



Telecom Decision CRTC 2005-76

Ottawa, 22 December 2005

Follow-up to Decision 2002-43 - Société en commandite Télébec's request to recover the start-up costs for local competition and local number portability

Reference: 8678-T78-200506420

*In this Decision, the Commission **approves** for Société en commandite Télébec the recovery of certain costs associated with the implementation of local competition and local number portability through draw-downs from the company's deferral account.*

1. The Commission received an application by Société en commandite Télébec (Télébec), dated 31 May 2005, in which the company proposed an exogenous adjustment to recover its estimated local number portability (LNP) start-up costs of \$7.45 million. In support of its application, the company filed a Phase II cost study.

Background

2. In *Local competition start-up costs proceeding, Telecom Public Notice CRTC 98-10*, Telecom Order CRTC 99-239, 12 March 1999 (Order 99-239), the Commission determined that for the large incumbent local exchange carriers' (ILECs) other than Télébec and TELUS Communications (Québec) Inc., now known as TELUS Communications Inc., LNP and local competition start-up costs should be calculated on a revenue requirement basis. Under the revenue requirement approach, the capital costs would be recovered through an annual depreciation expense. The Commission also concluded that these costs should be allocated among capped and uncapped services on the basis of retail switched exchange service network access services (NAS), with non-residence NAS weighted by a factor of 1.5. The recovery of costs allocated to capped Utility segment services would be by way of an exogenous factor.
3. In *Local competition start-up and LNP costs established*, Order CRTC 2000-143, 23 February 2000 (Order 2000-143), the Commission approved the local competition start-up costs and local LNP costs for ex-Stentor telephone companies.
4. In *Commission approves terms and conditions for local exchange and local payphone competition in the territories of TELUS Communications (Québec) Inc. and Télébec ltée*, Order CRTC 2001-761, 3 October 2001 (Order 2001-761), the Commission determined that Télébec and TELUS Communications (Québec) Inc. (the Companies) would each be responsible for recovering its own local competition and LNP start-up costs and that such costs would not be recovered from the National Contribution Fund (NCF). In addition, in order to control the magnitude of these costs, the Commission determined that both Companies should incur expenses only when and if required.

5. In *Implementation of price regulation for Télébec and TELUS Québec*, Telecom Decision CRTC 2002-43, 31 July 2002 (Decision 2002-43), the Commission determined that an exogenous factor would be a component of the price cap formula. An exogenous factor flows through the impact associated with events not captured by other elements of the price cap formula, provided the events or initiatives satisfied the following criteria:
 - a) they are legislative, judicial, or administrative actions which are beyond the control of the company;
 - b) they are addressed specifically to the telecommunications industry; and
 - c) they have a material impact as measured against the total company.
6. In Decision 2002-43, the Commission was of the preliminary view that the methodology used for the recovery of local competition and LNP start-up costs by the other large ILECs, as set out in Order 99-239, would be appropriate for the Companies. The Commission considered that, in their filings for an exogenous factor, the Companies should include the amount of local competition and LNP start-up costs, as well as the method of recovery, calculated using the methodology set out in Order 99-239. In addition, the Commission directed the Companies to distinguish between recurring and non-recurring costs.

The application

7. Télébec noted that competition had been allowed in its territory since 1 September 2002 and that several competitive local exchange carriers were present and active in its territory. Télébec submitted that, pursuant to Order 2001-761 and Decision 2002-43, it was proposing to recover its local competition and LNP start-up costs through an exogenous factor. Télébec estimated that the costs the company had incurred were \$7.45 million, of which \$4.60 million were non-recurring costs and the balance of \$2.85 million were recurring costs. The company indicated that its estimated costs included a mark-up to recover its fixed and common costs of 15 percent on costs allocated to NAS in high-cost serving areas (HCSAs) and 25 percent mark-up on costs allocated to other baskets.
8. Télébec submitted that, in accordance with the Commission's directives in Decision 2002-43, it had allocated its local competition and LNP start-up costs on the basis of NAS, with non-residential NAS weighted by a factor of 1.5 and residential NAS weighted by a factor of 1.0.
9. Télébec proposed the following method for recovery of costs associated with the implementation of local competition and LNP:
 - the recovery of costs allocated to Residential Local Exchange Services in HCSAs sub-basket from the NCF;
 - the recovery of costs allocated to Residential Local Exchange Services in non-HCSAs sub-basket and to the Other Capped Services basket from its deferral account;

- the recovery of costs allocated to the Business Local Exchange Services basket through an exogenous adjustment; and
 - the recovery of costs allocated to uncapped services through rate increases.
10. Télébec proposed that the non-recurring costs associated with the implementation of local competition and LNP be fully recovered over four years, from 1 August 2002 to 31 July 2006.

Process

11. The Commission received comments from Xit télécom inc., on behalf of itself, télécommunications Xittel inc., and 9141-8077 Québec inc. (collectively, Xit télécom), dated 5 July 2005 and reply comments from Télébec, dated 8 July 2005.
12. The Commission addressed interrogatories to Télébec, dated 4 October 2005. Télébec filed responses to the Commission's interrogatories on 12 October 2005.

Xit télécom's comments

13. With respect to the nature and value of Télébec's proposed costs, Xit télécom submitted the following:
- Télébec's proposed costs were too high;
 - The tax rate on public utility services (PUT), which had replaced the telecommunications, gas, and electric (TGE) rate, used by Télébec in its economic study was incorrect; the PUT rate being capped at 0.7 percent on a maximum of \$750 million; and
 - Télébec should not be permitted to recover costs associated with its membership in the Canadian LNP Consortium Inc. (the Consortium) as Xit télécom did not have the means to recover these costs.

Télébec's reply comments

14. Télébec stated that it had incurred the proposed costs to meet the Commission's directives set out in Order 2001-761 and in Decision 2002-43.
15. Télébec submitted that since the PUT threshold of \$750 million applied to the combined networks of the companies affiliated with Télébec, the average PUT rate was comparable to the old TGE rate.
16. Télébec submitted that the Commission had approved the establishment of the Consortium to implement LNP and had required that the company become a member of the Consortium in Order 2001-761. Télébec argued that, therefore, it should be able to recover the costs of its membership in the Consortium.

Commission's analysis and determinations

17. The Commission notes that in Decision 2002-43, it determined that the costs associated with the implementation of local competition and LNP met the first two criteria for exogenous events. The Commission considered that the requirement to implement the upgrades resulting from the Commission's directives to implement local competition and LNP in Order 2001-761, were a legislative, judicial, or administrative action that was both beyond the control of the company and addressed specifically to the telecommunications industry.
18. The Commission notes that Télébec estimated the costs associated with the implementation of local competition and LNP at \$7.45 million. Given the magnitude of the costs associated with this initiative, and consistent with Order 99-239, the Commission is of the view that Télébec's costs to implement local competition and LNP are significant and material in relation to the total company, and meet the third criterion for an exogenous event.
19. Accordingly, the Commission determines that these costs qualify for exogenous treatment.

Télébec's Phase II cost study

20. The Commission notes that it examined Télébec's Phase II costs associated with the implementation of local competition and LNP. The Commission also notes that the Télébec's costs are very similar in nature to the costs approved for the other large ILECs in Order 2000-143. The Commission has however made two adjustments to Télébec's proposed local competition and LNP start-up costs.
21. First, to reflect tax changes resulting from the applicability of the PUT, the Commission considers it appropriate to adjust the miscellaneous tax rate used in Télébec's Phase II cost study from 8 percent to 6.38 percent for the period from 2005 to 2009.
22. Second, the Commission notes that in Decision 2002-43 it determined that only incremental costs related to the implementation of local competition and LNP should be recovered. Since fixed and common costs are not incremental costs, the Commission finds it appropriate to remove the mark-ups proposed by Télébec for the recovery of fixed and common costs.
23. The Commission notes that costs related to membership in the Consortium are related to the implementation of LNP. The Commission considers that, consistent with its determinations in Decision 2002-43, Télébec may recover these costs.

Télébec's proposal for cost recovery

24. The Commission notes that it established the NCF to subsidize basic local service in HCSAs, and not to subsidize the implementation of competition. Accordingly, the Commission does not consider it appropriate for Télébec to recover costs allocated to residential subscribers in HCSAs from the NCF. With respect to Télébec's proposal to assign to residence subscribers, part of the start-up costs allocated to the Other Capped Services basket, the Commission considers that this proposal is not consistent with its directives in Decision 2002-43.

25. The Commission is concerned that Télébec's subscribers, which already pay the highest rates for local exchange services in Canada, could be faced with local rate increases if an exogenous adjustment was included in the price cap formula. Accordingly, the Commission considers it preferable to avoid additional rate increases, to the extent possible.
26. The Commission notes that there are, at present, sufficient funds in Télébec's deferral account for the recovery of Télébec's start-up costs for local competition and LNP for the period from 2005 to 2006. The Commission is of the view that Télébec should recover these costs from the deferral account as long as there are sufficient funds in the account. The Commission notes that the decision to be issued in the *Review and disposition of deferral accounts for the second price cap period*, Telecom Public Notice CRTC 2004-1, 24 March 2004 proceeding will detail the procedures Télébec will follow once the funds in the deferral account are depleted.
27. The Commission notes that there is less than one year until the end of Télébec's proposed recovery period. Accordingly, the Commission is the view that Télébec's recovery period for non-recurring costs associated with the implementation of local competition and LNP should be recovered over a four-year period starting 1 August 2005. The Commission considers that the recovery of recurring costs should start on the same date.
28. In light of the above, the Commission **approves** the following for Télébec:
 - an exogenous factor of \$1,074,900 per year for the recovery of non-recurring costs over four years, starting 1 August 2005;
 - an exogenous factor of \$560,700 for the recovery of recurring costs each year, starting 1 August 2005; and
 - the recovery of these amounts through draw-downs from Télébec's deferral account as long as there are sufficient funds in the account.

Secretary General

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