Telecom Decision CRTC 2004-42

Ottawa, 22 June 2004

Annual price cap filings deferral account – related issues

Reference: 8678-C12-13/02

In this decision, the Commission determines the amount of money that Aliant Telecom Inc. (Aliant Telecom), Bell Canada, MTS Communications Inc. and TELUS Communications Inc. must transfer into the deferral account as financial adjustments for (i) the reduction to the contribution revenue-percent charge, and (ii) the one-time start-up costs associated with local competition and local number portability already recovered.

In addition, the Commission ***denies*** *Aliant Telecom's proposal to draw down from the deferral account $6.4 million of unused price cap "room" carried forward from the first price cap period. The Commission also* ***denies*** *Aliant Telecom's proposal to exclude the revenues from the network access services in non high-cost serving area rates that are set below Phase II costs plus a mark-up of 25% in the calculation of the amount that should be transferred to the deferral account. A dissenting opinion by Commissioner Langford is attached.*

Introduction

1. In *Regulatory framework for second price cap period,* Telecom Decision CRTC 2002-34, 30 May 2002 (Decision 2002-34), the Commission noted that it had allowed the incumbent local exchange carriers (ILECs) certain financial adjustments in the initial price cap period. Most of the adjustments allowed the ILECs to recover costs by increasing rates to subscribers or mitigating required rate decreases. While most of the adjustments were intended to be ongoing, portions of two of these were time-limited. These two adjustments were for (i) the contribution revenue-percent charge, and (ii) the one-time start-up costs associated with local competition and local number portability (LNP). The Commission also noted in Decision 2002-34 that these time-limited exogenous adjustments had been applied to rates in both non high-cost service areas (non-HCSAs) and high-cost serving areas (HCSAs). The Commission determined that adjustments for the time-limited exogenous factors associated with non-HCSAs should be accomplished through the deferral account.

2. In Decision 2002-34, the Commission directed Aliant Telecom Inc. (Aliant Telecom), Bell Canada, MTS Communications Inc. (MTS), Saskatchewan Telecommunications (SaskTel) and TELUS Communications Inc. (TCI) to file their estimates, with supporting calculations, of the amounts corresponding to (i) the reduction to the contribution revenue-percent charge in 2002, and (ii) the one-time start-up costs associated with local competition and LNP already recovered.

3. As directed by the Commission, Aliant Telecom, Bell Canada, MTS, SaskTel and TCI filed their submissions on 6 August 2002.[1] In its submission, Aliant Telecom included two new proposals: to draw down, from the deferral account, unused price cap "room" from the first price cap period and to exclude certain non-HCSA network access services (NAS) revenues in the calculation of the amount to be transferred to the deferral account.

4. SaskTel noted that it had not been subject to price cap regulation before Decision 2002-34. SaskTel also noted that it had not increased rates to recover costs associated with the 4.5% contribution revenue-percent charge implemented in *Changes to the contribution regime*, Decision CRTC 2000-745, 30 November 2000 (Decision 2000-745). SaskTel indicated that, as a result, the company was not proposing a revenue reduction for the contribution revenue-percent charge. In addition, SaskTel noted that it had not increased rates to recover start-up costs for local competition and LNP and was accordingly not proposing any revenue adjustments associated with this time-limited exogenous factor.

5. The Canadian Cable Television Association (CCTA) and Allstream Corp. (Allstream, formerly known as AT&T Canada Telecom Services Company[2]) filed comments on the telephone companies' submissions on 21 August and 3 September 2002, respectively.[3] Replies to the CCTA's comments were filed as follows: Bell Canada on 30 August 2002, TCI on 4 September 2002, Aliant Telecom on 12 September 2002 and MTS on 13 September 2002. Replies to Allstream's comments were filed as follows: Aliant Telecom, Bell Canada and TCI[4] on 13 September 2002, and MTS on 16 September 2002.

6. The CCTA filed additional comments on 30 September 2002. Aliant Telecom, Bell Canada and MTS filed a joint response on 11 October 2002. TCI responded to the CCTA's additional comments on 15 October 2002.

7. In this decision, the Commission addresses the following issues:

- Adjustment to the deferral account for the contribution revenue-percent charge reduction;
- Adjustment to the deferral account for the one-time start-up costs associated with local competition and LNP already recovered;
- Aliant Telecom's proposal to draw down from the deferral account unused price cap "room" from the first price cap period; and
- Aliant Telecom's proposal to exclude certain non-HCSA NAS revenues in the calculation of the amount to be transferred to the deferral account.

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[1] Bell Canada and TCI filed revisions to their 6 August 2002 filings on 9 and 13 August 2002, respectively.

[2] The 3 September 2002 comments were filed by AT&T Canada Corp., on behalf of itself and AT&T Canada Telecom Services Company.

[3] In these submissions, the CCTA and Allstream also made requests for the disclosure of information filed under a claim of confidence by Aliant Telecom, Bell Canada, MTS and TCI on 6 August 2002. By Commission staff letter dated 27 March 2003, these telephone companies were requested to place certain information on the public record of this proceeding. TCI filed the requisite information on 11 April and 15 May 2003, and Aliant Telecom, Bell Canada and MTS filed on 14 April 2003.

[4] In responding to Allstream's comments, TCI referred to its 4 September 2002 comments on the CCTA's 21 August 2002 letter.

8. The Commission notes that SaskTel was not subject to price cap regulation and therefore would have no excess revenues in 2002 arising from the time-limited exogenous adjustment for the contribution revenue-percent charge and start-up costs for local competition and LNP.

A. Adjustment for the contribution revenue-percent charge reduction

Background

9. In Decision 2000-745, the Commission implemented a national revenue-based contribution collection mechanism and set the contribution revenue-percent charge at 4.5%. The Commission allowed ILECs under price cap regulation to include an exogenous factor adjustment of 4.5% in their 2001 price cap filings to recover the contribution revenue-percent charge applicable to capped services. As a result, Aliant Telecom, Bell Canada, MTS and TCI (the Companies) adjusted their respective overall price cap index and service basket limits (SBLs) by 4.5% and implemented increases to basic residential service rates to recover the revenue-percent charge.

10. In *Interim 2002 revenue-percent charge, national subsidy requirement and procedures for the revenue-based contribution regime,* Order CRTC 2001-876, 14 December 2001 (Order 2001-876), the Commission set the interim revenue-percent charge for 2002 at 1.4% of telecommunications services revenues, effective 1 January 2002.

11. In *Final 2002 revenue-percent charge and related matters,* Telecom Decision CRTC 2002-71, 22 November 2002 (Decision 2002-71), the Commission approved the final 2002 revenue-percent charge of 1.3% of telecommunications service revenues.

Position of parties

The telephone companies' proposals

12. In response to the Commission's directives in Decision 2002-34, Aliant Telecom, Bell Canada and TCI each proposed to calculate the amount of required revenue reduction as the difference between the 2001 capped services revenues as defined in the previous price cap period, which reflected a contribution revenue-percent charge of 4.5%, and the same revenues adjusted to reflect a contribution revenue-percent charge of 1.4%. The purpose of this adjustment was to reduce the 2001 capped services revenues by the 4.5% exogenous factor allowed in Decision 2000-745 and to reflect, instead, the interim contribution revenue-percent charge of 1.4% approved in Order 2001-876.

13. MTS submitted that it had only been able to increase its rates by 2.6% in 2001. MTS proposed to calculate the amount of required revenue reduction in 2002 as the difference between the 2001 capped services revenues under the previous price cap, which reflected a contribution revenue-percent charge of 2.6%, and the 2001 capped services revenues adjusted to reflect a contribution revenue-percent charge of 1.4%. The purpose of this adjustment was to reduce the 2001 capped revenues by the 2.6% actual rate increases taken by MTS and to reflect, instead, the interim contribution revenue-percent charge of 1.4% approved in Order 2001-876.

14. Aliant Telecom, Bell Canada and MTS proposed to allocate the impact of the contribution revenue-percent charge rate reduction on 2001 capped services revenues using the proportion of the sub-basket revenues for basic residential local services in non-HCSAs and HCSAs. TCI proposed to allocate that impact on the basis of the average number of residential network access lines (NALs) in each of those sub-baskets for 2001.

Allstream's comments

15. Allstream commented on MTS's proposed methodology, noting that the company claimed that it had decided to increase affected rates by 2.6%, instead of the full 4.5%, in 2001. Allstream argued that it was irrelevant whether an ILEC chose to exercise its ability to raise rates in full or in part for the determination of an exogenous factor adjustment. Allstream submitted that the contribution revenue-percent charge reduction should be calculated as the difference between 4.5% and 1.4%, and not as proposed by MTS.

16. Allstream also submitted that MTS's proposed implicit carry-forward credit should be denied and that MTS should be directed to calculate the exogenous factor adjustment related to the contribution revenue-percent charge on the basis of the actual reduction in 2002, relative to 2001.

MTS's reply

17. MTS noted that the Commission was aware that MTS did not have the ability to raise its rates to recover the full amount associated with the revenue-percent charge of 4.5% as a result of the rate increase flowing from the exogenous factor adjustment approved in *MTS Communications Inc. – Final rate increase to recover income tax expense,* Decision CRTC 2001-202, 30 March 2001 (Decision 2001-202).

18. MTS argued that, consequently, it was only able to recover 2.6% of the contribution revenue-percent charge. MTS also stated that no additional benefit existed or was realized in 2001, and no benefit was being carried forward as suggested by Allstream. MTS submitted that its proposed adjustments were consistent with the Commission's intent that actual data be used to determine the impact of an exogenous event.

Commission analysis and determination

19. The Commission notes that Aliant Telecom, Bell Canada, MTS and TCI proposed to use the 2001 capped services revenues, as defined under the first price cap regime, to estimate the impact of the reduction in the contribution revenue-percent charge. The Commission also notes that the Companies' proposal is consistent with the application of the exogenous factor adjustment for the contribution revenue-percent charge during the first price cap regime. As a result, the Commission considers that the Companies' proposal is appropriate.

20. The Commission notes that while Aliant Telecom, Bell Canada and MTS used 2001 basic residential service revenues to allocate the revenue-percent charge reduction between non-HCSAs and HCSAs, TCI used 2001 average residential NALs. The Commission, however, notes that based on the information provided by TCI, the allocation by revenues method yields the same results as the allocation method by NALs. Nevertheless, the

Commission considers that since the contribution revenue-percent charge is applicable to telecommunications service revenues, the allocation between non-HCSAs and HCSAs should be based on the service revenues in each of the basic residential service sub-baskets.

21. The Commission notes that MTS's 2001 annual price cap filings included two significant exogenous adjustments. These are the contribution revenue-percent charge and the exogenous adjustment for the recovery of income tax expense approved in Decision 2001-202. The Commission notes that, in the initial price cap regime, there was an overall constraint of inflation plus the two exogenous adjustments on the residential sub-basket and a further constraint, which specified that any single rate element could not be increased by more than 10%. There were similar 10% rate element constraints applicable to the single and multi-line business local exchange services and on the other capped services baskets. The Commission notes that the 10% individual rate element constraint actually prevented MTS from fully recovering the impact of the 4.5% contribution revenue-percent charge on capped services.

22. Upon review of MTS's annual price cap filings for 2001 and 2002 and subsequently approved tariff revisions, the Commission notes that MTS was only able to recover 2.6% of the 4.5% contribution revenue-percent charge through increased capped services rates. Therefore, the Commission considers MTS's proposal to adjust the 2001 actual capped services revenues by 2.6%, rather than by 4.5%, appropriate, as it reflects the actual level of recovery by MTS.

23. The Commission notes that the Companies used a 1.4% contribution revenue-percent charge in their calculations of the revenue impact associated with the reduction in contribution to the national contribution fund. The Commission also notes that in Decision 2002-71, it approved a final contribution revenue-percent charge of 1.3% for 2002. Accordingly, the Commission finds that the impact of the revenue-percent charge should be calculated using the final charge of 1.3%, rather than the interim charge of 1.4% for 2002. The Commission has reflected this adjustment in Table 1 below. Furthermore, the Commission considers that the impact of any reduction in the contribution revenue-percent charge subsequently approved by the Commission should also be reflected in the deferral account.

Table 1
Reduction in the contribution revenue-percent charge
to be transferred into the deferral account
($000)

Aliant Telecom	5,889.6
Bell Canada	83,330.9
MTS	2,448.5
TCI	38,576.8

24. The Commission notes that the adjustment for the contribution revenue-percent charge will be ongoing. Therefore, the Commission finds that the amount for the 2002 reduction in the contribution charge should be transferred into the deferral account for each of the four years of the current price cap period. The Companies are directed to transfer into their respective

deferral accounts the amount listed in Table 1 above for each of the four years of the current price cap period, and the impact of any change in the contribution revenue-percent charge subsequently approved by the Commission.

B. Adjustment for the one-time start-up costs associated with local competition and LNP already recovered

Background

25. In *Local competition*, Telecom Decision CRTC 97-8, 1 May 1997 (Decision 97-8) and *Responsibility for carrier specific costs for the provision of local number portability*, Telecom Order CRTC 97-591, 1 May 1997, the Commission determined that a carrier that incurred start-up costs for local competition and LNP would be responsible for recovering those costs.

26. 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 a revenue requirement methodology was appropriate for recognizing the start-up costs for local competition and LNP. In Order 99-239 the Commission approved, on an interim basis, the cash flows submitted by the telephone companies, modified to reflect the use of the revenue requirement methodology. In Order 99-239, the Commission permitted the telephone companies to use up to one-third of the interim approved amount of start-up costs for local competition and LNP in their 1999 price cap filings.

27. In Order 99-239, the Commission determined that the start-up costs for local competition and LNP were to be allocated between capped and uncapped services on the basis of retail switched exchange service NAS, with non-residence NAS weighted by a factor of 1.5. The Commission also determined that the ILECs would be allowed to recover the costs allocated to capped services through an exogenous factor.

28. In *Local competition start-up and LNP costs established*, Order CRTC 2000-143, 23 February 2000 (Order 2000-143), the Commission finalized its determinations with respect to the recognition and recovery of the start-up costs for local competition and LNP. In Order 2000-143, the Commission revised the 1997 to 2001 estimated start-up costs for competition and the roll-out of LNP, and it determined that the revenue requirement amounts for 1997 to 2001 should be modified accordingly. The Commission directed the telephone companies to include as an exogenous factor, over the remaining two years of the first price cap period, the start-up costs for local competition and LNP approved in Order 2000-143, less the costs which they had already recovered in 1999 pursuant to Order 99-239.

Position of parties

The telephone companies' proposals

29. Bell Canada submitted that the starting point for calculating the impact of the recovered costs was the original cost studies filed in the proceeding initiated by *Local competition start-up costs proceeding*, Telecom Public Notice CRTC 98-10, 12 May 1998. Aliant Telecom and MTS noted that they had used the same methodology as Bell Canada in their calculations.

30. The Companies determined the portion of revenue requirement that they had recovered during the first price cap period and which they would no longer need to recover on a going-forward basis. The Companies indicated that this would correspond to the start-up expenses and capital identified in the response to interrogatory SRCI(CRTC)5Aug98-11 that were recovered by the end of the first price cap period. The Companies determined the percent recovered by comparing the total amount that would need to be recovered over the various capital items' life spans versus the amount actually recovered from 1999 to 2001.

31. The Companies estimated the revenues that were reflected in their capped services rates to recover the costs approved in Order 2000-143 for the start-up of local competition and LNP. The Companies determined the amount of revenue requirement they no longer needed and allocated it between non-HCSAs and HCSAs on the basis of the NAS in the two residential sub-baskets. As directed by the Commission in Decision 2002-34, the Companies proposed to transfer into the deferral account the amount allocated to non-HCSAs.

Parties' comments

32. In its comments dated 21 August 2002, the CCTA noted that in response to an interrogatory filed in the proceeding initiated by *Price cap review and related issues,* Public Notice CRTC 2001-37, 13 March 2001, both Bell Canada and TCI stated that there would be no unrecovered costs at the end of the current price cap period. The CCTA suggested that these responses were at odds with the information provided in the companies' submissions.

33. In its comments dated 30 September 2002, the CCTA alleged that the methodology proposed by the Companies was an attempt to reverse-engineer the revenue requirement for these costs for the second price cap period. The CCTA noted that the Companies started with their estimates of the revenue requirement approved for the first price cap period and deducted from that their estimates of start-up costs for local competition and LNP that had been recovered.

34. The CCTA argued that there was no reason to expect that the results submitted by the Companies were true estimates of local competition and LNP revenue requirements for the second price cap period. The CCTA argued that the Companies had not provided estimates of the level of ongoing costs for the second price cap period. The CCTA submitted that, at best, the Companies' estimates represented the percent of revenue requirement associated with start-up versus ongoing costs for the first price cap period, and would have no relevance in determining the amount of ongoing costs that needed to be recovered over the second price cap period.

35. The CCTA also submitted that the Companies had not provided any supporting calculations for the amount of revenue that was incorporated into the capped services rates to recover the start-up costs for local competition and LNP.

36. Allstream stated that it agreed with the submissions of the CCTA regarding the proposed calculations for the adjustment related to the start-up costs for local competition and LNP. In addition, Allstream submitted that the requirements of Decision 2002-34 were clear and that the ILECs should be directed to reverse the exogenous factor that initially allowed for the

recovery of these costs as approved in Order 99-239 and Order 2000-143. It also suggested that the ILECs should be directed to assign the associated revenues to their respective deferral accounts.

The Companies' reply comments

37. In response to the CCTA's comments that in the price cap review proceeding the Companies had indicated that there would be no unrecovered costs at the end of the first price cap period, Bell Canada and TCI noted that their respective responses to the interrogatories in the proceeding that led to Decision 2002-34 confirmed that they had recovered the permitted amount over the first price cap period. Both companies indicated that their responses did not address recovery of costs after the first price cap period, which, Bell Canada noted, was an issue that had not been raised in the interrogatory.

38. Bell Canada indicated that, in its submission of 6 August 2002, it had calculated the ongoing revenue requirement recovery associated with the start-up of local competition and the roll-out of LNP by applying certain adjustments to the recoverable costs permitted by the Commission during the first price cap period. The company stated that these adjustments were intended to eliminate the portion of one-time costs associated with the start-up of local competition and LNP that had been recovered during the first price cap period. Bell Canada also stated that the ongoing revenue requirement consisted of ongoing capital and expenses associated with the start-up of local competition and LNP and one-time costs that had not been recovered during the first price cap period.

39. TCI stated that its 6 August 2002 submission attempted to determine the requirement for continuing recovery of the ongoing costs and unrecovered one-time capital costs related to the start-up of local competition and LNP that were not recovered during the first price cap period.

40. Aliant Telecom, Bell Canada and MTS noted that if the life of capital assets extended beyond the first price cap period, only a portion of the associated capital expenditures would have been recovered during the first price cap period using the revenue requirement approach. In addition, the companies noted that the longer the life of an asset, the smaller the proportion of capital expenditure that would have been recovered during the first price cap period. Aliant Telecom, Bell Canada and MTS further noted that in Order 99-239, the Commission had recognized that this approach would defer the recovery of some of the local competition and LNP start-up costs. On that basis, the companies submitted that only a portion of the start-up costs for local competition and LNP would have been recovered over the first price cap period.

41. Aliant Telecom, Bell Canada and MTS submitted that the CCTA's concerns about the Companies not having provided an estimate of the level of ongoing costs for the second price cap period, and whether the results represented a true estimate of the revenue requirement for the ongoing costs for the start-up of local competition and LNP for the second price cap period, were unfounded.

42. Aliant Telecom, Bell Canada and MTS argued that they had calculated the adjustments associated with the expiry of the exogenous adjustment for the start-up of local competition and LNP in accordance with the Commission's directives set out in Decision 2002-34. In addition,

they submitted that investigating the revenue requirement as suggested by the CCTA would be a complicated and contentious task, given that the information was not on the record of the proceeding leading to Order 2000-143. Finally, they submitted that the approach suggested by the CCTA would not meet the Commission's directive set out in Decision 2002-34.

43. In response to the CCTA's concern that the Companies had not indicated how the revenues currently incorporated into capped rates to recover start-up costs for local competition and LNP had been calculated, Aliant Telecom, Bell Canada and MTS submitted that they had provided full details supporting the calculations of these figures.

44. In response to Allstream's submission that the ILECs should be directed to reverse the exogenous factors allowed during the first price cap period for the recovery of local competition and LNP costs, and to assign the associated revenues to their respective baskets as stated in Decision 2002-34, Bell Canada noted that the orders referred to by Allstream had allowed the ILECs to recover both one-time and recurring costs associated with the exogenous factor for the implementation of local competition and LNP. Bell Canada argued that in Decision 2002-34, the Commission directed the ILECs to make adjustments for the effects of the expiry of portions of the exogenous adjustment related to start-up of local competition and LNP. Aliant Telecom and MTS indicated that they concurred with Bell Canada's view and TCI referred Allstream to its comments on the CCTA submission.

Commission analysis and determination

Methodology

45. In Order 99-239, the Commission acknowledged that based on the approved depreciation life characteristics, the revenue requirement approach would defer the recovery of some start-up costs for local competition and LNP beyond the first price cap period.

46. The Commission notes Allstream's submission that the ILECs should be required to reverse the exogenous adjustment for start-up costs for local competition and LNP, and to assign the associated revenues to their deferral accounts. The Commission further notes that Decision 2002-34 requires the assignment to the deferral account of only the time-limited portion of that exogenous adjustment that is allocated to non-HCSAs.

47. The Commission considers that the methodology used by the Companies to estimate the portion of the start-up costs for local competition and LNP that have been recovered is reasonable because it is based on the methodology approved by the Commission in Orders 99-239 and 2000-143. The Commission therefore approves the Companies' proposed amounts to be transferred into the deferral account annually for each company.

48. The Commission notes that the adjustment for the recovery of the start-up costs for local competition and LNP will be ongoing. Therefore, the Commission considers that the amount corresponding to the start-up costs for local competition and LNP already recovered and allocated to non-HCSAs should be transferred into each company's deferral account for each year of the four years of the price cap period approved in Decision 2002-34.

49. Table 2 below provides the amounts to be transferred into the deferral account by each company for recovered start-up costs for local competition and LNP, for each of the four years of the second price cap period.

Table 2
Start-up costs recovered for local competition and LNP
Estimates to be transferred into the deferral account
($000)

Company	($000)
Aliant Telecom	1,130
Bell Canada	17,755
MTS	2,483
TCI	11,758

Next review period

50. The Commission considers that, when an ILEC's start-up costs for local competition and LNP are fully recovered, it should file for approval a proposal to transfer the additional amounts recovered into its deferral account. The Companies are directed to file a report, with supporting calculations, on the status of the recovery of the start-up costs for local competition and LNP, no later than at the end of the second price cap period. The report should show the amount of the one-time costs that have been recovered, any amount of start-up costs that may remain to be recovered, and the amount of the ongoing costs that will be required going forward.

C. Aliant Telecom's proposal to draw down unused price cap "room" from the deferral account

Aliant Telecom's proposal

51. Aliant Telecom proposed to draw down its deferral account by $6.4 million to reflect the unused price cap "room" carried forward from the first price cap period. In support of its proposal, the company argued that in Decision 2002-34 the Commission had allowed the carry-forward of unused room from one price cap year to the next. The company also noted that in Decision 2002-34, the Commission directed that the SBLs and service band index (SBI) should be reset at 100, effective 31 May 2002.

52. Aliant Telecom noted that in the case of the former Maritime Tel & Tel Limited (MT&T), it had not raised rates in response to the increased room available due to the application of the exogenous factor related to the introduction of the contribution revenue-percent charge. Aliant Telecom submitted that it would be unreasonable to require the reversal of an exogenous adjustment on a revenue base that had not included revenue derived from such an exogenous adjustment.

Allstream's comments

53. Allstream submitted that Aliant Telecom had misinterpreted the carry-forward provisions set out by the Commission in Decision 2002-34, and therefore its proposal should be denied. Allstream argued that the carry-forward provision in Decision 2002-34 pertained to price changes within the residence basket, from one year to the next over the course of the current price cap period, for the years 2002 to 2005. Allstream argued that in the decision the Commission had made no reference to carry-forward room from the previous to the current price cap period. Allstream further argued that in Decision 2002-34 the Commission had reset the going-in price cap indices to 100 effective 31 May 2002, and that no provision had been made to allow for the draw-down from the deferral account in the manner proposed by Aliant Telecom.

Aliant Telecom's reply

54. Aliant Telecom submitted that Allstream had taken liberties with the interpretation of the meaning of Decision 2002-34. Aliant Telecom argued that in Decision 2002-34 the Commission had not specifically stated that the carry-over provision only applied to the current price cap period. It also argued that the carry-over provision was consistent with the previous price cap regime, as there was no reference to unused room from one price cap period to the next.

55. Aliant Telecom argued that its carry-over proposal was consistent with the Commission's determinations in Decision 2002-34. In Aliant Telecom's view, it was clear that the Commission had not intended to deny any ILEC the ability to carry-over unused room from one year to the next. It argued that the Commission had specifically stated that unused room could be carried forward with respect to the residential basket. Aliant Telecom also argued that it was implicit in Decision 2002-34 that exogenous events from the first price cap period would be carried forward in the second price cap period. Otherwise, Aliant Telecom argued, the Commission would be choosing to carry forward only those elements that would be detrimental to the company, while ignoring beneficial elements.

56. Aliant Telecom also argued that such an approach would be punitive and inconsistent with the Commission's stated objective to balance the interests of the three main stakeholders in the telecommunications market.

57. Aliant Telecom further argued that its proposal was consistent with the Commission's determinations that its unused room, which was mathematically negated by the resetting of the SBLs and SBIs, should be considered within the structure of the deferral account. Aliant Telecom also argued that this was consistent with other transition elements from the first to the second price cap period.

Commission analysis and determination

58. The Commission notes that Aliant Telecom, in the territory formerly served by MT&T, had not used all of the price cap room that was available for increases to the rates for services in the overall basket of capped services during the first price cap period.

59. The Commission acknowledges that in Decision 2002-34 it allowed any carrier that does not increase residential local exchange rates in a given year to carry forward the unused room to subsequent years. The Commission also notes that any rate adjustment would be subject to the rate element constraint. However, the Commission notes that these provisions apply only within the current price cap period. In Decision 2002-34, the Commission did not intend to allow for carry-over of unused room from the first price cap period into the current price cap period, which is why it reset the SBIs and SBLs at 100 effective 31 May 2002.

60. Accordingly, the Commission **denies** Aliant Telecom's proposal to draw down $6.4 million from the deferral account for the unused room from the first price cap period.

D. Aliant Telecom's proposal to exclude certain non-HCSA NAS revenues in the calculation of the amount to be transferred to the deferral account

Aliant Telecom's proposal

61. In determining the residential local services revenues for non-HCSAs that would be subject to the basket constraint equal to the inflation rate less a productivity offset, Aliant Telecom proposed to exclude the revenues associated with residential NAS in bands where rates were set below Phase II costs plus a 25% mark-up. In support of its proposal, Aliant Telecom noted that in Decision 2002-34, the Commission stated that the pricing policy established in *Pricing policy for services subject to price caps*, Telecom Order CRTC 99-494, 1 June 1999 (Order 99-494) would continue to apply to other capped services.

62. Aliant Telecom noted that in Decision 2002-34, the Commission had stated that it would not require price reductions below Phase II costs plus a 25% mark-up in order for an ILEC to meet its price cap requirement. Aliant Telecom also noted that the Commission had stated that this policy would apply to other capped services. The company proposed that this policy should also apply to residential services in non-HCSAs.

63. Aliant Telecom submitted that it would be inappropriate to require rates that were below the Phase II costs plus the 25% mark-up level to contribute to the deferral account. Aliant Telecom indicated that to do so would, in effect, be requiring these services to cover additional costs or incur implicit rate reductions. Aliant Telecom argued that this would be contrary to the determination made by the Commission in Decision 2002-34 not to require rate reductions below Phase II costs plus a 25% mark-up. Aliant Telecom further argued that such reductions would hamper the development of effective competition.

64. Aliant Telecom proposed that the non-HCSA revenues that would be subject to the inflation minus the productivity offset constraint would be reduced, resulting in $2.8 million being transferred to the deferral account for 2002.

Parties' comments

65. The Commission received no comments on this issue.

Commission analysis and determination

66. The Commission notes that in Order 99-494, it finalized its interim determination with respect to NBTel Inc. (NBTel), stating that it would not require the company to file, for a service, a rate reduction below its Phase II cost plus a mark-up of 25%, in order for NBTel to meet its price cap requirements. In that order, the Commission extended this policy to other ILECs subject to price cap regulation. In Decision 2002-34, the Commission determined that the policy established in Order 99-494 would continue to apply to other capped services.

67. The Commission notes that its determination in Decision 2002-34 pertains to individual rates for other capped services not being reduced to below Phase II costs plus 25%, while the revenues that a company must place in the deferral account are based on a constraint applied to revenues in the basket of residential local services in non-HCSAs. The basket of residential local services in non-HCSAs includes the revenues for local exchange services and residential optional local services. The Commission considers that, on an overall basis, Aliant Telecom's rates in the basket of residential local services in non-HCSAs are compensatory when the contribution revenues from residential optional local services are included.

68. The Commission further notes that the revenues to be placed in the deferral account corresponding to the application of the constraint on the basket of residential local services in non-HCSAs was to reflect the efficiencies that the ILECs are expected to achieve in providing all these services.

69. Accordingly, the Commission **denies** Aliant Telecom's proposal to exclude the revenues from the NAS in non-HCSA rates that are set below Phase II costs plus a mark-up of 25% in the calculation of the amount that should be transferred to the deferral account.

70. The dissenting opinion of Commissioner Langford is attached.

Secretary General

This document is available in alternative format upon request and may also be examined at the following Internet site: http://www.crtc.gc.ca

Dissenting opinion of Commissioner Stuart Langford

I agree with the majority on all findings but for its conclusions contained in section B of its decision, paragraphs 25 to 50. I refer to the amounts of money to be transferred into deferral accounts as financial adjustments referable to start-up costs for local competition and the rolling out of local number portability (LNP). In my opinion, there is simply insufficient evidence on the record to support the amounts submitted by the companies affected and accepted as correct by the majority decision.

Ideally, these issues should have been rolled into the broader question of how to dispose of the considerable funds accumulating in telephone company deferral accounts, a question which is now the focus of a separate proceeding before the Commission. Alternatively, the majority order made today could have been made only after a current and comprehensive review of expenditure requirements in the second price cap period. To make a final order based on dated and possibly inaccurate cost filings, as the majority has done, is to run the risk of unjustly enriching the shareholders of some of Canada's largest telephone companies at the expense of the customers they serve.

A little background please

Paragraphs 1 and 2 of the majority decision are instructive, but they overlook the important question of what a deferral account is and how it is supposed to work.

The deferral account mechanism introduced by Decision 2002-34 is unique. For example, none of the 42 American states that have moved to a price cap system of regulation have adopted it. Nor was a deferral account mechanism part of Canada's first price cap regime that was in place between 1998 and 2002. A deferral account's purpose is to prevent constant fluctuations in prices for basic telephone services. With a deferral mechanism in place, prices for basic service can go up but they cannot go down unless the telephone companies apply to lower them. Put that simply, it does not sound very consumer-friendly. In context, however, and always assuming that it is handled properly, a deferral account element in a price cap regime can benefit telephone customers.

Price cap systems are intended to artificially imitate the impact of market forces where no meaningful competitive market forces exist. This is done by incenting monopoly or near-monopoly service providers like Bell Canada, MTS, Aliant Telecom and TELUS to improve their productivity and to pass the savings that result from doing so on to their customers. Under a price cap regime, as in a truly competitive market place, more efficient firms fare better than less efficient ones. In theory, as efficiency increases prices should decrease. Successful firms are rewarded because profits are not regulated, only prices. Super efficient telephone companies can meet the price regulations and still return high dividends to their shareholders.

What about customers?

The relevant provisions of the current Canadian price cap regime allow regulated phone companies to raise prices only when the rate of inflation exceeds the productivity gains they are able to achieve. When productivity outstrips inflation, prices should decrease. That's the way it works in most price cap systems, but not in Canada. Here, the savings that one would

expect to see passed on to customers are set aside by regulated telephone companies and credited to their deferral accounts. The money in those accounts does not belong to the telephone companies. It is held by them for the benefit of customers. Decision 2002-34 which sets out the terms of the current price cap system contains provisions for ensuring that the funds are used to achieve "the Commission's objectives for the next price cap framework" (paragraph 413). How exactly that will be done is, as I have already mentioned, the subject of a separate comprehensive procedure currently before the Commission.

Exogenous claims

From time to time, those telephone companies that keep a deferral account apply to the Commission for permission either to draw money from it or, as is the case in this matter, for permission to deposit a smaller amount into it than they apparently should. Such applications are typically supported by a claim that an "exogenous" event, something unexpected, some exigency outside the predictable parameters of business life, something beyond their control has caused the companies to realize unexpected savings or to make unexpected expenditures. The matters underlying this dissent, competition start-up costs and local number portability, are examples of exogenous adjustment claims that the Commission has accepted.

During the first price cap regime, the Commission directed monopoly providers of local telephone services to take the steps necessary to ensure that new phone companies could begin offering customers alternative sources of service. Generally, the Commission ordered existing phone companies to adjust their plants in order to allow competitors access to certain necessary facilities. For example, the Commission decreed that phone numbers should be portable, that customers who switch service providers should be able to keep their existing telephone numbers.

Here's the rub

Because these were adjustments to their facilities and business practices that the incumbent monopolies would never have considered making without regulatory prompting, the Commission allowed them to treat the expenses incurred as exogenous factors. Under the current price cap regime, because productivity has and continues to outstrip inflation, the regulated companies have been making annual deposits of amounts equivalent to foregone rate decreases into their deferral accounts. The question in contention in this case is how much can the companies deduct from their annual deferral account deposits to cover costs related to competition start-up and LNP exogenous factors?

The problem and the reason for this dissent is that the answer to that question is far from clear. In my opinion, the record of this proceeding, even when fleshed out by earlier related proceedings (see Order 99-239 and Order 2000-143) simply does not contain sufficient information upon which to make an informed decision. Yet, the majority has not only accepted the companies' under-supported totals, it has approved an identical reduction to deferral account deposits for each of the four years of the current price cap regime. When one considers how limited competitive inroads have been into local residential wireline phone markets and how very nearly impossible it is to predict future success or failure for competitive service providers, it seems imprudent to say the least to make such a long-reaching final decision.

In my view, what is required and what is missing is hard evidence for which no amount of speculative cost analysis, based as the companies' projections are on four and five year old information, is an acceptable substitute. No matter how sound the methodology, if the raw data is inadequate, the results must be suspect. In a case such as this, where the rewards for guessing incorrectly may be huge windfall profits to the companies sourced from deferral accounts, the Commission has a responsibility to err on the side of extreme caution.

Too little, too late

To declare as the majority does in paragraph 50, that "the Companies are directed to file a report, with supporting calculations, on the status of the recovery of the start-up costs for local competition and LNP no later than at the end of the second price cap period," is, in my opinion, to miss meeting the Commission's responsibility to Canadian telephone users by a country mile. If such a report is needed, and in my view it most certainly is, it is needed now. During the four years of the second price cap regime, the companies will siphon into their coffers many millions of dollars that, perhaps, should be going into their deferral accounts, accounts held for the benefit of customers who under the regime are forced to forego the pleasure, pending further process, of enjoying price decreases.

No end in sight

It is worth returning to the historical context underlying this case before leaving this matter. In paragraph 1 of the majority decision reference is made to the fact that the costs at issue in this case have been characterized by the Commission as "one-time" or "time-limited". In paragraph 678 of the second price cap decision, Decision 2002-34, the Commission declared: "While most of the adjustments were intended to be ongoing, portions of two of these adjustments were time-limited." In paragraph 679, this proposition is restated: "The Commission is of the view that an adjustment should be made to recognize the expiry of these two time-limited exogenous events, and hence the expiration of the requirement for the original adjustment."

Interveners have argued that today's majority decision leaves one with quite another sense of what we are dealing with here. Again, the reference is to paragraph 50 and the majority's final pronouncement on this issue in the context of the reports expected, at the latest, by the conclusion of the second price cap regime: "The report should show the amount of the one-time costs that have been recovered, any amount of start-up costs that may remain to be recovered, and the amount of the ongoing costs that will be required going forward." Suddenly, the broad interpretation that common usage and some interveners give to the term "one-time" seems completely misplaced. References to "costs that may remain" and "ongoing costs" give the distinct impression that claims against the deferral account will continue, perhaps forever.

It is unacceptable in my view to allow present and future claims against customers' money to rest on four and five year old calculations, on figures that no matter how carefully prepared at the time may well be flawed today and more seriously flawed tomorrow. The competitive agenda in the provision of local wireline telephone service has not rolled out as the Commission hoped or the former monopoly companies feared. Penetration rates by

competitors are small, so small that, arguably, the on-going costs associated with servicing competitive entry and LNP are but a fraction of what the companies reasonably expected four or five years ago. The majority decision appears to overlook these factors.

In my view, rather than make the final order contained in the majority decision, a wiser course would have been to require the companies involved to provide fresh financial evidence demonstrating that the amounts in question will in fact be spent on competition start-up and LNP over the second price cap regime. Alternatively, this application could have been rolled into the broader deferral account procedure currently before the Commission. To make a final order, thereby depriving the Commission of the power to make later adjustments and then to add to that a requirement to report retrospectively is to choose the worst of all available options. It offers no guarantee of accuracy and down the road provides the Commission with no way to correct any errors that may have been made.