Telecom Notice of Consultation CRTC 2015-225 (the "Notice")

Summary

1. VMedia Inc.("VMedia") is filing this initial submission, in response to the Notice, with both hope and trepidation. Hope, because a dramatically improved framework is essential to ensure the future of the independent internet service provider("IISP") segment of the internet service market, and with it competition in the provision of those absolutely essential services to Canadians, and trepidation because past amendments to the framework have unfortunately gotten us to this place where IISPs, and the real competition that will generate optimal innovation and affordable prices that Canadians deserve, face such a tenuous future.

2. In the course of recent proceedings including (i) TNC CRTC 2013-551, and (ii) Shaw's TN 22("TN22") tariff application VMedia has consistently expressed the view that the current costing model for wholesale access services is deficient, and has resulted in a pricing framework which, if it is not substantially transformed, will result in the obliteration of the IISP segment.

Background

3. The current framework is in concept suitable but in execution has resulted in inexplicable outcomes, starting with (i) the misguided and unnecessary attempt to discourage Canadians from actually taking advantage of all the benefits the internet offers every single Canadian, through the imposition of usage based billing in Telecom Decision 2010-255 (the "UBB Decision"), (ii) the wide range of wholesale rates approved by the Commission pursuant to TRP CRTC 2013-703 (the "CBB Decision"), (iii) the subsequent adjustments to them through a myriad of review and vary proceedings, and finally (iii) what must rank as the watershed moment illustrating the potential abuses of the current framework, TN 22.

4. As a result of the existing wholesale pricing model, IISPs look on with great concern at the growing public appetite for video over the internet. As that appetite grows, the noose around the neck of IISP segment tightens, for each new

consumer that embraces VMedia TV or Netflix needs IISPs to provide them with more bandwidth, and the more bandwidth IISPs provide to their customers, the more their cost of goods increases.

Policy

5. All of that would be irrelevant, since it is not the role of the CRTC to buttress IISPs in a vacuum. Policy does not require the Commission to support this segment just because IISPs happen to be in business, and deserve regulatory intervention. It is instead policy that has been shaped for the benefit of Canadians, for consumers, as stated by the Commission itself many times.

6. The previous processes with the exception of the interim disposition of TN22, have only served to make the position of IISPs more precarious, and for the sake of sustaining policy, if not for the sake of sustaining the IISP segment, things must change.

Scope of the Notice

7. VMedia is strongly supportive of the measures being considered in the Notice, but VMedia does not believe they go far enough. Conceptually, the Notice leaves intact the ability of the incumbents to dictate the terms of the Phase II costing process, by continuing to allow the detailed review and analysis of the inputs to be restricted to a bilateral process between themselves and the Commission.

8. The Commission has historically accepted the inputs of the incumbents as the basis for their deliberations, and while the likelihood of exaggeration and cost inflation was understood, processes and outcomes seemed to reflect the belief that judicious discounts to their "asks" would result in fair pricing. Regrettably the lessons of the UBB Decision, and now the CBB Decision, seem to indicate that the incumbent objective is not to mitigate the impact of IISPs on their business, but to eliminate it completely.

9. This perception is further reinforced by the detailed accounts of anti-competitive practices carried on by certain incumbents as detailed in the recent Part 1 application by the Canadian Network Operators Consortium Inc.("CNOC"), practices which VMedia has been subjected to as well.

10. In combination, it is obvious to VMedia that greatest scrutiny must be given to the information provided by the incumbents to the Commission in proceedings relating to wholesale pricing, and the burden of proof in justifying their claims

must fall on the incumbents, to be thoroughly examined by the Commission and all affected stakeholders.

A Call for Full Transparency

11. It is for this reason that VMedia proposes that the protection of confidentiality with respect to tariff applications, which has for so long given the incumbents cover, be eliminated, and that IISPs and other stakeholders be permitted to review the incumbents' submissions in full, and be able to knowledgeably comment on every claim and detail.

No Harm to Incumbents

12. There is no substance to the usual claims by incumbents that full disclosure would give anyone a competitive advantage.

13. With respect to the competition between IISPs and the incumbents, the incumbents as wholesale access providers know virtually everything about IISPs' business - their cost of goods, their customer base, their usage and their profitability. And very often, such as in the case of their access to IISPs' customers, incumbents abuse that information, information that would be subject to a fiduciary duty in most other contexts.

14. With respect to competition with other incumbents, that too is a baseless concern. When the CBB Decision was announced and the wildly varying rates awarded to the incumbents were disclosed, a senior industry executive, referring to the costs awarded to his company's competitors said “Why would my costs be any different than theirs? It doesn’t make any sense.”

15. Full transparency is the only way to ensure that any new framework, or the current one adjusted in accordance with the parameters set out in the Notice, can achieve unassailable credibility, and a pricing structure which enables the Commission to ensure that its policy objectives are achieved.

16. VMedia submits that the incumbents deliberately obfuscate the performance of their internet businesses, by failing to segment the financial disclosure in such a way as to enable IISPs and regulators to better understand the actual profitability of that business. At the very least the incumbents should be obliged to provide greater detail to enable the Commission and stakeholders to test their costing submissions against the margins they actually make on those services.

17. VMedia submits that until the base costs, upon which other adjustments such as costs of capital should be layered, do not approximate these costs - and they are far from them - no tariffs will have credibility, and those which suggest, such as in the case of the TN22 application, that IISPs should pay based on nearly twice that, are absurd. Only complete transparency will avoid the continuation of such incredible scenarios.

18. For the foregoing reasons, which in sum prove the structural flaws in the current costing process that go beyond the issues raised by the Commission in the Notice, VMedia implores the Commission to use the opportunity presented by this process to implement measures including

    a. the elimination of the entitlement of incumbents to file cost impact and other details in confidence to the Commission, and

    b. the requirement that incumbents provide detailed segmented financial disclosure in connection with its internet services of sufficient detail, at least comparable to that of Time Warner, to enable a clear understanding of the actual costs they incur in providing internet services to their residential customers.

The Six Issues

I. Should the cost and rate structure of wholesale HSA services(whether based on the flat-rate billing or CBB model) be simplified?

19. Every measure possible should be taken to simplify the existing structure. The cost in time and money for all, in particular IISPs, is tremendous in the aggregate, and inevitably contributes disproportionately to the costs borne by consumers.

20. The status quo clearly is not an option as it is not simple and arguably, based on past outcomes, not coherent. If the rate setting approach described in Approach 1 is to be truly cost-based, then there needs to be consideration given to those cost elements that create “significant” sensitivity to wholesale rates or the market will not evolve in a competitive fashion.

II. Should the Commission's 20% annual traffic growth assumption be modified to more accurately reflect current usage growth trends?

21. Absolutely. VMedia itself made that point in a recent proceeding, referring to a growth rate of at least 40% that was projected in one of the leading recent studies of data consumption.

22. The potential market for that demand remains somewhat untouched, as reflected in the Commission's *Communications Monitoring Report 2014*, which showed that in 2013, admittedly a long time ago in the context of internet usage growth, 60% of the Canadian market was using internet service with speeds below 15Mbps. That number is surely lower now but the market potential remains substantial, ensuring that the growth rate predicted in the above-noted study will certainly continue in Canada. It is precisely that growth rate which is choking IISPs paying CBB wholesale rates.

23. VMedia's own usage in its two years in business has grown by an average of 30% per year in that period, despite beginning at a higher level due to its skew toward IPTV-using customers, which has resulted in a much higher distribution of customers using higher speed services. In VMedia's case only 15% of its subscribers have speeds below 25Mbps.

24. For these reasons we do not project a 40% growth rate for our customer base, but rather closer to 35% per annum for the period from 2015 to 2019.

III. Should the annual unit cost reduction assumption of minus 10% be modified to more accurately reflect current equipment cost trends?

25. VMedia wishes to restate that with full transparency this would not be an issue, Assumptions would not have to be built into the model but could rather be replaced with costs on an actual basis as individual tariff applications are submitted from time to time. In any event, VMedia agrees with the Commission's view that 10% is not a adequate reflection of falling prices and should be modified.

26. The foregoing five year suggestion depends on how sensitive the wholesale rate is to those elements - if highly, then they should be updated annually.

Other Proposed Modifications

27. VMedia strongly urges the Commission, if it is reviewing these assumptions, to fully reconsider the other key elements that establish pricing benchmarks, the mark up on costs, and the cost of capital.

28. With respect to mark ups of up to 40% (the "Mark Up") it has never been clear to VMedia what is being compensated for in exchange for such a substantial upcharge.

29. If it is all to provide a margin to the incumbents in the same way any wholesale goods or service provider is entitled to a markup over its cost of goods or services, that would be understandable, although the amount is highly excessive for a wholesale markup, especially in a purportedly competitive environment.

30. In VMedia's view it is excessive especially when compared to real overall costs. Indeed, VMedia pays additional fees for every service provided by the incumbent to VMedia, including installation fees and transfer fees, and no services other than customer care for escalated technical issues are provided without additional charge.

31. VMedia urges the Commission to review the continued fairness of the imposition of the Mark Up and modify it accordingly.

32. Similarly, with respect to cost of debt and equity, a full review should be undertaken, in view of that fact that those benchmarks were established as far back as 2000, and the tectonic shifts that have occurred in the capital markets since that time demand a full review of these assumptions in conjunction with this process.

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IV. Should the study period be changed from the current ten years to a shorter period? if so, would a five-year study period be appropriate?

33. This would depend on how the new costing models that might emerge from this process are arrived at, and whether full transparency is incorporated into the changes being considered in the Notice. The changes to the business, and the unrelenting efforts of certain incumbents to drive IISPs out of business, or to prevent them from launching their businesses in the first place, calls out for a shorter horizon.

34. Absent any other consideration, a five year study period would be more appropriate.

V. Should the usage sensitive equipment (e.g. CMTS, Optical Node) be assigned to the traffic-driven portion of cost models? If so, to what extent(e.g. 100%).

35. Again, VMedia is of the view that there is not enough information available to even determine what is reasonable to put into those categories, let alone the costs associated with them. If they are items which "include Internet Protocol routers and Ethernet switches, and their associated interconnection links" as the Commission has described[1], then if the associated links between the CMTS and the point of interconnection only account for 20% of the CBB then 80% of the CBB must relate to routers and switches, which would be absurd.

36. Assuming that all the elements that comprise usage sensitive equipment, and their costs, direct and associated, are disclosed through a fully transparent process, VMedia would not object to them being assigned to the traffic-driven portion of the cost models.

VI. How should the Commission determine final rates for destandardized services?

37. .VMedia itself, because of its relatively short history, is not materially affected by the outstanding destandardized services which remain to be granted final rates. However, with the very elements the Commission is considering in the Notice it would be likely that final rates would reflect the falling prices for higher speeds, and accordingly would result in lower retroactive wholesale costs and possible much needed and deserved rebates for IISPs.

[1] TRP CRTC 2011-703, Footnote 26