Intelligence MEMOS

From: Ken Engelhart

To: Canadians Concerned About Internet Prices

Date: September 14, 2020

Re: **Regulating Wholesale Internet Rates: Let's Stop**

In Canada, if regulation doesn't work, the answer always seems to be more regulation. And so it is now with wholesale internet rates.

In August, the Cabinet (mildly) criticized the CRTC's new wholesale internet rates, noting that because they are so low, they may "undermine investment in high-quality networks."

This sentiment is justified, but the Cabinet needs to go much further. This is an opportunity for Canada to finally accept that our government-directed internet "market" is not working – and to create a system of authentic competition.

First, why is the CRTC setting these rates? Canada has a form of wholesale internet regulation unique in the world, even though its market is no different. As in most countries, Canadians can get residential broadband internet from the phone company or the cable company, or sometimes from a third-party player that has installed fibre optics or fixed wireless. Because most of Canada has good 4G coverage, cellular broadband is another option (albeit, with data caps that make Netflix wildly expensive).

Still, for the past 20 years, the CRTC has decided that it needs to create more competition. Its solution is to force cable and telephone companies to lease some of their lines at mandated, federally regulated wholesale rates to independent third-party internet service providers (ISPs). Almost no other country imposes a wholesale obligation on cable broadband providers, though some do impose it on telco broadband. The US deregulated both years ago.

So, are Canadian consumers better off? Do we have the lowest broadband prices in the world? Hardly. Year after year, consumer groups complain that our prices are higher than in other countries. Given this, you might expect Canada to adopt other countries' systems and do away with mandated wholesale "competition." Instead, the government has stubbornly hung on.

Mandated wholesale regulation can never work. It requires experts in Ottawa to figure out the wholesale price that telcos and cablecos can charge independents. This is a fool's errand, because the networks are used for a mix of broadband, television and telephone service – and deciding how much of the cost is for broadband is virtually impossible. There are different ways to do the costing, all legitimate and all leading to wildly different answers. So, the Ottawa experts have developed their own costing models, which can be adjusted to create the rate they want.

Historically, these rates have been set at roughly 50 percent of the retail price. The big carriers hate giving away some of their lines at half-price and are constantly threatening to cut investment. Why would anyone build a network if you have to sell it to your competitors for substantially less than the market rate? These companies were especially enraged by the most recent (August 2019) CRTC decision to set wholesale rates at a shocking 70 percent discount from retail rates. Their lobbyists argue that the whole broadband business could be wrecked.

It's not a great business for the smaller independents, either. Right now, they spend most of their money on leasing lines from Rogers or Bell. Another chunk of cost goes to marketing and sales and to web connection. To attract customers, the small carriers also have to undercut the big carriers by 10 or 20 percent. Even if they are extremely efficient, they still won't have enough left to make much of a profit.

Consumers fare worst. The prices they pay never seem to go down.

The CRTC's 2019 decision to cut rates (which it is now reviewing) seems to have been inspired by a formal "Cabinet direction" earlier in the year that told the Commission to "encourage all forms of competition and investment." The CRTC interpreted that to mean rates should be slashed. But the real, long-lasting solution is to get rid of the mandated wholesale system.

Imagine if Canada were short on supermarkets – and the government's solution was to force Loblaws to rent competitors a few aisles of its stores at discounted rates (set by regulators), and to charge them for the use of Loblaws' cashiers. There are no efficiencies to be gained by any of the companies. And at the end of the day, all that shoppers have is the same Loblaws, selling the same stuff.

If we got rid of the system, we would see more independents building their own networks and undercutting the large companies. Wireless carriers might also start to compete in fixed broadband using 5G. In other countries, entrepreneurs are building fixed wireless and fibre networks to compete with the biggest broadband carriers.

Let's get rid of mandated wholesale entirely and finally have some real competition in Canada.

Ken Engelhart is a lawyer specializing in communications law, an adjunct professor at Osgoode Hall Law School and a senior fellow at the C.D. Howe Institute.

To send a comment or leave feedback, email us at blog@cdhowe.org.

A version of the memo first appeared in the Financial Post.