competition in the federal government. Federal policy-makers and the CRTC believe that competition will result in more rapid technological innovation, increased choice in services, lower prices and will contribute to the free flow of information in our society by maximizing opportunities for the presentation of diverse points of view.

Many people today agree that this is sound public policy.

However, what remains to be seen is whether the federal government has a similar commitment to ensuring that competition in various parts of the communications industry can survive and thrive. This is the real challenge facing federal policy-makers today.

And make no mistake. The promise of last week's headlines which bravely announced "consumer choice" following the release of the CRTC report will only be realized if there are cable television companies and other competitors strong enough to offer that choice when the full financial might of the monopoly telephone companies is unleashed.

The dominant monopoly telephone companies have immense economic power and strong incentives to use this power to engage in a wide variety of anti-competitive activities. Unless this power is checked and these incentives eliminated, we will never have sustainable competition in Canada in any of long distance, local telephony or cable television. Instead, we will just come full circle, back to a bigger and far more menacing telephone company monopoly.

This decidedly would not be in the public interest and we should take steps to prevent it.

Perhaps this is a case where we could learn from others.

The US has one of the most competitive economies in the world. For more than a century, policy-makers there have understood the importance of establishing and enforcing conditions to ensure sustainable competition, even when this has meant taking on some of the largest and most successful companies in the country.

The Sherman Act makes conspiracy in restraint of trade and monopolization of trade an offence, enforceable through a civil or criminal prosecution brought by the Department of Justice or by private civil action. The Clayton Act provides for treble damages in the case of a successful private civil action.

In the 1890's, Standard Oil exercised near monopoly control over all segments of the oil industry in the US. The Department of Justice successfully brought a suit against Standard Oil which alleged that the company was using its dominant position to engage in a wide variety of anti-competitive practices and to control prices to consumers. Standard Oil was broken up into thirty-three separate companies, which formed the basis for the competitive oil industry in the US today.

In 1974 the Department of Justice launched a suit against AT&T. The Department identified many specific acts by AT&T which violated US competition law. It alleged that these acts constituted a consistent pattern of abuse designed to disadvantage competitors and to impair the development of effective competition in the US telecommunications market.

The suit against AT&T was settled in 1982. AT&T was allowed to retain ownership of Western Electric, its equipment manufacturing company, and of its long distance telephone service division. It was required to divest of all of its local telephone companies.

Before divestiture, AT&T had both the means and the incentive to engage in a wide variety of anti-competitive behaviour to undermine effective competition in long distance.

After the divestiture, AT&T could no longer rely on cross-subsidies from monopoly local telephone service and on other anti-competitive practices to disadvantage competitors. It had to face up to competition fair and square.

Just five years after the divestiture, prices for long distance had fallen dramatically and total long distance minutes had doubled. AT&T's share of the market fell by 30%, but its revenues increased by almost 70%. New competitors, such as MCI and Sprint, saw their revenues grow from almost nothing to over $10 billion.

Today, competition in the US telecommunications industry is the standard against which other countries compare themselves.

For example, in his most recent review of competition in telecommunications in the United Kingdom, the Director General of Oftel, the British equivalent of the CRTC, stated that he was trying to:

> "establish why the USA enjoys a wider range of telecommunications services than the UK, and why there is a greater diversity of companies providing services in that country."

The answer, I believe, was that US policy-makers were suspicious of the immense power of the AT&T monopoly and took strong action to stop abuses based on this power. The British, on the other hand, did not take similar steps with British Telecom.

More recently, in this past year, the US Department of Justice has turned its attention to competition in the computer software industry and in particular to Microsoft, the world's largest and most successful computer software company.

In July 1994, the Department reached an agreement with Microsoft which requires the company to change the way it licenses the use of its operating system software. As well, the Department has successfully blocked Microsoft's proposed acquisition of Intuit, the producer of market-leading financial software packages.

In these cases, the Department was not so much concerned with the current dominant position of Microsoft as it was with the potential for Microsoft to use this dominant position to control the development of and to thwart competition in a wide variety of emerging computer software and services markets.

As we in Canada consider policies to promote competition on the information highway, we too should be concerned about the potential for some companies to use their dominant position in one market to control the development of and to thwart competition in other markets.

The monopoly Canadian telephone companies which are members of the Stentor cartel are huge and powerful economic forces in each of the regions of the country in which they provide service and collectively in the national economy as a whole.

In 1993, Bell Canada alone, which serves Ontario and Quebec, had revenues of almost $8 billion. That's about four times the revenues of the entire Canadian cable television industry.

In 1993, the Stentor member companies had combined revenues of over $14 billion, making this cartel larger than all but one other Canadian company -- Bell Canada Enterprises, or BCE as it is commonly known.

In 1993, BCE -- the parent company of Bell Canada, Northern Telecom, Bell Mobility and other well-known Canadian companies -- had revenues of over $20 billion, increasing to almost $22 billion in 1994, making it by a very wide measure the largest Canadian company.

In contrast, AT&T is currently only the fifth ranked company in the US by revenues, with about half the revenues of companies like General Motors and Ford. It is surrounded by such economic powerhouses as Exxon, Wal-Mart, Mobil, IBM and General Electric.

In Canada, BCE stands alone at the top of the revenue heap, with its nearest rival more than $4 billion behind in 1993. No one else is even close.

Today, the monopoly telephone companies in Canada are at least as powerful in relative terms, if not more powerful than AT&T was in the US before divestiture.

And they behave like AT&T did before divestiture.

Over the past fifteen years, the CRTC has regularly found the monopoly Canadian telephone companies to be engaging in, or seeking to engage in a wide variety of anti-competitive practices, including the cross-subsidization of competitive services from monopoly services and the denial of access by competitors to bottleneck services and facilities.

No competitor -- actual or potential, large or small -- has escaped the attention of the telephone companies.

Competitive suppliers of mobile telephone equipment, paging services, cable companies seeking access to telephone company support structures, competitive suppliers of residential and business terminal equipment, cellular services and long distance telephone services have all felt the crushing weight of the anti-competitive actions of the telephone companies.

Nowhere has the attack by the telephone companies been more savage than in the long distance market.

The Canadian telephone companies are using their dominant, vertically integrated position in both the local and long distance markets to eliminate their competitors.

They have slashed rates for long distance services.

They say that these rate reductions are made possible by increased operating efficiencies.

However, the evidence suggests that it is cross-subsidies, not operating efficiencies, which have allowed the monopoly telephone companies to drive their rates for long distance so low, so fast.

The evidence is compelling:

- Stentor entered into a partnership with MCI in the US to strengthen the competitiveness of its member companies' long distance telephone services. Bell subsequently admitted that it had "inappropriately" allocated almost all of its share of the cost of this long distance partnership, totalling $125 million, to the cost of providing local telephone service.

- The CRTC recently found that Bell was allocating more than half of all of its business sales expenses to the cost of providing monopoly local telephone service. It concluded that this allocation was improper and directed Bell to allocate only a fifth of these expenses to local telephone service. This "misallocation" alone amounted to a $46 million a year subsidy by local telephone subscribers to Bell long distance services.

- Today, even though most of the average telephone bill is devoted to an itemized record of long distance calls, subscribers to Bell's monopoly local telephone service pay for almost 90% of the hugely expensive system necessary to produce these bills. Bell's long distance competitors, on the other hand, must pay for their billing systems entirely from the rates they charge for their long distance services.

The monopoly telephone companies have other advantages which they are ruthlessly exploiting.

They know the calling pattern for every telephone customer in Canada. They also know when a customer has chosen to receive long distance telephone service from a competitor. They use this information to launch highly targeted marketing initiatives.

This kind of information is not available to the long distance competitors and should not be available to the telephone company long distance marketers. But it is.

The telephone companies will go to almost any length to disadvantage their competitors. They will contravene their own tariffs, ignore CRTC rules and violate the Telecommunications Act.

Over just the past few months, the CRTC has on four separate occasions found the telephone companies engaged in a wide variety of illegal and anti-competitive practices.

It found that Bell had responded to competition from Mediacasting, a reseller of remote broadcast transmission facilities, by providing competing services to Mediacasting customers for free, in violation of its own tariffs. The CRTC expressed extreme concern with the telephone companies' long-standing non-compliance with its rules on sharing groups. It found that Bell had entered into arrangements with hotels and motels for the provision of long distance service which were contrary to Bell's own tariffs and in violation of the Telecommunications Act. The Commission also found that MT&T had offered improperly bundled services and illegal rebates and concessions to the Government of Nova Scotia, contrary to its own tariffs and in violation of the Telecommunications Act.

The telephone companies say that their extreme actions are necessary to meet intense competition in the long distance market and to stop the erosion in their market share.

In fact, they still have a virtual monopoly in the long distance market.

In 1994, the Stentor member companies captured 94% of all revenues from public long distance services.

The long distance competitors captured just 6% of all revenues from public long distance services after payments to the telephone companies, and lost almost $400 million for their trouble.

Telroute has now gone under and Unitel is losing $1 million each business day.

Competition in long distance will not survive much longer under these conditions.

The ferocious attack by the telephone companies on the long distance competitors has not distracted them from other attacks on a whole range of potential or actual competitors, including cable television companies.

The CRTC has declared that it is appropriate for telephone companies, hydro companies and cable companies to share poles and underground ducts wherever possible. It would not be in the public interest to erect three sets of poles along every street.

In spite of this, the telephone companies continue to seek every opportunity to deny cable television companies access to their support structures on fair and reasonable terms.

For example, NB Tel initially refused to allow Fundy Cable to attach fibre optic cable to its support structures unless Fundy agreed to severe, anti-competitive conditions on the use of this cable and paid rates that were twice those for ordinary coaxial cable.

In downtown Toronto, Bell has denied Rogers Cable access to its underground ducts on the ostensible grounds that Bell must save space to meet its own possible requirements over the next 20 years, despite the fact that these underground ducts should now be getting much less crowded since fibre optic cable takes up much less space than comparable capacity copper wire.

BC Tel has entered into restrictive agreements with its unions which prevent cable television company personnel from placing their own equipment on BC Tel support structures.

I could go on, but I think the point is clear.

The dominant, integrated monopoly telephone companies have immense economic power. In every market in which they directly participate and in which they face competition, they have both the means and the incentive to use this power to unfairly disadvantage competitors.

Federal policy-makers and the CRTC are now taking steps to introduce competition in the local distribution market.

Canadian direct broadcast satellite services, providing programming services in competition with cable, will be available within a few months.

Last Fall, the CRTC said that it was prepared to consider applications by cable television companies and others to provide competitive local telephone services. It is now reviewing a submission from the telephone companies on how such competition could be introduced.

In its report last Friday, the CRTC proposed rules to govern entry by the telephone companies into the cable television business. Based on these proposals and proposals which may be contained in the upcoming report by the Information Highway Advisory Committee, federal policy-makers will be in a position to establish a clear and comprehensive policy framework for local competition.

There are three key policy principles which must form part of this policy framework to ensure effective and sustained competition in the local distribution market:

1. On a going-forward basis, telephone companies should be allowed to enter competitive markets only through structurally separate subsidiaries, with on-going and rigorous regulatory monitoring of inter-corporate transactions.

The dominant, integrated monopoly telephone companies have immense economic power. In any market in which they face competition, they have both the means and the incentive to use this power to unfairly disadvantage competitors.

The only exception to this rule is in cellular telephone service in British Columbia, Ontario and Quebec.

In these provinces, the telephone companies were required to provide their cellular telephone services through structurally separate subsidiaries, subject to on-going regulatory monitoring of inter-corporate transactions. Cellular competition in these markets is flourishing. In fact, it is the only place where competition actually is working in Canada. Prices are lower and the penetration rate is much higher than would otherwise have been the case.

The US Congress is now reviewing a number of bills to update communications legislation in that country. These bills would allow the US telephone companies to enter the cable television business only on the condition that they do so through structurally separate subsidiaries.

Structural separation is the only approach which has proven effective in ensuring sustained competition in Canada and in the US in markets in which telephone companies participate. It is the only approach which will eliminate both the opportunity and the

incentive for telephone companies to engage in a wide variety of anti-competitive practices to unfairly support their entry into new markets, such as the cable television market.

2. Competition in the local distribution market should be based on regulatory symmetry. Telephone companies should not be allowed to enter the cable television market before cable can enter the local telephone market.

At the CRTC Convergence hearing, the telephone companies argued that since the local telephone market was now open to competition, they should immediately be allowed reciprocal entry into the cable television business.

However, in the proposal which they later filed with the CRTC, the telephone companies identified a number of difficult issues, including local number portability and rate rebalancing, which must be resolved before it will be possible to have effective competition in local telephone service.

In the meantime, incredible as it might seem, the telephone companies are now seeking to implement a strategy to re-monopolize the local telephone market even before competition has been introduced.

Bell has asked for permission to pre-emptively reduce local telephone rates in larger urban markets -- where it might face competition -- and to increase rates in smaller, more rural markets where competition is less immediately likely.

The Stentor companies also have said that, no matter what happens in a competitive local telephone market, they should always be "made whole" because they have a "social contract" to provide basic telephone service to all customers. They say that if competitors are successful in gaining customers by providing a superior local telephone service, then these competitors should be "punished" by having to give the majority of their revenues from these services to the telephone companies -- who lost these customers in the first place.

At the same time, the telephone companies are telling shareholders that they have no intention of honouring their "social contract".

In the 1994 BC Tel Annual Report, Lynn Patterson, President, BC Tel Sales and Services, wrote:

> "we are learning that we no longer can be expected to serve all market segments, or continue to be all things to all people. As we find innovative ways to say 'yes' to customers, we're also learning how, when and why to say 'no'.
>
> This requires a significant cultural shift for employees accustomed to a service-oriented, not retail-oriented, world. I know it's not easy to tell customers we no longer provide the subsidized services or products they have come to expect from us."

The telephone companies' strategy is clear. They want to be allowed to enter the core cable business while they maintain and make it as difficult as possible to remove barriers to competitive entry into the local telephone business. At the same, they want to establish conditions which will ensure that if and when competitive entry does occur, it will not be successful.

In contrast, our position on competition is quite straight forward.

We accept competition in the cable television market from the telephone companies, provided that it does not involve cross-subsidies from monopoly local telephone service to the video distribution arm of the telephone company.

Unlike the telephone companies, we are not seeking to be "made whole" or to be compensated in any way for loss of market share. Instead, we are asking for regulatory symmetry.

We believe that telephone companies should not be allowed to enter the cable television market until they have taken all possible steps to remove the barriers to competitive entry into the local telephone business. The best way to accomplish this is to establish policies which make telephone company entry into the cable television business conditional upon the removal of these barriers.

The CRTC endorsed this approach to telephone company entry in last Friday's report. It stated:

"It is essential that many of the issues surrounding local telephone competition be resolved before any applications by telephone companies for broadcasting distribution licences (e.g. entry into the core cable business) are approved."

We will continue to urge federal policy-makers to match this conditional entry approach with a requirement that telephone companies enter the cable television business only through structurally separate subsidiaries. Only with these two conditions in place can we be assured of effective and sustainable competition in the local distribution market.

3. Specific conditions to ensure effective and sustainable competition must be accompanied by commitment to the vigorous enforcement of Canadian competition law.

In the US, many Members of Congress and members of the Clinton Administration are saying that they want competition law to continue to play a prominent role in the development of the US communications industry.

Competition law also should play an important role here in Canada in the development of our communications industry, as a further check on the potential for anti-competitive behaviour by the dominant telephone companies.

Stentor is an unregulated consortium through which the monopoly telephone companies behave in a cartel-like fashion to co-ordinate the services which they provide and to undertake joint marketing and lobbying initiatives. The members of Stentor respect each others' geographic monopoly. They do not compete against each other.

The Director of the Competition Bureau has launched a proceeding to review the formation of Stentor. I hope that he will take action to mitigate the anti-competitive impact of this huge and powerful cartel. However, I must say that thus far I am deeply disappointed at the lack of meaningful action taken by the Director.

In the future, the Director will need to be ever more vigilant to guard against anti-competitive behaviour by the telephone companies as they are allowed to enter many new and different markets.

Last Fall, the CRTC opened the door to the telephone companies to directly enter the information services business. In the report which it released last week, the Commission proposed that the telephone companies be allowed to own radio and television stations and other programming services through structurally separate subsidiaries.

These are very high stakes policies.

What if the hugely powerful Canadian telephone companies behave in the content market in the same sinister and menacing ways as they behave in the telecommunications market?

There are already clear indications that they will.

The Director recently found that the Yellow Page publishing divisions of the Stentor companies were engaged in anti-competitive practices with respect to the sale of national advertising. The Stentor companies have now accepted a consent decree which requires them to allow independent selling companies to enter the market.

This is their record so far in the content market in Canada.

Left to their own devices in this market in the future, we can expect the telephone companies to cross-subsidize and by any and all other means seek to advantage themselves and to disadvantage their competitors.

That is what they know. That is how they do business.

And they clearly have the resources to dispatch any competitor in the content market who happens to get in the way.

Bell Canada alone has more than twice the annual revenues of the five largest broadcasting and cable companies in Canada combined. BCE had higher revenues in 1993 than the top twelve Canadian printing and publishing companies combined.

If federal policy-makers are committed to competition on the information highway, this commitment must be accompanied by a new commitment to the vigorous enforcement of Canadian competition law

as a further check on anti-competitive behaviour by the dominant telephone companies.

In the short term, this commitment could be expressed by providing the Director with additional resources to support more extensive and speedier enforcement actions. Beyond this, the government should consider establishing a right under the Competition Act for treble damages from successful private civil suits.

As I said at the beginning of my speech, I believe that the information highway does hold great promise for the Canadian economy, for Canadian expression and for Canada's education system. I also agree that competition is most likely to maximize these benefits.

However, competition on the information highway is not guaranteed.

If policy-makers are committed to competition, then they must take the actions necessary to ensure that competition is effective and sustainable.

They must take action to ensure that the promise of "consumer choice" is in fact realized.

If we do this, we will give Canada and all Canadians the best chance to thrive and prosper in a new age.