Oral Presentation by VMedia Inc. Before
The Canadian Radio-Television and Telecommunications Commission

Telecom Notice of Consultation CRTC 2013-551

November 24 - December 3, 2014

1. Thank you Mr. Chairman, Vice-Chairmen, and Commissioners.

2. My name is Alexei Tchernobrivets and I am the CEO of VMedia Inc., an independent internet service provider. To my right is VMedia's advisor, George Burger.

Background

3. The range of issues considered in these proceedings is broad, and much of the analysis and commentary on most matters relating to the interests of independent ISPs have been extensively and expertly addressed by CNOC and others in their submissions and appearances at these hearings.

4. VMedia is the only ISP offering a triple play alternative to consumers in all of the markets of Ontario dominated by incumbent telcos, featuring its own BDU and home phone services. The central focus of its business is the development of a competitive, compelling and innovative IPTV-delivered BDU service. As such VMedia has a unique perspective on the importance of the outcome of these proceedings, and the extent to which that outcome will determine choice, fair-pricing and innovation for Canadians.

5. VMedia will limit its comments to the relationship between the wholesale service issues under consideration, and the ability to create and nurture a competitive environment in which diverse and fairly priced video content is permitted to flourish. That video content includes not only content delivered on its own BDU service but also (i) over the top content exempt from regulation pursuant to orders by the CRTC

issued from time to time, (ii) the ability of a grandmother to communicate with her grandchildren face to face on Skype wherever they may be, (iii) the ability of educators to most effectively communicate their knowledge to students around the world, and (iv) the ability of doctors, scientists and other thought-leaders to share their experiences and maximize outcomes for the betterment of all.

6. Moreover, VMedia seeks to help develop a market in which ISPs like VMedia can compete with the duopolies to serve residential homes with the sort of bundle offerings that Canadian homes, over 83% of them according to a recent J.D.Power report[1], demand.

7. VMedia hopes that in the course of these proceedings there is a recognition that:

    a. internet service cannot be considered in isolation from other services that comprise bundles;

    b. video distribution over the internet is the ultimate "killer app", and is an integral part of the process of determining wholesale internet access policies; and

    c. that a fair wholesale framework within which independent ISPs can strive and survive is an essential underpinning to a robust competitive market for bundled services that will benefit Canadian consumers.

8. While the residential internet market is substantial, with nearly $6 billion in revenues in 2013, and alone merits a supportive wholesale framework, the BDU market, with nearly $9 billion in revenues in 2013, raises the stakes considerably. For at this point, the only new entrants which would be able to provide choice in BDU services to Canadians across the country, alternatives to the duopolies which currently dominate the market, are ISPs.

9. Accordingly, as go these proceedings, so too will go the ability of Canadians to enjoy all of the rich, diverse content that the internet can deliver to them, including BDU services, at fair prices.

10. Our comments are comprised of three parts. The first is our view of the current competitive environment in Canada, the second, a discussion of the importance of fair pricing in wholesale services to enable competitors to enter the market and

[1] J.D. Power 2013 Canadian Television Provider Customer Satisfaction Study.

provide alternatives for Canadians, and third, our responses to the three areas of focus set out in the Commission's letter of October 23.

The Competitive Environment

11. VMedia is acutely aware of the fragile state of competition in the delivery of content in its market. Surrounded by behemoth vertically integrated entities which are both its suppliers and its competitors, VMedia's ability to establish a robust business which is capable of delivering the competition which Canadian consumers want and deserve is difficult in the best of circumstances, but it is severely constrained in the absence of a fair, if not entirely level, playing field.

12. From VMedia's point of view, these proceedings will determine whether Canadians will be limited to duopolies in virtually all the major markets throughout Canada in the delivery of services - television, internet and phone - which in the aggregate generate over $50 billion in revenues for the four largest incumbents in the country.

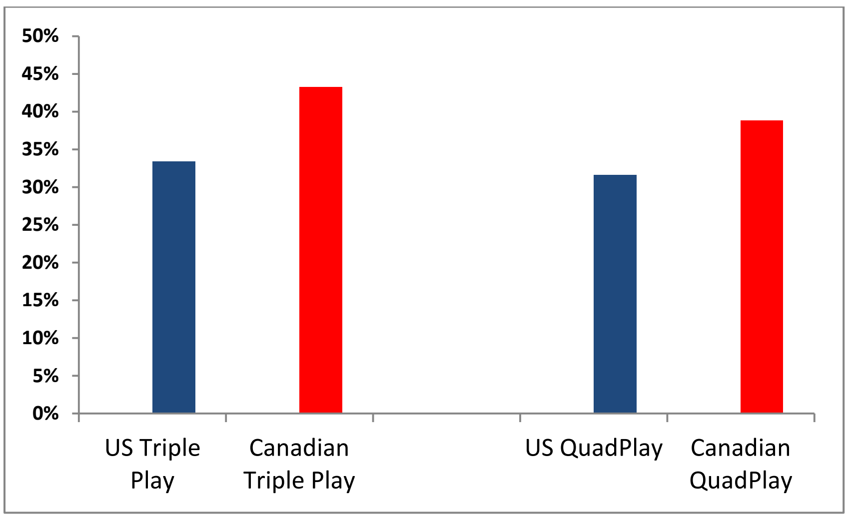
13. Put in perspective, in most of those markets, for most of those services, and certainly for a triple play bundle, Canadians are limited to a choice of two suppliers from among four companies that dominate the fourth biggest industry in Canada after only banking, food and natural resources. This is an unacceptable concentration of services and market power, and underscores the importance of these proceedings.

14. If the proceedings result in a framework in which ISPs have access to bandwidth at prices which will allow them to offer internet and IPTV services at competitive prices, even as usage continues to inexorably rise, and one in which service levels required of incumbents in providing that bandwidth enable ISPs to provide the best possible service for their customers, consumers may yet experience robust choice in their bundles and services.

15. It is useful to compare consumer choices between the major cities in each of Canada and the USA, Toronto and New York City. Both Toronto and New York City are served by four different content delivery platforms. But that is where the similarities end. A consumer in Toronto has two satellite-delivered BDU services and two terrestrial ones available to her. One of them, Shaw Direct, is virtually invisible in the market, concentrating its marketing on its home territories in Western Canada. That leaves three platforms, but really two providers, with Bell TV delivered on both satellite and IPTV.

16. In New York City consumers can choose between Time Warner Cable, Verizon's FiOS, Direct TV and DISH. Four unrelated platforms, competing vigorously for subscribers.

17. The results of this competition is reflected in numbers. The best way to determine whether consumers have the benefit of competitive pricing between markets, excluding unique market differences, is to compare margins. As the simple chart below shows, in comparing the EBITDA margins of triple play providers in the respective markets, margins in the USA are on average 10% less than in Canada. Among quad play providers, the margin difference, again to the benefit of Canadian providers, is 7%.



18. This comparison, when applied to the revenues of the companies in question, translates into over $5 billion in excess costs to consumers at the high end, and $3.5 billion at the low.

19. It is important to note that this analysis contradicts the claim that higher prices are justified to account for geographic differences, and the capital expenditures related to accommodating those difference. Margins are margins, ROI is ROI, and despite those geographic challenges Canadian companies are generating margins up to third greater than their US counterparts.

20. VMedia acknowledges that these are telecom hearings, and the focus is on internet services in particular. Unfortunately the costs related to the various business segments of the incumbents are not segmented so it is difficult to show the margins relating to the respective services. However, we remind the Commission that one of the incumbents presenting at the "Let's Talk TV" hearing acknowledged that its TV

services generated a gross margin of 70%, while its internet margins were 100%. So we can only assume that these numbers do not unfairly characterize the disparity relating to telecom services - or the substantial margins attributable to them.

21. VMedia acknowledges that delivering its competitive and innovative bundle alternative to consumers is dependent on its ability to obtain access to bandwidth on economical terms, based on reasonably determined tariffs which reflect the true cost of those services to the wholesale suppliers, and a fair return. As such the central consideration for VMedia or any other ISP in formulating any business plan that provides bundle alternatives, is the ability to benefit from fair pricing. In VMedia's view, fair pricing is currently not a feature of the existing framework.

Fair Pricing

22. VMedia's central strategy is to provide as much choice and flexibility in content consumption to Canadians as its technology can deliver. VMedia is content agnostic, encouraging its subscribers to watch regulated television as well as over the top content without limitation. However, the core of VMedia's business, and central to its profitability, is its BDU business. VMedia delivers its BDU service on an IPTV platform, and as such its cost of delivering those services to its subscribers includes not only the wholesale cost of channels but also the bandwidth required to deliver that content. That bandwidth is, of course, acquired from incumbent telcos.

23. Accordingly, in order to enable VMedia to deliver content of a quality matching that distributed by incumbents, VMedia must be assured of the affordability of its internet service to consumers. If the wholesale pricing of the services VMedia acquires from incumbents is not fairly arrived at, VMedia's business model is impaired, and its ability to compete at a quality of service level comparable to VIEs is diminished.

24. VMedia has developed processes and adapted technologies to maximize quality while reducing bandwidth consumption. VMedia delivers content consuming on average over three megabits per second of speed. This is in comparison to seven plus megabits per second which VMedia understands is deployed by incumbent IPTV services.

25. Notwithstanding that, in order to be able to compete in the long-term through the provision of content delivered with the same speeds as that used by the incumbent IPTV providers, it is even more important for VMedia to be able to provide similar speeds and still compete on pricing, sustaining VMedia's value proposition.

26. The key element in enabling it to do so is fair pricing for bandwidth.

27. Specifically, at current tariffs, in order for VMedia to replicate the quality of service delivered by the incumbent IPTV services, based on the foregoing assumptions, VMedia would have to pay nearly $100 wholesale ($25.60 fixed monthly access rate per subscriber, plus $10.36 X 7Mbps) for the capacity it would require to ensure it could deliver those speeds to its subscribers at peak. Together with other costs and a reasonable markup, its retail cost would be $140, a price at which VMedia could not compete.

28. The price compares with internet service available from the incumbent which retails at $64.95 per month, and even less in a bundle.

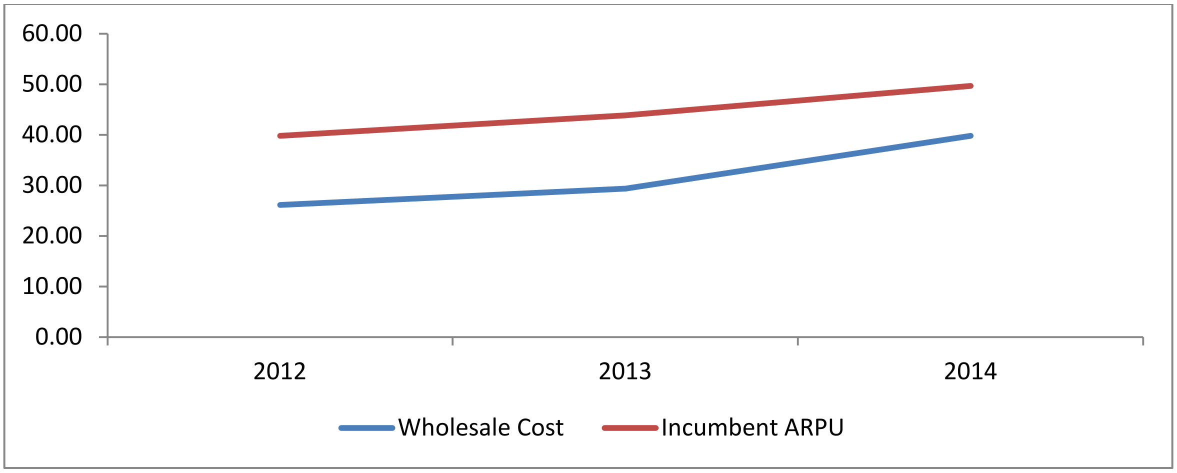
29. VMedia submits that this disparity must be considered in these proceedings because its perpetuation, which appears to be unjustified, will severely impede the ability of VMedia or any other new player to deliver the level of competitive services which Canadians demand and deserve.

30. In effect, by including a constant seven Mbps use with the IPTV service, the incumbent IPTV customer is getting the video-related capacity for free, capacity for which VMedia is required to pay $72.52 wholesale. This raises questions regarding undue preference shown by the incumbent's wholesale internet service in favour of its IPTV division, and discriminatory pricing imposed on VMedia and other potential competitors.

31. As mentioned above it is impossible based on the publicly filed financial statements to determine the cost to incumbents of their internet services, other than the comment of an incumbent we referred to previously. However, VMedia does have a estimate of the increasing cost of wholesale services from at least one provider, as well as the ARPU trend for internet services as derived from the 2014 Communications Monitoring Report[2].

32. The chart below describes the respective trends, and infers an incompatibility between the rising cost of wholesale bandwidth, and incumbent ARPUs.

[2] Table 5.3.6.



33. The chart reflects a dramatic move in a very short time in wholesale prices. In that period, between an increase in the tariffed basic end-user charge and CBB, wholesale prices increased at a CAGR of over 23 per cent. In that period, the incumbent ARPU increased at a CAGR of 12% per cent. The respective increases in the last year were 35 per cent and 13 per cent.

34. This trend is alarming enough, but admittedly covers a brief period. However, the chart below shows the impact of projecting those trends out just five years. The assumptions driving the growth of wholesale prices is based on a recent study[3] commissioned by NLKabel, the Dutch telco, and CableEurope, the European trade association representing telcos in the EU.

35. The study projects a CAGR for downstream traffic demand of 40 per cent. Our own observations of growth in these relatively early days of the availability of high-quality video over the internet is 30 per cent over the three years since CBB was adopted, and so we have applied that measure going forward.

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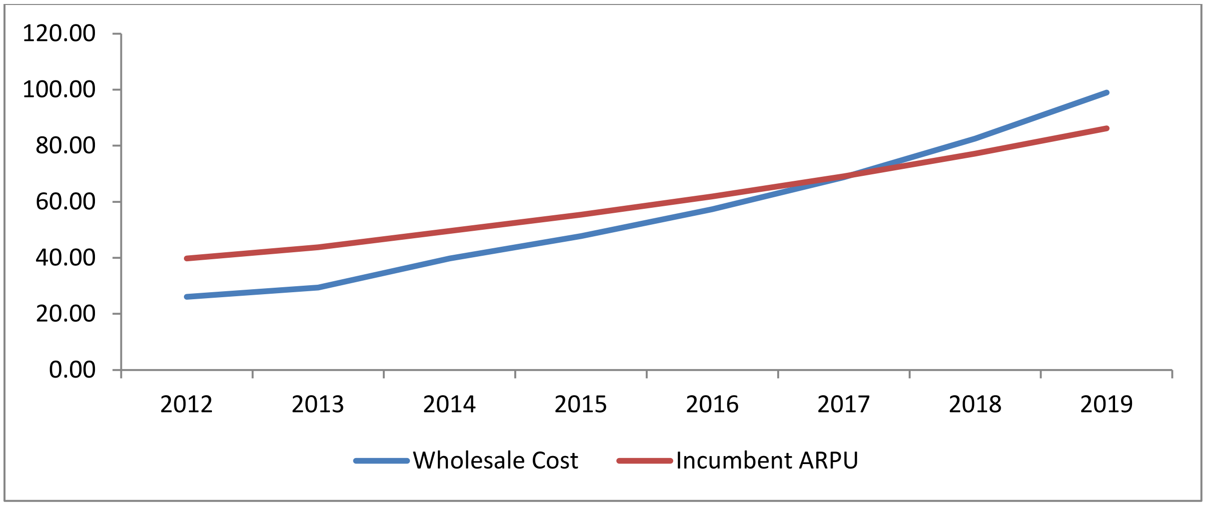
[3] *Fast Forward » How the speed of the internet will develop between now and 2020*, June 2014, Dialogic and the Eindhoven University of Technology, Part 6, beginning at Page 35,



36. The chart shows that based on projected traffic growth trends, under the current CBB regime wholesale prices will exceed retail prices in just over two years. It is not difficult to predict what kind of an impact that will have on the independent ISP sector, and the ability of ISPs to provide alternatives to incumbents in offering triple play services to the market.

37. VMedia believes that a renewed focus on wholesale pricing, with a view to addressing and correcting these obvious disparities, will result in a fair pricing framework that will avoid recourse to costly proceedings before the CRTC, and the end of meaningful competition in the provision of these key services that are so central to the lives of Canadians.

The Three Areas of Focus

Wholesale Services Framework

38. In our view the current framework is written too narrowly to serve the new environment within which telecom services are provided. As VMedia has attempted to show in these comments, in the current environment wholesale wireline service issues, almost exclusively focused on internet service, are inextricably linked to the provision of video services, and more particularly BDU services. Policy objectives to ensure a competitive landscape in providing both services are dependent on the outcome of these proceedings. Similarly, in order for the proceedings to achieve that outcome, the framework has to be expanded to allow consideration of issues which more formally would be within the purview of the Broadcasting Act.

39. At the "Let's Talk TV" hearing comments regarding competition in the BDU sector inevitably touched on competition in the provision of internet service, but discussion

was forestalled as those matters were reserved for telecom proceedings. VMedia respectfully submits this divide should no longer be observed by the Commission.

40. VMedia recommends that the scope of the framework, the areas which it seeks to encompass, the issues which it considers in its application, and the very structure of that framework, ought to feature an integrated approach which acknowledges that as goes the state of competition in internet services, so goes competition in the highly concentrated BDU sector.

41. In addition to the better integration of broadcasting policy issues into the process, the framework should more extensively consider approaches that would enable ISPs to economize on bandwidth usage through tariffed access to points of interconnection and other facilities, for example installing equipment to cache content, and other solutions for reducing last mile capacity usage.

42. Finally, in view of the apparent disparity described above in the provision of bandwidth for IPTV customers, a greater emphasis ought to be placed on undue preference regulation, and self-dealing, to integrate internet pricing into the VIE code, to the extent that such disparities unduly lessen competition.

Specific Wholesale Services

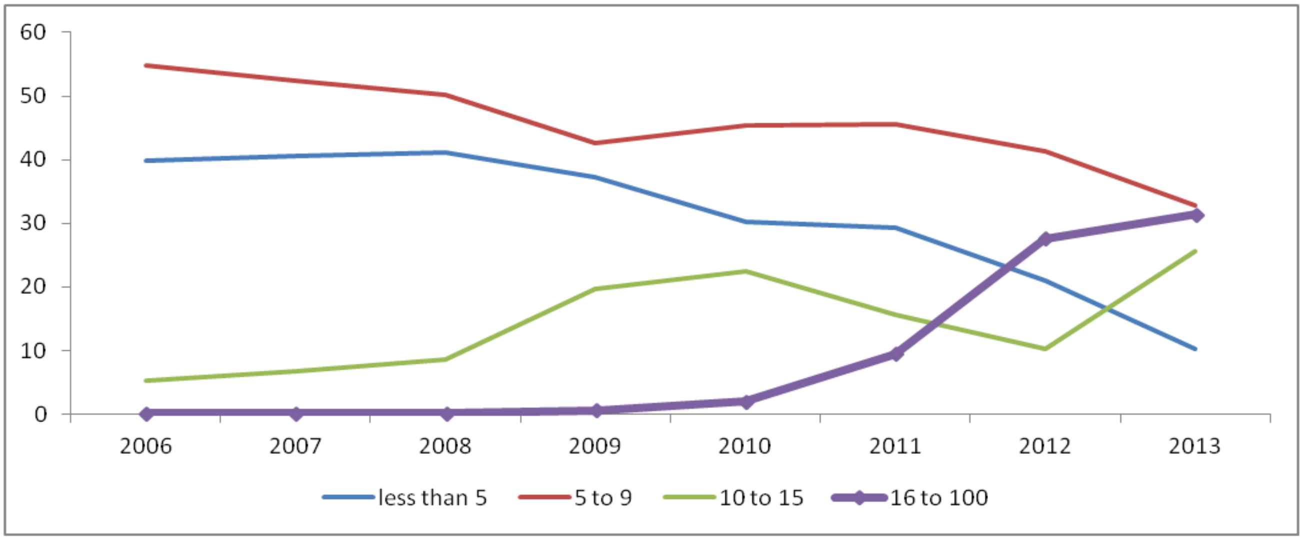
43. Our comment on specific wholesale services is limited to the question of whether FTTP should be a mandated service made available to ISPs at fairly determined rates.

44. There is no question that FTTP should be a mandated service. The general issues regarding whether incumbents would continue to build out FTTP facilities in such a regime have been ably addressed in detail by CNOC and others, and we will only reinforce the view that whatever detrimental impact giving the ISP community access might have, is far outweighed by the business opportunity to grab increasing amounts of cablecos' market share. That, coupled with a fair price for access to ensure a reasonable rate of return, will ensure that the investment will continue to be made.

45. VMedia does however wish to categorically reject any suggestion that FTTP represents part of the existing market, and that it is substitutional with existing services. As the following chart shows[4], there is a growing need for speed in the

[4] Communications Monitoring Report, 2014, Table 5.3.10, and equivalent tables from preceding years.

market, an insatiable appetite driven by video consumption. The CableEurope report dramatically reinforces this trend[5].



46. The percentages, to be clear, reflect market share, not growth rate. In just four years the "16Mbps and over" segment has grown nearly exponentially from near zero to over 30% of the market. This reflects a combination of higher cable speeds and the introduction of high-speed ADSL service.

47. The trend clearly reflects an increasingly widespread demand for speed, and each new platform that increases access to speed creates its own new market in the face of such demand. An analogy would be to the introduction of colour television. If colour TV were only made available to one retail store, all other TV stores would over time go out of business, simply because the public appetite was so strong for colour TV. As it happened there were multiple providers almost from the outset, but the demand was so strong that pricing on an exclusively marketed basis would likely have extracted exorbitant margins, especially once all retail competitors had been put out of business.

48. FTTP, particularly with its unique ability to enhance the TV viewing experience, would not only impair an ISP's ability to compete in terms of internet service, but completely frustrate its ability to compete as a BDU.

[5] Ibid, Page 47.

Wholesale Rate Setting

49. Regarding the wholesale rate setting process, only one modification that has to be made: complete transparency. The recent rate setting processes have from VMedia's perspective been flawed and unsupportable, starting with the obvious issues with the UBB decision, and then the complicated and inconsistent results of the CBB process. In each of those cases, despite an intense effort by ISPs to be involved and to analyse costing inputs, the inability to examine key information has relegated ISPs, certainly VMedia, to feel like we are looking at shadows on a wall.

50. We are left to question outcomes based on inference, such as our earlier discussion regarding margins, or the disparity in bandwidth costs for IPTV services. We can be nothing less than skeptical about outcomes when CBB costs after much examination are determined to range between $3 and $24 per Megabit, among incumbents asking for CBB, to an acceptable flat rate for other incumbents apparently content to bear the risk of increased demand.

51. As an incumbent executive mused at the time of the CBB decision, he had thought everybody's cost is pretty much the same. Knowing that, the range is particularly egregious, but more importantly, the costing elements cannot be so sensitive that they can not bear full examination by ISPs and their advisors, to ensure a robust and vigourous process leading to an unimpeachable outcome.

52. Finally, with regard to that rate setting, in view of the constantly falling cost of equipment, and the increasing ARPUs of incumbents, it must be recognized that the return on investment measure is constantly changing. Accordingly, under the appropriate circumstances, the determined rates should be reexamined as frequently as necessary to ensure fair pricing.

Conclusion

53. The impact on our culture of the internet, with its diversity, ease of access and, properly priced, its universal affordability, is transformative. The entertainment, the knowledge, and the interconnection that video content over the internet affords offers previously unimagined benefits. This technological marvel cannot be squandered by its sequestration in the hands of a small number of gatekeepers which, through their control of the means of access, or of the content itself, make its bounty prohibitively expensive.

54. VMedia again thanks the Commissioners for this opportunity, and will be pleased to answer your questions.