

June 6, 1997

Mr. A. J. Darling
Secretary General
Canadian Radio-television and
Telecommunications Commission
Ottawa, Ontario
K1A 0N2

Dear Mr. Darling:

Subject: Telecom Order CRTC 97-144 - SRB Broadband Transfer Pricing and
Tracking Proposal

1. AT&T Canada Long Distance Services Company (AT&T Canada LDS) is in receipt of proposals from Bell Canada, dated March 31, 1997, NB TEL, dated March 27, 1997, TCI, dated April 1, 1997, BCTel dated April 17, 1997, MTS dated April 21, 1997 and MT&T, Island Tel and NewTel, each dated May 16, 1997, regarding the filing requirements for new broadband investment and related expenses as set out in Telecom Decision CRTC 95-21 - Implementation of Regulatory Framework - Splitting of the Rate Base and Related Issues (Decision 95-21) and more specifically Telecom Order CRTC 97-144 (Order 97-144), dated January 31, 1997. AT&T Canada LDS hereby provides its comments on the proposals filed by the telephone companies noted above.
2. AT&T Canada LDS is also in receipt of the Commission's letter to parties, dated May 13, 1997, directing NBTel, BCTel and MTS to file by May 22, 1997 justification for submitting proposals that diverge from the Commission's determinations in Order 97-144 respecting the assignment of fibre facilities. NewTel, MT&T and Island Tel were also requested to file justifications for any similar divergence from the Commission's determinations. AT&T Canada LDS also provides comments on this additional issue.

Introduction

3. In Order 97-144, the Commission issued clear directions to the telephone companies regarding cost assignment and reporting requirements for the treatment of new broadband investment and related expenses. The

Commission directed the telephone companies to file the following information in the March 31/April 1, 1997 time frame:

Item 1(d) - in instances where fibre is used jointly to provide Utility and Competitive Segment services, the telephone companies are directed to assign all the investment and cost incurred in 1997 for the placement of that fibre and underlying support structures to the competitive segment and to file tariffs for transfer prices, by 1 April 1997, using the access to support structure rates approved in Decision 95-13 to account for the portion of the placement costs for fibre used to provide Utility segment services.

Item 1(g) - the telephone companies are directed to file tariffs for transfer pricing, by 1 April 1997, to reflect instances where FOTS equipment and facilities are jointly used for the provision of both Utility and Competitive segment services (regardless of whether the Competitive services are existing services or new broadband services).

Item 1(h) - the telephone companies, except BC TEL, are directed to file, by 1 April 1997, a detailed description of the proposed methodology for tracking and reporting transfer price payments and, by the same date, the telephone companies, including BC TEL are directed to file a proposed level of detail for reporting the transfer price payments, including comments on the appropriateness of reporting the revenues and costs at a level of detail at which the transfer price tariffs are applied.

Item 5 - With respect to the filing requirements set out on pages 71 and 72 of Decision 95-21, the telephone companies are directed to file, by 31 March 1997, a proposed format for the tracking of revenue and cost streams at the level of detail at which the tariffs are applied. (Emphases added)

4. AT&T Canada LDS also notes that the Commission issued the following general directives to the telephone companies:

Item 1(e) - in instances where support structure facilities are used for fibre cable facilities in which individual fibre strands are used on a shared basis to transport both Utility and Competitive segment services, the telephone companies are directed to use transfer pricing.

Item 1(f) - in specific instances where broadband overlay facilities would require the use of existing support structure facilities that were assigned to the Utility segment as of 1 January 1995, BC TEL, Bell, Island Tel, MT&T and NB Tel are required to provide a detailed explanation as to why the Competitive segment should not pay the Utility segment the approved access to support structures rate in the event that they no longer consider this method to be feasible.

Item 1(k) - TCI is directed to include fibre feeder cable facilities in its costs assignment procedures for spare, drop and distribution facilities.

5. AT&T Canada notes that the proposals submitted by the telephone companies take considerably different approaches to fulfilling the Commission's directives with respect to transfer price filings, mark-ups on transfer prices, and the allocation of jointly used fibre facilities and support structures. AT&T Canada LDS addresses each of these subject areas in separate sections, highlighting the differences and inconsistencies with the Commission's directives.

Transfer Price Filings

6. At the outset, AT&T Canada LDS notes that the Commission directed each of the telephone companies to file their transfer prices as tariffs, both in Decision 95-21 and in Order 97-144. Page 36 of Decision 95-21 states:

Further, as with other bottleneck services, use of these Utility segment resources by the Competitive segments of the telephone companies or by competitors should be subject to a tariff. (Emphasis added)

7. In these filings however, none of the telephone companies have filed any proposed tariffs or revised tariff pages which set out the transfer prices to be charged the Utility segment for the use of fibre facilities. The fact that the telephone companies have not filed these tariffs is entirely inconsistent with the Commission's directives in this regard. Indeed, the telephone companies continue to ignore this requirement even after being further directed to do so in Order 97-144.
8. While TCI has recognized that it was directed to file tariffs, on page 2 of its submission, TCI argues that:

The transfer pricing between Competitive and Utility segments have the same attributes as intercorporate transactions. For this reason, TCI does not believe it would be appropriate to characterize the transfer prices as tariffs by issuing tariff pages. Instead the Company proposes to update its Phase III Manual section AGT/BSCC 63.730 Transfer Pricing Study to include transfer price pages.

9. TCI's assertion that transfer prices have the same attributes as intercorporate transactions is unsubstantiated and should be rejected by the Commission. AT&T Canada LDS submits that these two types of transactions are not the same since the Utility segment will not seek bids from any company other than its own Competitive segment for the provision of broadband facilities.

10. AT&T Canada LDS submits that the Commission should once gain direct the telephone companies to file forthwith proposed tariff pages which incorporate the transfer prices filed by the telephone companies in this proceeding.
11. AT&T Canada LDS further submits that the transfer prices to be charged to the Utility segment must be placed on the public record. Publication of these tariffs is necessary in order to ensure compliance with the Commission's objective of not permitting the telephone companies to engage in predatory pricing or the cross-subsidization of new broadband services by Utility segment subscribers.¹ It is contrary to the objectives established in Decision 95-21 to have these prices maintained in confidence as would be the case if the Commission were to approve these transfer prices as intercorporate transactions. Publication of the tariffs for transfer prices is also consistent with the requirements in Item 1(h) of Order 97-144 regarding the tracking and reporting of transfer price payments at the level of detail at which the tariffs are applied.

Transfer Price Mark-Ups

12. In Decision 95-21, the Commission stated that the transfer prices:

[s]hould be based on the Phase II incremental costs incurred by the Competitive segment to provide these services, with an appropriate mark-up, recognizing that there will be circumstances where the incremental costs are negligible. Further, the Commission considers that the level at which the transfer price is set should allow for some reasonable portion of the costs savings associated with delivering Utility segment services over the broadband infrastructure to flow to the Utility segment.²
13. AT&T Canada LDS notes that TCI proposed a mark-up of 25%, consistent with the percentage mark-up applied in the case of other services. Most other telephone companies did not place on the public record their proposed mark-up. In addition, several of the telephone companies sought to justify their mark-up on grounds which are inconsistent with the Commission's principles in Decision 95-21. BCTel failed to provide any indication of its proposed mark-up or any justification for the level of mark-up.
14. Bell stated that its proposed mark-up is based first on the savings, or benefits of economies of scope, of using the same broadband facilities to deliver Utility and Competitive services, and second, on the risks borne by the Competitive segment as a result of warehousing the facilities in that segment. AT&T Canada LDS submits that it is entirely inappropriate to have the mark-up include recovery of the risks borne by the Competitive segment. In particular, it is contrary to the Commission's findings in Decision 95-21 which sought to

¹ Decision 95-21 page 34.

² Ibid, page 37.

protect Utility segment subscribers from “bearing the risk associated with the telephone companies’ new broadband investment”.

15. AT&T Canada LDS notes that, similar to Bell, MTS stated that its mark-up accounts for the risks borne by the Competitive segment for warehousing the broadband facilities. MTS also sought to further justify the mark-up as one which reflects the fact that the existing spare capacity was built in to meet the future needs of both Utility and Competitive services. Accounting for spare capacity in the mark-up undermines the Commission’s objective to ensure that the telephone companies are not permitted to allocate spare fibre capacity to the Utility segment. AT&T Canada LDS submits that neither of these justifications is consistent with the principles in Decision 95-21 for establishing an appropriate mark-up.
16. NBTel also proposed to establish a transfer price which would over-charge the Utility segment. As described in Attachment 2 of its submission, NBTel appears to be establishing its mark-up based on offsetting, if not neutralizing, the benefits to the Utility segment of re-assigning the company’s broadband investments. AT&T Canada LDS considers that this approach to setting the mark-up is contrary to the Commission’s goals of ensuring that Utility segment subscribers do not bear the risk of NBTel’s substantial broadband investments, and that Utility segment services share in a reasonable portion of the cost savings resulting from the use of the broadband infrastructure. Rather, NB Tel’s approach would penalize Utility segment subscribers for the company’s inability to properly assign its broadband investments between the Utility and Competitive segments.
17. MT&T and Island Tel appear to adopt a similar rationale as NBTel in determining the mark-up and transfer price, in that these companies also contend that a given level of mark-up would be appropriate as long as the Utility segment shortfall does not increase. This approach however, does not allow the Utility segment to benefit from any cost savings realized through the delivery of its services over the broadband infrastructure. AT&T Canada LDS submits that this again is a misrepresentation of the principles in Decision 95-21 and should not be accepted.
18. In light of the above, AT&T Canada LDS submits that the Commission should reject the transfer price proposals of Bell, MTS, NBTel, MT&T and Island Tel as these companies have sought to incorporate excessive mark-ups in setting their transfer prices. In addition, BCTel should be directed to provide a detailed explanation of how it arrived at the mark-up employed in setting its transfer price, including a description of how this mark-up is consistent with the principles established in Decision 95-21. The Commission should not accept any mark-up which either seeks to recover the risk of broadband investments or reduces the savings that should otherwise flow to the Utility segment.

Assignment of All Broadband Investments to the Competitive Segment

19. In the submissions of NBTel, BCTel, NewTel, MT&T, Island Tel and MTS, it was proposed to assign all fibre, regardless of vintage, to the Competitive segment and to use transfer pricing to charge the Utility segment for its use of the fibre. The Commission, in a letter dated May 13, 1997, noted that these proposals may be considered as applications to review and vary the Commission's directives in Decision 95-21 and order 97-144 and directed these telephone companies to address the criteria used by the Commission to assess review and vary applications.
20. In the telephone companies' replies, dated May 22, 1997, the following main arguments were made regarding their proposed treatment of fibre facilities:
 - (i) the proposals comply with the intent, if not the exact letter, of the Commission's directives with respect to ensuring that Utility subscribers are not required to bear the cost of broadband investments; and
 - (ii) the proposals represent practical and effective methods to implementing the Commission's directives in light of the telephone companies' difficulties in establishing workable vintage methodologies to segregate pre-1995 from post-1994 investments.
21. In regard to the latter point, NBTel also stated that its pre-1995 broadband investments were not dedicated solely to Utility segment use.
22. AT&T Canada LDS notes that only BCTel and NewTel specifically addressed the criteria used by the Commission to assess review and vary applications. They argued that, because the telephone companies have been unable to establish a workable vintage methodology, there has been a fundamental change in circumstances or facts and there is substantial doubt as to the correctness of the Commission's decision. AT&T Canada LDS submits that the telephone companies' inability to implement a Commission decision does not, in and of itself, provide sufficient grounds for granting a variance of that decision. Rather, it is important that the Commission assess whether the principles underpinning its directives can be satisfied by the telephone companies' proposed changes and to what extent accepting these proposals require other changes to maintain the integrity of the Commission's original purpose.
23. MT&T, Island Tel and NBTel stated that their proposed approach to implementing the Commission's directives would also have the effect of reducing the Utility segment shortfall. AT&T Canada LDS submits that this outcome will only hold if the proposals are accompanied by an appropriate transfer pricing approach. In this regard, as noted above, NBTel does not seek to establish transfer prices based on the incremental cost of using the fibre facilities. Rather, NBTel would base the transfer price on considerations of whether the transfer payments made by the Utility segment offset a sufficient

portion of the revenue gains achieved by re-assigning fibre investments to the Competitive segment.

24. AT&T Canada LDS submits that the companies' proposals to assign all fibre to the Competitive segment should be considered only if accompanied by stringent cost-based transfer prices to be charged to the Utility segment. Accordingly, AT&T Canada LDS submits that, in the event the Commission accepts the telephone companies' proposals to assign all pre-1995 as well as post-1994 fibre investments to the Competitive segment, the telephone companies should be required to charge the Utility segment transfer prices based strictly on the Phase II incremental cost of the fibre facilities used by the Utility segment with a mark-up sufficient only for the recovery of an appropriate portion of fixed and common costs. In addition, if the re-assignment is permitted, the affected telephone companies should be directed to file details of the revenue and cost impact on the Utility segment.

Allocation of Support Structures

25. NBTel, BCTel, NewTel, MT&T and Island Tel have each proposed to assign support structures entirely to the Utility segment and to charge the Competitive segment a transfer price based on those established in Decision 95-13 where these support structures are used to provision fibre facilities that carry Competitive services.
26. AT&T Canada LDS notes that this assignment seems to be driven by an inability to separate the investments and costs associated with support structures used primarily to carry fibre facilities. As described by MT&T:
- the sharing of its classical support structures (poles, strand and underground) between its "copper", fibre and coaxial outside plant is and will be ubiquitous.
27. NewTel did not provide any specific rationale for not assigning fibre-related support structures to the Competitive segment.
28. AT&T Canada LDS further notes that the submissions filed by Bell, MTS and TCI indicate that these companies will be able to assign to the Competitive segment the support structures associated with new fibre facilities.
29. AT&T Canada LDS submits that the proposal of the other telephone companies to assign all of their support structures to the Utility segment could represent a major initiative on their part which must be examined with care by the Commission. It would be unacceptable to allow such an assignment on the basis that it is needed simply to counter-balance these telephone companies' proposals to move all fibre facilities to the Competitive segment. In this regard, MTS is proposing to assign to its Competitive segment all of its fibre facilities as well as the underlying support structures for fibre facilities.

30. Only NBTel has described the impact on its Utility segment revenues and costs resulting from its re-assignments, albeit with the dollar impacts filed in confidence. It is unclear to AT&T Canada LDS what assumptions NB TEL has used to estimate that such a shift would ultimately have a positive impact on the Utility segment.
31. AT&T Canada LDS submits that the proposals by NBTel, BCTel, NewTel, MT&T and Island Tel should not be approved. These proposals are inconsistent with the principle established in Decision 95-21 that all new investments and related expenses associated with the deployment of fibre, coaxial cable, opto-electrical equipment, ATM and video servers should be assigned to the Competitive segment.
32. AT&T Canada LDS further submits that these telephone companies have not described the tracking or reporting methodology which would be used to ensure that the assignment to the Utility segment of the underlying support structure investments and costs would exclude any portion of the fibre cable material costs that should rightfully be assigned to the Competitive segment. AT&T Canada LDS submits that, should the Commission approve the proposed assignments, those telephone companies proposing to assign all existing and new support structures to the Utility segment should be required to file detailed tracking and reporting methodology for ensuring that the assignment of the underlying support structures to the Utility segment is exclusive of any investments or expenses associated with fibre cable material costs. In addition, if the re-assignment is permitted, the affected telephone companies should be directed to file details of the revenue and cost impact on the Utility segment.

Other Issues

Bell Canada

Item 1(d)

33. Bell Canada states that the transfer price charged to the Utility segment for use of support structures for instances where different strands within the same sheath are used to provide both Utility and Competitive segment services is the support structure rate approved by the Commission in Decision 95-13. Bell also states that the rates will be applicable to each sheath. According to Bell's description, each sheath will contain fibre strands that are used by both the Utility and Competitive segment services. It is unclear to what extent the rate charged per sheath will be apportioned between the Utility and Competitive segments to accurately reflect the portion of strands in each sheath that are used to carry Utility segment services.
34. AT&T Canada LDS submits that it would be inappropriate to charge the Utility segment the entire amount of the support structure rate applied at the sheath level when some of the strands within that sheath are shared by both segments

or used entirely by the Competitive segment. The Commission should direct Bell to charge to the Utility segment only a portion of the support structure rate per sheath based on the relative usage of the fibre strands within the sheath. The relative usage methodology should be that required pursuant to Item 1(b) of Order 97-144.

TCI

35. AT&T Canada LDS notes that TCI is proposing to apply differential transfer prices for conduit predicated on whether it is existing or newly constructed, with the transfer price for newly constructed conduit based on replacement costs. TCI attempts to justify this proposal by citing Decision 95-13 in which the Commission stated:

If a telephone company constructs or reinforces support structures for the use of a customer, the Commission considers it reasonable that charges based on costs incurred continue to apply.

36. AT&T Canada LDS submits that this reference from Decision 95-13 applies to the special case where support structures are put in place and/or maintained for the use of a particular customer and does not contemplate the application of unique rates for every newly built support structure to be used by the telephone company's services. TCI's proposal would have its Utility segment treated as an individual customer of its Competitive segment. This approach contradicts the Commission's direction in item 1 (d) of Order 97-144 to apply the access to support structure rates approved in Decision 95-13. In that decision, the Commission made the following determination:

In this proceeding, Shaw supported the use of Bell rates as a benchmark in an effort to achieve national uniform rates. In the specific case of support structures, the Commission considers that there is merit in adopting uniform rates...Accordingly, below, the Commission is prescribing uniform rates to apply to the support structures of the telephone companies, with the exception of Ed Tel.

37. It is evident from Decision 95-13 that the Commission intended for the rates for access to support structures to be uniform. AT&T Canada LDS further submits that nothing in Decision 95-21 or Order 94-144 contemplated striking a unique rate for support structures to be charged to the Utility segment. Accordingly, the Commission should reject TCI's proposal to charge the Utility segment a different rate for newly constructed conduit and direct TCI to conform with the directives found in Order 97-144.
38. In the "Tracking and Reporting Requirements" of its proposal, TCI once again ignores the Commission's directives on how to assign facilities and establish transfer prices. AT&T Canada notes that TCI introduces no fewer than seven

new “ratio” factors in order to generate transfer pricing payments between the Utility and Competitive segments. AT&T Canada LDS submits that TCI’s proposed ratios are simply a new mechanism for avoiding the Commission’s directives for the treatment of broadband investment.

39. The seven new factors are:

- 1) working fibre ratio to be based on information in its Competitive Fibre Database;
- 2) circuit study Utility segment ratio, which appears to be based on its Phase III Manual section BSCC 73.056;
- 3) circuit study Competitive segment ratio, which is the inverse of the ratio for the Utility segment;
- 4) the company-wide average Planning Fill Factor;
- 5) ratio of conduit assigned to the Utility segment, which appears to be based on its Phase III Manual section BSCC 73.074;
- 6) Utility segment fibre cable usage ratio; and
- 7) Utility segment copper cable usage ratio.

40. The working fibre ratio is a critical component of most of TCI’s tracking reports. Unless this ratio accurately reflects the actual usage of all fibre strands, then the transfer payments between the Utility and Competitive segments will be incorrect. In this regard, AT&T Canada LDS notes that, in Order 97-144, the Commission rejected the telephone companies’ proposals to rely on relative strand or working circuit usage. It should also be noted that the working fibre ratio depends on TCI’s “enhanced” Competitive Fibre Database. In Order 97-144, the Commission directed TCI to:

[e]ncompass fibre facilities in the feeder portion of the access network and as a consequence, TCI’s cost assignment procedures for spare, drop and distribution facilities should also include fibre feeder cable facilities.

41. It is not clear from TCI’s submission that the enhancement to this database includes fibre facilities in the feeder portion of the access network. The working fibre ratio would fail to produce transfer pricing payments that accurately reflect the Commission’s directives if the database does not include fibre in the feeder.

42. TCI proposes to use a company-wide average planning fill factor as a proxy for determining the working versus available spare capacity in the FOTS terminals. It should be noted that, in Order 97-144, the Commission concluded that it is essential to properly determine the spare capacity in FOTS terminal equipment and that, as a general principle, the determination should take into account the ultimate potential design capacity of the FOTS terminal equipment in relation to its actual proportional use by the Utility segment. AT&T Canada LDS submits that TCI has not provided any supporting detail or evidence that its proposed “average planning fill factor” complies with this general principle.

43. In addition, TCI's proposed Utility segment fibre cable usage and copper cable usage ratios have not been described, nor has any supporting information been provided. AT&T Canada LDS submits that it is not possible to determine whether the proposed ratios will result in the Utility segment paying appropriate transfer payments for the use of the conduit assigned to the Competitive segment. It is also not clear why TCI should be permitted to assign to the Competitive segment support structures for copper cable facilities that are used to provide Utility segment services.
44. AT&T Canada LDS submits that the Commission should direct TCI to describe in detail its proposed factors and to provide a full explanation as to why TCI considers these new factors to be consistent with the Commission's directives in Order 97-144. AT&T Canada LDS further submits that the Commission reject TCI's proposed company average planning fill factor and direct TCI to file a revised methodology which complies with the Commission's general principle that the determination of spare FOTS terminal equipment take into account its ultimate potential design capacity.

Yours truly,

Carlo Di Luch

cc. Interested Parties

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