Canadian Radio-television and Telecommunications Commission | Conseil de la radiodiffusion et des télécommunications canadiennes

Telecom Decision CRTC 2005-54

Ottawa, 15 September 2005

Northwestel Inc. - Supplemental funding requirements for 2004 and 2005

Reference: 8695-C12-200413625

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In this Decision, the Commission ***approves, on a final basis,*** *supplemental funding for Northwestel Inc. (Northwestel) of $9.3 million for 2004 and $9.1 million for 2005. The Commission directs Northwestel to file an application for its 2006 supplemental funding by* ***17 October 2005.***

The Commission will issue a public notice shortly to initiate a proceeding to review Northwestel's regulatory framework.

Background

1. In *Long-distance competition and improved service for Northwestel customers*, Decision CRTC 2000-746, 30 November 2000 (Decision 2000-746), the Commission established, effective 1 January 2001, the terms and conditions for long distance competition in Northwestel Inc.'s (Northwestel) territory. The Commission also determined that it would continue regulating Northwestel on a rate base/rate of return basis at least until the end of 2002. Northwestel's regulatory framework included a bundled carrier access tariff (CAT) rate of $0.07 per minute and no earnings sharing for amounts earned in excess of the top of the company's return on common equity (ROE) range of 11 percent. The Commission also approved a four-year service improvement plan (SIP) for 2001 to 2004 to extend and improve service in the North. Further, the Commission approved supplemental funding of $15.1 million for 2001 and determined that it would conduct annual reviews of the supplemental funding required by Northwestel.

2. In *Northwestel Inc. - Initial annual review of supplemental funding*, Telecom Decision CRTC 2003-39, 20 June 2003 (Decision 2003-39), the Commission approved supplemental funding of $13.4 million for 2002. The Commission also approved interim supplemental funding of $13.4 million for 2003, and approved Northwestel's revised SIP, including its toll-free Internet access proposal and part of its call management services (CMS) proposal. The Commission further determined that Northwestel's existing regulatory framework would remain in place at least until the completion of the company's SIP at the end of 2004.

3. In *Northwestel Inc. - Supplemental funding requirement for 2003*, Telecom Decision CRTC 2004-64, 30 September 2004, as amended by *Northwestel Inc. - Supplemental funding requirement for 2003*, Telecom Decision CRTC 2004-64-1, 18 October 2004 (Decision 2004-64), the Commission approved, on a final basis, supplemental funding of $9.6 million for 2003; approved, on an interim basis, the same amount of supplemental funding for 2004; and approved the extension of the roll-out of Northwestel's SIP to 2005.

4. In Decision 2004-64, the Commission determined that it was appropriate to extend Northwestel's existing regulatory regime to the end of 2006. The Commission also determined that it would address Northwestel's 2004 and 2005 supplemental funding requirements in a single process that would focus only on issues essential to the determination of these amounts.

The Commission indicated that it expected to undertake a review of the company's 2006 supplemental funding requirement and regulatory framework after issuing its decision on the final supplemental funding amounts for 2004 and 2005.

5. In *Northwestel Inc. - Annual review of supplemental funding for 2004 and 2005*, Telecom Public Notice CRTC 2004-6, 23 November 2004 (Public Notice 2004-6), the Commission initiated a proceeding to review Northwestel's 2004 and 2005 supplemental funding requirements. The Commission indicated that the determination of the 2004 and 2005 supplemental funding amounts would include an assessment of the following issues:

   - variances in Northwestel's capital plan;
   - productivity measures;
   - changes to depreciation life characteristics;
   - equal access expenditures;
   - the roll-out of Northwestel's SIP;
   - the company's recent quality of service (Q of S) results;
   - the roll-out of long-distance competition in Northwestel's operating territory; and
   - significant matters that might have a material impact on Northwestel's supplemental funding.

6. The Commission received comments pursuant to Public Notice 2004-6 from the Government of the Northwest Territories (GNWT); the Public Interest Advocacy Centre, on behalf of the Consumers' Association of Canada, the National Anti-Poverty Organization, and l'Union des consommateurs (the Consumer Groups); the Utilities Consumers' Group (UCG); and the Yukon Government (YG).

Capital expenditures

Service improvement plan

7. In Decision 2003-39, the Commission approved a revised four-year SIP of $75.1 million for Northwestel.

8. In Decision 2004-64, the Commission was of the view that Northwestel's SIP was essentially on track and that Northwestel would complete most of its SIP in 2004. Based on the unique operating circumstances in Northwestel's territory, the Commission found that it was reasonable for a small number of projects to be carried over into 2005, and therefore extended the SIP roll-out schedule to 2005.

9. Northwestel indicated that its 2004 view of the total SIP capital expenditures was $84.5 million, an increase of $9.4 million over the 2003 view. Northwestel also indicated that the revenue requirement associated with the SIP would remain significant for the foreseeable future.

10. Northwestel noted that it expected to complete the SIP roll-out in 2005. Northwestel submitted that it had contended with changes in technology, vendor business plans, and supplier product lines throughout the duration of the SIP. The company indicated that it had also contended with changes in project scope predicated on refinement of network design, and a compressed schedule, further constrained by short construction seasons and often inhospitable environments.

11. Northwestel submitted that to accomplish the overall objective of the SIP, it found it necessary to revise the scope of some projects that it had identified in 1999, and that these changes accounted for the majority of the difference between Northwestel's 2003 and 2004 views of the SIP capital expenditures. Northwestel noted that some projects scheduled for 2003 were deferred or carried over into 2004 and 2005 to accommodate changes in other projects. Northwestel indicated that most of the work scheduled for 2005 involved the completion of access extensions and upgrades to small groups of customers or individual customers. Northwestel also indicated that some transport network projects would be carried over into 2005.

12. Northwestel noted that while the SIP had brought about significant and valued improvements to telecommunications services in the North, there would continue to be gaps in the availability or quality of various telecommunications services in the North compared to those generally available in the rest of Canada. Northwestel submitted that upgrades to four additional areas could be considered in a future SIP: the satellite system used to provide toll service; the asynchronous (DS3-based) heavy-route digital radio systems; the light-route radio systems that required replacement to meet Industry Canada's Standard Radio Spectrum Use Policies; and the communities in the North that could not afford public safety services, including 9-1-1 service. Northwestel also submitted that it anticipated that some individuals with seasonal dwellings would move to presently unserved locations and request phone service that would, in many cases, be uneconomical to provide.

13. The Consumer Groups noted that, in contrast to Northwestel's previous submissions, which indicated that the SIP was mainly on budget, Northwestel's present submission indicated that the total cost of the SIP had increased from $75.1 million to $84.5 million, an increase of 12.5 percent. The Consumer Groups submitted that Northwestel should not be permitted to undertake such significant changes to its SIP without prior notification to the Commission and that the Commission should require telephone companies undertaking approved SIP programs to identify material changes to the cost of these programs when they arise or become known.

14. The YG noted the Consumer Groups' concern regarding the total cost of the SIP and submitted that Northwestel's capital plan filings and responses to interrogatories sufficiently demonstrated that the SIP costs were reasonable and necessary to ensure the completion of the SIP as intended.

15. The YG and the GNWT noted Northwestel's argument that there continued to be gaps in the availability or quality of various telecommunications services in the North. The GNWT submitted that the majority of northern communities continued to lack access to enhanced calling features. The GNWT also submitted that completion of the SIP should be viewed as an

important first step in meeting the Basic Service Objective,[1] and not as the conclusion of the Commission's or Northwestel's efforts in this regard. The YG submitted that consideration should be given to the development of a further SIP to address the four potential areas noted by Northwestel or, at a minimum, to the establishment of a mechanism that would enable the extension of service to future customers on terms similar to those in the current plan.

16. The UCG submitted that, for future proceedings, the Commission should direct Northwestel to provide surveys and customer feedback when Northwestel makes reference to these in an application.

17. Northwestel replied that the reasonableness of specific increases in the scope of the SIP projects had not been questioned by any party. Further, Northwestel submitted that it had complied with the process set out in Decision 2000-746, which was consistent with the process that the Commission had used to review SIP projects for the southern incumbent local exchange carriers (ILECs), as set out in *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002.

18. Northwestel submitted that the SIP program was nearing completion and that if the Commission were to change the procedure by which it reviewed SIP programs, as suggested by the Consumer Groups, access to service and the implementation of new services would be delayed.

Commission's analysis and determinations

19. Based on the company's latest schedule, the Commission considers that it is reasonable to expect that Northwestel will complete its SIP roll-out in 2005.

20. The Commission notes that Northwestel's projected increases in SIP capital expenditures for 2004 and 2005 are $2.2 and $7 million, respectively. The Commission also notes that the total increase in the SIP capital expenditures for 2003, 2004, and 2005 amounts to $9.4 million, representing a 12.5 percent increase to the previous forecasted total cost of $75.1 million. The Commission further notes Northwestel's submission that the 2004-view-over-2003-view differences for the test years 2004 and 2005 were due to a number of factors, as described above.

21. The Commission is of the view that cost overruns of the type described by Northwestel can be expected on large, complex projects carried out in inhospitable environments, and considers that Northwestel has provided satisfactory explanations for the capital cost increases. In light of the above, the Commission finds the forecasted increase in capital expenditures for Northwestel's SIP acceptable. Accordingly, the Commission **approves** Northwestel's revised SIP estimate of $84.5 million.

22. With regard to the Consumer Groups' submission that Northwestel should not be permitted to undertake significant changes to its SIP without prior notification to the Commission, the Commission notes that, pursuant to Appendix 3 of Decision 2000-746, Northwestel is required to file a SIP tracking report annually. In this annual report, the company is required to provide

[1] The Commission established the Basic Service Objective for local exchange carriers in *Telephone service to high-cost serving areas,* Telecom Decision CRTC 99-16, 19 October 1999.

explanations for all changes to the SIP. The Commission considers that this tracking report has been, and continues to be, sufficient to inform the Commission of significant changes to the company's SIP.

23. The Commission notes the point raised by some parties that there continued to be gaps in the availability of telecommunications services and that the majority of northern communities continued to be without access to enhanced calling features, which include CMS. The Commission notes that it has already addressed matters related to the provisioning of CMS in Decisions 2003-39 and 2004-64. In Decision 2004-64, the Commission noted that funding for rolling out CMS had been thoroughly examined in the proceeding leading to Decision 2003-39. Accordingly, as noted in Decision 2004-64, the Commission is of the view that it has already disposed of issues related to the provisioning of CMS in Northwestel's serving territory in Decision 2003-39.

24. The Commission notes Northwestel's and the YG's submissions concerning a new SIP. The Commission intends to consider whether a new SIP is required in the upcoming review of Northwestel's regulatory framework, which is discussed later in this Decision.

25. The Commission notes that the UCG was interested in reviewing details of customer feedback with respect to the company's SIP implementation in future public proceedings. The Commission is of the view that, at this time, there is no need to direct Northwestel to provide details of customer feedback in order to review future SIPs. However, any concerns with SIP implementation should be reported immediately to the Commission through its complaint process, in order to allow the Commission to address these as they arise.

Internet access program

26. Northwestel indicated that there was an increase in costs and in the revenue requirement for the Internet access program when comparing the 2003 and 2004 results.

27. The UCG submitted that, since this proceeding did not include an examination of Internet access, expenses, and costs, the Commission should initiate a separate proceeding soon to examine these issues. The UCG also requested that the Commission examine the increase in costs from 2003 to 2004 before approving Northwestel's ten-year Internet plan.

28. Northwestel replied that the increase in the revenue requirement from 2003 to 2004 resulted primarily from the fact that most communities were provisioned with Internet in 2004.

Commission's analysis and determination

29. The Commission is of the view that Northwestel has adequately responded to the UCG's concerns, and, as a result, no further examination of the expenses and costs for the Internet access program is required. Accordingly, the Commission does not consider it necessary to initiate a separate proceeding to address this program.

Capital plan

30. Northwestel indicated that the 2004 view of its capital plan for 2004 to 2007, including SIP capital expenditures, was $182 million, compared to the 2003 view of $159.3 million for the years 2003 to 2006. Northwestel indicated that for the common years 2004 to 2006 its forecast had increased by $24.7 million. Northwestel submitted that expenditures for growth, modernization, replacement, and support comprised 51.2 percent, 29.3 percent, 2.3 percent, and 17.2 percent, respectively, of the total expenditures in the 2004 view. Northwestel also submitted that some net present value (NPV) studies were not available at the time that it filed its capital plan for 2004 and 2005.

31. The Consumer Groups noted that Northwestel's 2004 view of planned capital expenditures for 2005 and 2006 had increased by 41 percent and 35 percent, respectively, over the 2003 view for the same years.

32. The Consumer Groups submitted that the Commission should not approve Northwestel's capital plan unless Northwestel has adequately demonstrated that these expenditures were justified. The Consumer Groups also submitted that the Commission should require Northwestel to demonstrate that new projects have a positive NPV before permitting their inclusion in the approved capital plan. The Consumer Groups noted that Northwestel had identified 13 new capital projects that were added to the 2004 view of the capital plan, but had provided no supporting economic evaluations.

33. In its reply argument, Northwestel submitted that the Consumer Groups' suggestion that the Commission withhold approval of Northwestel's capital plan was without merit. Northwestel submitted that it had filed a detailed and comprehensive capital plan for 2004 to 2007 in response to a Commission interrogatory and had responded to all Commission interrogatories as requested. Northwestel noted that its capital plan had been stable in recent years, and that all changes had been explained. Accordingly, the company argued that its 2004 capital plan was reasonable.

Commission's analysis and determinations

2004 expenditures

34. The Commission notes that for the 2004-view-over-2003-view comparison of capital expenditures for 2004, there was a decrease of $0.6 million. The Commission also notes that the growth component of the capital expenditures has been supported by increased demand for local, toll, and data services. The Commission further notes that, in Decision 2004-64, it stated that it expected Northwestel to file a positive NPV study to support continuing the Terminal Servers project, and that the company has now provided an NPV study that shows positive results. Accordingly, the Commission finds Northwestel's proposed capital expenditures for 2004 reasonable.

2005 expenditures

35. The Commission notes that for the 2004-view-over-2003-view comparison of capital expenditures for 2005, there was an increase of $13.2 million. The Commission notes that this increase is mainly due to increases totalling $7 million to the SIP projects noted above, and that

the remaining $6.2 million of capital expenditures resulted primarily from the forecasted introduction of new services. The Commission also notes that the growth in capital expenditures has been supported by increased demand for local, toll, and data services.

36. In Decision 2004-64, the Commission stated that it expected new discretionary projects to be supported by positive NPV studies before assessing their reasonableness. In the Commission's view, NPV studies are required for only six discretionary projects of the 13 new projects introduced by the company in its 2004 view. Northwestel did not file NPV studies for these six projects,[2] indicating that it could not provide them at the time that it filed its capital plan for 2004 and 2005.

37. The Commission finds that the company's 2005 capital expenditures are reasonable, subject to Northwestel filing NPV studies for the six discretionary projects. The Commission directs Northwestel to file NPV studies for these projects in the upcoming regulatory framework proceeding.

2006 and 2007 expenditures

38. The Commission notes that for the 2004-view-over-2003-view comparison of capital expenditures for 2006, there was an increase of $12.1 million. The Commission also notes that Northwestel's forecasted 2006 and 2007 total capital expenditures of $46.2 and $43.2 million, respectively, are approximately the same as the 2005 capital expenditure total of $45.3 million, which includes $7 million in SIP expenditures. As the SIP will be completed in 2005, the Commission is of the view that, absent special circumstances, the total capital expenditures for 2006 and 2007 should be lower than those for 2005.

39. The Commission directs Northwestel to review the forecasted level of total capital expenditures for 2006 and 2007 with a view to reducing the total for each year, taking into consideration the company's obligation to maintain the required Q of S standards and the fact that the SIP will have been completed, and to file the results of this review in the upcoming regulatory framework proceeding. The Commission notes that it will perform a detailed review of the 2006 and 2007 capital expenditures in the upcoming regulatory framework proceeding.

Competitive issues

Equal access roll-out

Commission's analysis and determination

40. The Commission notes that Northwestel's evidence indicates that there had been no change since the 2003 supplemental funding proceeding with regard to the number of equal access subscribers or the interconnection arrangements between these subscribers and Northwestel. Accordingly, equal access roll-out is not addressed in this Decision.

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[2] In response to interrogatory NWTel(CRTC)03Feb05-101, Northwestel listed six discretionary projects: Projects 1.1.56, 1.2.7, 1.2.9, 1.3.2, 3.1.17, and 4.1.5.

Status of long distance competition

41. In Decision 2004-64, the Commission considered that long distance competition in Northwestel's territory was evolving at a rate similar to that experienced by southern ILECs two years after the introduction of competition, but in a different way. The Commission noted that long distance competition in the North existed mainly in the form of resale and prepaid cards, and that equal access was available only in larger cities. The Commission concluded that parties should not have had unrealistic expectations that competition in the North would evolve the same way as it had evolved in the South.

42. Northwestel estimated that competitors would possess approximately 18 percent of the total toll market in its territory at the outset of 2005. Northwestel submitted that although long distance competition continued to grow in its territory, its market share loss continued to be comparable to the market share loss experienced by southern ILECs during a comparable stage in the development of toll competition in their territories.

43. Northwestel noted that, in previous supplemental funding reviews, it had indicated that competitors' prepaid card services were competing directly with Northwestel's regular toll plans. Northwestel submitted that while two competitors were also providing long distance service in the company's territory using Northwestel's equal access service, prepaid cards continued to be the primary form of toll competition in its territory. Northwestel also submitted that competitors' rates for these cards were considerably lower than its lowest rate for prepaid cards. Northwestel argued that competitors could offer their cards at significantly lower rates since competitors tended to be national or international service providers and were able to spread their costs across the entire market. Northwestel submitted that, as a result, competitors' pricing did not reflect the higher costs of providing long distance service solely in the North.

44. Northwestel submitted that, due to the relatively high rates of its prepaid cards and intense competition in the prepaid card market, its prepaid minutes in 2004 had declined significantly from the 2003 level. Northwestel noted that it had become difficult for the company to compete with unregulated, lower-priced prepaid services and that, as a result, the company had exited the prepaid market in early 2005.

45. Northwestel submitted that it anticipated that voice over Internet protocol (VoIP) would contribute to the growth of competition in the North. Northwestel noted that VoIP was being offered in the North, but that it did not have the ability to track the use of such services or measure their impact at the present time.

46. Northwestel noted that the regulatory framework established in Decision 2000-746 included a bundled CAT. Northwestel submitted that the bundled CAT was designed to promote the rational growth of long distance competition while maximizing revenues in order to reduce Northwestel's dependency on supplemental funding. Northwestel indicated that it was concerned that VoIP would facilitate the bypass of the CAT mechanism, thereby resulting in the erosion of CAT revenues.

47. The UCG submitted that its members were concerned that Northwestel was getting a stranglehold on all telecommunications markets in the North and that the roll-out of long distance competition would not be allowed to develop as it had in southern jurisdictions.

48. The UCG requested that the Commission direct Northwestel to continue to provide prepaid card services, noting that Northwestel was the service provider of last resort in many northern communities.

49. The YG submitted that there was no effective long distance competition in the Yukon; that there was no choice of full service provider, other than a national entity, prepared to absorb losses in serving the North; and that Northwestel's withdrawal from the prepaid card market had reduced the degree of competitive choice available to customers.

Commission's analysis and determinations

50. In determining the appropriate amount of supplemental funding for Northwestel for 2004 and 2005, the Commission assesses the long distance minutes provided by the company with a view to determining how long distance competition is evolving in Northwestel's territory and whether it had, or would have, a significant impact on the company's supplemental funding.

51. The Commission considers that the forecast growth in the total market minutes and market share held by Northwestel and competitors, respectively, is reasonable. The Commission notes that, with respect to the impact of long distance competition on Northwestel's supplemental funding, any difference between the actual and the forecast for toll, settlement, and CAT revenues will accumulate in Northwestel's revenue deferral account. Accordingly, the Commission finds it appropriate to accept Northwestel's forecast of long distance toll minutes.

52. With respect to the UCG's submission that the Commission should direct Northwestel to continue to provide long distance prepaid card services, the Commission notes that competitors have been able to offer prepaid cards at a much lower price per minute than the company's prepaid cards, and the competitors' prepaid cards have been widely available. Accordingly, given that customers have reasonable access to alternate prepaid card services, the Commission finds that it is not necessary to direct the company to continue to provide prepaid card services.

53. The Commission considers that, taking into account the high cost of serving the North and the wide availability of low-cost prepaid cards, parties should not expect that facilities-based competition will be widely available in the North. However, as high-speed Internet connections penetrate the North, VoIP may become an alternate form of competition. Nevertheless, the Commission considers that more information and time is required to assess whether VoIP will become a viable form of competition in Northwestel's territory.

54. The Commission intends to further assess the status of long distance competition in Northwestel's territory in the upcoming review of the company's regulatory framework.

Wholesale rates for broadband and ADSL

55. The Commission addressed the issue of wholesale pricing for Internet access services in Decision 2003-39. It found that the YG's request for a review of the pricing of the Internet Gateway services and its effect on competition in Northwestel's territory was outside the scope

of that proceeding. The Commission indicated that competitors were free to apply to the Commission if they felt that the issue of the pricing of Internet Gateway services, or other similar competitive services, should be explored further.

56. The UCG requested that the Commission initiate a separate proceeding to review the wholesale rates for broadband and asymmetric digital subscriber line (ADSL) service given that the Commission did not wish to review these issues in the present proceeding.

Commission's analysis and determinations

57. The Commission notes that it had received only one complaint with respect to wholesale Internet access pricing by the close of the record of this proceeding and that it disposed of the complaint in its regular complaint process.

58. The Commission notes that it is currently examining the requirement for a wholesale ADSL service for most southern ILECs. The Commission considers that it would not be appropriate to address this issue for Northwestel's territory at this time.

59. In light of the above, the Commission will not initiate a separate proceeding to examine wholesale rates for broadband and ADSL services at this time.

Supplemental funding requirements for 2004 and 2005

Supplemental funding methodology for 2004

60. Northwestel noted that in an interrogatory the Commission had requested the company's view on the appropriateness of calculating its 2004 supplemental funding on the basis of the actual results for the year. Northwestel argued that using the actual results would be inconsistent with the regulatory framework established in Decision 2000-746 and that such a change would be contrary to the required standards of procedural fairness.

61. Citing *Northwestel Inc. - Follow-up to Decisions 2004-64 and 2004-64-1 - Repayment of 2003 excess supplemental funding and disposition of the 2003 revenue deferral account balance*, Telecom Decision CRTC 2004-82, 13 December 2004 (Decision 2004-82) as a precedent, the UCG submitted that it would be appropriate for the Commission to calculate Northwestel's 2004 supplemental funding on the basis of actual results.

62. The YG submitted that it would be inappropriate for the Commission to change the methodology used to calculate the supplemental funding at this point. The YG stated that the assumption shared by all parties was that, consistent with past practice, the forward test-year approach would be used in this proceeding.

63. In reply argument, Northwestel submitted that the UCG's argument was based on a misconception with respect to Decision 2004-82. Northwestel noted that the Commission had established its 2003 supplemental funding in Decision 2004-64, and that Decision 2004-82 was a separate process for the repayment of excess funding received by Northwestel and for the disposition of revenues accumulated in the revenue deferral account. Further, Northwestel submitted that the Commission had not required year-end actual results for 2003 when

determining the 2003 supplemental funding. In Northwestel's view, this was consistent with the process established in Decision 2000-746 and the practice established for setting its 2001 and 2002 supplemental funding.

Commisssion's analysis and determination

64. Consistent with the regulatory framework established in Decision 2000-746, the Commission finds that it continues to be appropriate to assess Northwestel's supplemental funding requirement for 2004 on the basis of the existing forward test-year methodology, rather than on actual results.

Revenues

Commission's analysis and determinations

65. The Commission has reviewed Northwestel's forecasted revenues for 2004 and 2005 and the explanations it provided for year-over-year variances.

66. With respect to 2004, the Commission notes that the actual revenues were 0.7 percent, or $933,000, higher than forecasted. The Commission considers that the difference between the forecast and actual revenues is minimal and, therefore, finds that the forecast for 2004 is reasonable and should be used in the determination of the company's 2004 supplemental funding.

67. With respect to the 2005 revenue forecast, the Commission notes that the forecasted revenues are 1.8 percent higher than the actual revenues for 2004, due to projected increases in demand. The Commission considers that the 2005 forecast is reasonable and that it should be used for the determination of the 2005 supplemental funding, with one adjustment. The Commission notes that in Telecom Order CRTC 2005-198, 25 May 2005, the Commission approved a 15 percent increase to the monthly rates for Voice Grade Channels - Intercity Mileage, effective 4 June 2005. As a result, Northwestel will receive additional revenues with respect to the Private Wire services which were not reflected in the company's 2005 revenue forecast. Accordingly, the Commission considers it appropriate to make an adjustment to take into account these additional revenues. The adjustment will result in a reduction of approximately $140,000 to the 2005 supplemental funding.

68. The Commission directs Northwestel to file an application for the disposal of the 2004 balance in the revenue deferral account **30 days after the date of this Decision**, and for the disposal of the 2005 balance by **31 March 2006**.

Depreciation expense

69. In Decision 2004-64, the Commission examined Northwestel's proposed changes to depreciation life characteristics for 2003 and, among other things, denied the proposed reduction in the average service life (ASL) for Asset Code (Account) 60 - Cable-Aerial/Underground from 26 to 22 years. The Commission based this finding on the fact that the 2003 study for Account 60,

submitted on 14 November 2003 as part of Northwestel's final argument, did not comply with the Commission's Phase I depreciation directives.[3]

70. As part of its application, Northwestel filed, for Commission approval, an amended 2003 depreciation study (the 2003 study) reflecting the Commission's determination in Decision 2004-64, and a 2004 depreciation study (the 2004 study).

71. Northwestel submitted assessments of 15 accounts in the 2003 study. Of these 15 accounts, Northwestel proposed to close three, indicating that this would have no financial impact on the company. Northwestel submitted that a review of the other 12 accounts indicated that no change to depreciation life characteristics was warranted, with one exception - Account 60. However, in light of the Commission's finding in Decision 2004-64 that the ASL for Account 60 should remain at 26 years, Northwestel indicated that it was not seeking a lower ASL for this Account in either 2004 or 2005.

72. Northwestel submitted assessments of 13 additional accounts in the 2004 study, with no proposed changes to depreciation life characteristics. Of these 13 accounts, Northwestel proposed to close two, again indicating that this would have no financial impact on the company.

73. Northwestel estimated its depreciation expense at $30.6 million and $33.4 million for 2004 and 2005, respectively.

Commission's analysis and determinations

74. The Commission considers that the 26-year ASL for Account 60 should be retained for 2004 and 2005. The Commission will, however, re-evaluate the depreciation life characteristics of Account 60 in the upcoming regulatory framework review proceeding.

75. The Commission considers that Northwestel's proposal to close five accounts as a result of its 2003 and 2004 depreciation studies is reasonable. The Commission also considers that no changes should be made to the depreciation life characteristics of the remaining accounts in the studies, as proposed by Northwestel.

76. Accordingly, the Commission **approves** the proposed depreciation life characteristics for those accounts submitted in the 2003 study, effective 1 January 2004, and the depreciation life characteristics for those accounts submitted in the 2004 study, effective 1 January 2005. The Commission also **approves** Northwestel's proposed 2004 depreciation expense of $30.6 million and its proposed 2005 depreciation expense of $33.4 million. A complete listing of the Commission's approved depreciation life characteristics for the accounts for which detailed studies were performed is provided in Appendices 1 and 2.

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[3] Subsequent to the close of the record of the proceeding that led to Decisions 2004-64 and 2004-64-1, Northwestel filed, on 20 May 2004, its 2003 depreciation study for implementation in 2004. However, with the issuance of Decision 2004-64 on 30 September 2004, wherein the Commission denied the company's request to reduce the ASL of Account 60 to 22 years, Northwestel requested that its 2003 depreciation study be withdrawn, noting that it would resubmit these studies as part of the supplemental funding review. By Commission staff letter dated 25 November 2004, Northwestel's request was found to be acceptable.

Operating expenses and productivity

77. In Northwestel's previous supplemental funding review proceedings, the Commission applied a two percent total implied productivity (TIP)[4] to the operating expenses approved for the previous year, after adjusting for growth and inflation, to arrive at the approved operating expenses for the current year.

78. In Decision 2004-64, the Commission approved, on a provisional basis, Northwestel's proposed adjustments to the TIP methodology to add the estimated network access services (NAS) displaced by ADSL to the NAS growth and to apply a unique growth factor to the portion of satellite transponder expenses attributable to data services. However, the Commission denied Northwestel's proposal to exclude the pension expense (income)[5] component from the TIP methodology.

TIP methodology and forecast 2004 and 2005 operating expenses

79. Northwestel noted that it supported the Commission's objective of ensuring that the company achieved, on average, two percent productivity per year. However, the company proposed to exclude the forecast pension expense (income) from the TIP calculation. The company submitted that the theory and principles of a sustainable TIP model depended on the inclusion of load factors and price indicators that proxied the realities of the company. Northwestel argued that if the load and price factors were inaccurate proxies, the TIP model would impose unrealistic expense constraints and jeopardize the company's ability to maintain and extend the network, maintain the Q of S, and support northern communities. Northwestel noted that the Commission had recognized, in Decision 2004-64, that NAS as a sole proxy for load was inappropriate, and that the approved changes to the TIP methodology better reflected the realities of the company's operations.

80. Northwestel submitted that its forecasted operating expenses, determined using the TIP methodology, were $72.8 million for 2004 and $73.9 million for 2005[6].

81. Northwestel argued that in order to meaningfully evaluate the total operating expenses over the 2003 to 2005 period, two significant factors that affected the magnitude and timing of the company's operating expense incurrence would have to be considered.

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[4] TIP is a measure of efficiency that compares the year-over-year change in operating expenses after factoring out the impact of changes in price (inflation) and growth (load), using NAS growth as a proxy for load on operating expenses. The calculation of TIP starts with the base of total operating expenses, excluding depreciation and operating taxes (satellite transponder expenses are also reflected in the total operating expense base for inflation and productivity). The base operating expenses may be adjusted further to reflect the impact of abnormal expenses. Depreciation is excluded from the TIP calculation as it is calculated on the basis of Commission-approved capital spending and Commission-approved life cycles that Northwestel applies to the investment related to the capital assets. Operating taxes are excluded from the TIP calculation since the company has little or no control over property taxes, employment taxes, and other taxes imposed by various levels of government.

[5] The pension component was an income in 2001, but in 2002 it changed to an expense. The company has forecasted that it would continue to be an expense in the short-to-medium term.

[6] The total operating expenses used in the determination of the supplemental funding includes operating taxes. This results in total operating expenses of $74.9 million for 2004 and $75.7 million for 2005.

82. Northwestel submitted that the first factor related to the timing of Commission decisions on its supplemental funding requirement, which were released well after completion of each fiscal year. The company submitted that while it considered that the Commission's decision to conduct a two-year review in this proceeding would mitigate this problem on a going-forward basis, the previous delays had significantly affected the company's decisions related to operating expenses in 2003 and 2004.

83. Northwestel submitted that the second factor related to the inclusion of the pension expense (income) component in the TIP methodology. The company indicated that the pension expense (income) had been a component of the TIP methodology and, as such, had been reflected in the allowable operating expenses from 2001 to 2003. The company submitted, however, that due to large year-over-year increases in pension expense, which were largely uncontrollable by management, coupled with the incorporation of pension income in the TIP model, the company had to absorb these variances through reductions to controllable operating expenses. Northwestel argued that the inclusion of the pension expense (income) in the calculation under the TIP methodology was therefore inappropriate.

84. Northwestel indicated that these two factors had prompted management to take aggressive steps to temporarily defer expenses on a company-wide basis. The company submitted, however, that while these actions were made in the interest of fiscal prudence, they were unsustainable.

85. The YG submitted that the evidence in this proceeding demonstrated that Northwestel would experience significant financial hardship through the application of the current TIP methodology. The YG submitted that, as a matter of principle, the operation of a regulatory methodology intended to protect some aspect of the public interest - in this case the reasonable cost of service, and therefore, just and reasonable rates - should not jeopardize other aspects of the public interest, such as the Q of S standards, the introduction of new services, and improvement in the effective provision of services.

Pension expense (income)

86. Northwestel noted that, up to and including 2003, the Commission had ruled that pension expense (income) should be included in the operating expense base. Northwestel proposed that in order to ensure that the company would be able to continue to provide quality service on a sustainable basis, it should be permitted to exclude, on a going-forward basis, the pension expense (income) component from the TIP calculation for 2004 and subsequent years.

87. Northwestel submitted that there was a significant and widening gap between the pension income amounts that resulted from using the TIP methodology and the actual/forecasted pension expense amounts. In this regard, Northwestel noted that there had been significant changes in its pension expense in recent years, and that the pension plan costs were growing at a greater rate than the income generated by the plan assets. Northwestel indicated that this trend was forecasted to continue in upcoming years.

88. The company noted that the increase in pension costs was primarily driven by the amortization of experienced losses,[7] and that these losses were, in large part, due to the poor performance of the financial markets in 2001 and 2002. The company acknowledged that many organizations had experienced similar pension dilemmas for similar reasons. However, it argued that these organizations were not required to calculate annual allowable operating expenses using the TIP methodology, and as such, had more flexibility to find a solution.

89. Northwestel submitted that, as the gap between the pension income projected by the TIP methodology and the actual/forecast pension expense continued to widen, it had become increasingly difficult for the company to continue absorbing the differences through reductions in operating expenses. The company further submitted that making drastic reductions to the controllable operating expenses would severely impair its ability to provide service at the level expected by consumers and the Commission.

90. The Consumer Groups submitted that Northwestel's proposal to remove the pension expense (income) component from the TIP methodology represented an attempt by Northwestel to review and vary Decision 2004-64 without following the appropriate procedures. The Consumer Groups noted that pension expense (income) had traditionally been incorporated in the TIP methodology and argued that certain elements of pension expense (income), such as the level of benefits and obligations provided to employees, as well as the fund manager selection and the setting of investment objectives, were within the control of the company. The Consumer Groups further argued that changes to the TIP methodology should only be considered as part of the regulatory framework review proceeding. Accordingly, the Consumer Groups submitted that Northwestel's proposal to exclude the pension expense (income) component from the TIP methodology should be denied.

91. The UCG requested that the Commission review the increase in Northwestel's pension expense (income) and Northwestel's employee benefits expense. With respect to Northwestel's proposal to exclude the pension expense (income) from the TIP calculation, the UCG submitted that Northwestel had enjoyed the benefits of pension surpluses in the past and argued that it must now endure the pension losses and absorb the difference like all other investors. The UCG submitted that the Commission should deny Northwestel's proposal.

92. The YG submitted that it was concerned with respect to the detrimental impacts that the continued inclusion of pension expense (income) in the TIP calculation could have on the company's ability to meet Q of S standards, maintain ongoing service levels, and introduce new services. The YG submitted, however, that it was also concerned that Northwestel had not addressed the steps or measures the company had taken or considered to deal with its growing pension plan losses.

93. In reply argument, Northwestel noted that the Consumer Groups had identified two methods by which Northwestel could have influenced the pension expense, namely the level of benefits and obligations provided to employees, as well as the fund manager selection and the setting of investment objectives. Northwestel submitted that both methods were unreliable approaches to

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[7] Amortization of experience (gains)/losses, used in the calculation of pension expense (income), represents the difference between the return actually earned by the plan's assets each year and the expected return that was calculated at the beginning of that year.

reducing the pension expense in the short-to-medium term and would not alter the company's current dilemma of an increasingly volatile pension expense.

94. With respect to the level of benefits provided to employees, Northwestel argued that the company benchmarked compensation to industry standards in northern Canada, and that reducing the level of pension benefits or service costs would make the company less competitive in its labour market. Northwestel also argued that interest costs comprised a considerably larger portion of the impact on pension expense than service costs. Accordingly, Northwestel submitted that any immediate reduction to pension benefits would not significantly affect the overall pension expense until years later.

95. With respect to selecting a fund manager and setting investment objectives, Northwestel argued that its choice of investment fund manager and strategy were designed to ensure the highest probability of generating above-average annual investment returns and producing superior long-term performance while minimizing risk. Northwestel argued that its fund managers had served the company well and suggested that, compared to the S&P/TSX[8] composite annual return, its pension fund had mitigated volatility well. Northwestel argued that all funds and fund managers were subject to the same market volatility and submitted that, accordingly, changing the investment strategy would increase the risk in the investment portfolio.

Commission's analysis and determinations

96. The Commission notes Northwestel's concerns regarding the continued appropriateness of including the pension expense (income) component in the TIP calculation. The Commission notes that in Decision 2004-64 it was of the view that any further modifications to the TIP methodology should be considered in the regulatory framework review proceeding. However, in Public Notice 2004-6, the Commission provided for consideration, in this proceeding, of significant matters that might have a material impact on the company's supplemental funding.

97. The Commission notes that Northwestel did not characterize its proposal as a review and vary application, and that the company does not seek to change Decision 2004-64 as it pertains to the supplemental funding determinations for 2003, but rather to change the supplemental funding methodology on a going-forward basis for 2004 and subsequent years. The Commission notes, however, the Consumer Groups' argument that the company's proposal was an attempt to review and vary Decision 2004-64 without following the appropriate process.

98. In *Guidelines for review and vary applications,* Telecom Public Notice CRTC 98-6, 20 March 1998, the Commission indicated that where an application raises substantial doubt as to the correctness of the original decision, the Commission will generally consider the application as a review and vary application. However, where the application essentially relates to the continuing correctness of a decision rather than the original correctness, the application will generally be treated as a new application. In general, where an original decision was correct at the time it was made, but new facts or circumstances had arisen that render the original decision inappropriate or obsolete in light of them, the Commission treats the application as a new application.

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[8] The S&P/TSE composite index, formerly the Toronto Stock Exchange 300 composite index, prior to 1 May 2002. S&P stands for Standard & Poor's.

99. The Commission notes that Northwestel's actual/forecasted pension expense for 2004 and 2005 increased significantly over 2003. In this regard, the Commission notes that while Northwestel's pension expense was $79,000 in 2003, it increased to $638,000 in 2004, and is forecasted to increase to $821,000 in 2005.

100. The Commission also notes that including the pension expense (income) in the TIP methodology would result in a reduction in the allowable operating expenses due to pension income amounts of $919,000 and $933,000 in 2004 and 2005, respectively. The Commission further notes that this reduction in allowable operating expenses, combined with the increasing actual/forecasted pension expense, would result in the company being required to absorb differences of $1,557,000 and $1,754,000 in 2004 and 2005, respectively.

101. The Commission considers that the data filed by Northwestel in this proceeding raises substantial doubt as to the continuing appropriateness of including the pension expense (income) in the TIP methodology. In the Commission's view, the additional two years of data clearly demonstrate significant increases in the pension expense for 2004 and 2005, as well as the growing divergence between the pension income forecasted by the TIP methodology and the actual/forecasted pension expense. Considering that the issue is one of the continuing, rather than the original, correctness of the inclusion of the pension expense (income) in the TIP methodology, the Commission is of the view that Northwestel's request is properly characterized as a new application.

102. The Commission recognizes the company's concerns and agrees that the cumulative impact of including pension income in the TIP methodology is not sustainable. In this regard, the Commission notes that the increasing gap between the pension income resulting from the application of the TIP methodology and the actual pension expense incurred by the company is causing the company to absorb progressively larger cost differences to realize the expected productivity.

103. The Commission notes the YG's submission that the Commission should require Northwestel to address the steps or measures the company had taken or considered to deal with its growing pension plan losses. The Commission is of the view that, in the short-to-medium term, any immediate changes relating to pension expense elements under the company's control would not result in any significant change to the company's pension expense.

104. In light of the above, the Commission finds that Northwestel's proposal to exclude the pension expense (income) component from the TIP calculation on a going-forward basis is appropriate.

Growth/load factor

105. Northwestel submitted that the Commission's determination in Decision 2004-64 to adjust the load/growth factor to add to the NAS the estimated NAS displaced by ADSL continued to be appropriate. The company noted that the NAS continued to be displaced by substantial year-over-year growth in ADSL.

106. Northwestel submitted that, while the industry generally acknowledged that the prevalence of high-speed Internet offerings had dampened and displaced the overall growth in NAS, including the growth in second lines, it was difficult to accurately measure the displacement effect.

Northwestel noted that in order to provide a reasonable estimate of the displacement effect of ADSL on NAS, it would have had to isolate certain factors. The company noted that, in the proceeding that led to Decision 2004-64, it had conducted a study that carefully selected communities with stable economic conditions and where wireless service was unavailable. The company submitted that the study concluded that the overall effect of ADSL on total NAS was a 0.47 decrease in NAS for each ADSL gained. Northwestel noted that changing economic conditions and market realities in the company's operating area made the production of a subsequent study unfeasible at the present time. The company submitted that it was confident of both the integrity and reasonableness of the 0.47 displacement factor and proposed to continue to use this factor for the purpose of estimating total NAS displaced by ADSL.

107. The Consumer Groups submitted that they were concerned as to the validity of an older estimate from the previous study and noted that there was no mechanism available to judge the ongoing suitability of the 0.47 NAS displacement factor. The Consumer Groups submitted that in order to assess Northwestel's assumption that the cost of providing a NAS service was comparable to the cost of providing an ADSL service, the Commission should direct Northwestel to undertake an updated study to estimate the displacement factor, and to track and report the Phase II costs of ADSL and NAS service. The UCG submitted that the adjustment of the growth/load factor related to ADSL was of great concern and requested that the Commission explore this issue further.

108. In reply argument, Northwestel submitted that the Phase II costs of providing ADSL were not related to the TIP load factor. The company argued that, in Decision 2004-64, the Commission had recognized the company's argument that ADSL growth had resulted in an increase in the company's expenses that was not reflected in the current TIP methodology. The company further noted that, accordingly, the Commission had adjusted the TIP model's NAS growth factor by adding to the NAS the estimated NAS displaced by ADSL.

Commission's analysis and determinations

109. The Commission notes that, in Decision 2004-64, it accepted Northwestel's proposal to adjust the growth factor by adding back the estimated NAS displaced by ADSL. The Commission considers it reasonable to assume that NAS would continue to be displaced by substantial year-over-year growth in ADSL. Accordingly, the Commission considers that it is appropriate for Northwestel to continue adjusting the growth/load factor by adding to the NAS the estimated NAS displaced by ADSL. However, the Commission directs Northwestel to provide a study to estimate the additional operating expenses to provide ADSL over the NAS and to update the study for the NAS displacement at the time of the upcoming regulatory framework review proceeding.

Unique load for satellite transponder costs related to data services

110. Northwestel submitted that the Commission's determination in Decision 2004-64 to apply a unique driver to the portion of transponder expenses attributable to data services remained appropriate. Northwestel submitted that the costs associated with its use of satellite technology were largely unrelated to NAS, and were instead driven mainly by increased demand for data and private line services.

111. The YG submitted that the continued application of unique drivers to the portion of transponder expenses attributable to data services should remain part of the TIP calculation.

Commission's analysis and determination

112. The Commission notes that in Decision 2004-64 it applied a unique factor to the portion of transponder costs attributable to data service. The Commission notes that this factor represents the costs associated with the company's use of satellite technology and that this technology is largely unrelated to NAS, since it is driven mainly by increased demand for data and private line services. The Commission recognizes that the current TIP methodology makes no specific provision for demand growth in these types of services. Accordingly, the Commission determines that applying a unique factor to that portion of transponder costs attributable to data services remains appropriate.

Price/inflation factor

113. Northwestel indicated that the price/inflation factors it used for 2004 and 2005 were two percent and 1.9 percent, respectively. The company noted that these factors were determined by averaging the Consumer Price Index (CPI) forecasts obtained from five Canadian banking institutions: CIBC World Markets, BMO Financial Group, National Bank Financial, RBC Financial Group, and TD Bank Financial Group.

Commission's analysis and determination

114. The Commission notes that the price/inflation factor of two percent used for 2004 is close to the actual CPI of 1.9 percent.[9] The Commission also notes that the price/inflation factor used for 2005 is in line with current forecasts from Canadian financial institutions. Accordingly, the Commission finds that the company's proposed price/inflation factors for 2004 and 2005 are appropriate for the determination of the 2004 and 2005 supplemental funding requirements.

Appropriate TIP for Northwestel

Commission's analysis and determinations

115. As in previous Commission decisions related to Northwestel's supplemental funding, the Commission is of the view that, rather than considering the reasonableness of the various components of the company's 2004 and 2005 operating expense forecasts, the use of a two percent TIP continues to be appropriate, as an incentive to reduce expenses.

116. The Commission considers that adherence to the established productivity target of two percent is critical in order to safeguard against inefficiency in this type of regulatory regime. The Commission determines that, consistent with its practice in previous years, Northwestel's 2003 operating expenses, as approved in Decision 2004-64, are to be used as the base for determining the TIP calculation for 2004, and further, that the 2004 approved operating expenses be used as the base for the 2005 operating expenses.

[9] Statistics Canada, January 2005.

117. The Commission **approves** Northwestel's forecast total operating expenses, including operating taxes, of $74.9 million for 2004 and $75.7 million for 2005.

Accounting matters

Refinancing of investment in affiliates

118. In Decision 2000-746, the Commission determined that Northwestel's capital structure should be used to determine the financing of Northwestel's investments in affiliates. As a result, Northwestel's investments in non-regulated affiliates were deemed to have been financed on the basis of the company's capitalization, which was composed of debt and equity. With respect to the proportion of the investment in affiliates deemed to be financed by debt, the average interest expense adjusted for the income tax impact was treated as a regulatory income adjustment and was used to reduce the amount of supplemental funding required. In addition, the proportion of investment in affiliates deemed to be financed by equity was deducted from the common equity. This reduced the amount of common equity to which the allowed ROE was applied, and in turn, reduced the amount of required return included in the supplemental funding.

119. Northwestel noted that it had wound up its investment in Andron Limited (Andron), a holding company, and that its wind-up in Northwestel Cable Inc. (NCI) had resulted in a simpler capital structure. It indicated further that NCI had secured a line of credit from its bank to finance the return of capital to Northwestel. As a result, Northwestel noted that except for a nominal $2, NCI was financed entirely by debt. On that basis, Northwestel proposed to discontinue the regulatory adjustment that was deemed to finance Northwestel's investments in affiliates.

120. Northwestel indicated that the company guaranteed NCI's bank financing, and that it recognized that a regulatory equity adjustment would be required, should the guaranty be exercised.

121. The UCG expressed concern regarding the refinancing of Northwestel's affiliates, Andron and NCI.

Commission's analysis and determination

122. The Commission notes that Northwestel's midpoint ROE of 10.5 percent was set in Decision 2000-746 on the basis of, among other things, the company's capital structure, and that the refinancing of its investment in its affiliates has not resulted in any changes to the ROE. The Commission also considers that the funds that were used to finance the investment in the affiliates are now being used to finance the company's regulated operations. As a result, the Commission determines that it is appropriate for Northwestel to discontinue the regulatory adjustments for the financing of its investment in affiliates.

Reasonableness of interest rate on some debt issues

123. In its financial statements, Northwestel listed some long-term debt issues that would be considered high-cost in the current market.

124. The UCG noted that interest rates had been lower for a number of years and requested that the Commission examine the prospect of requiring Northwestel to refinance some of its long-term debt issues.

Commission's analysis and determinations

125. The Commission has reviewed Northwestel's long-term debt issues. The Commission notes that, given the terms under which certain series of Northwestel's high-cost debt are redeemable, there may be no financial advantage to refinancing those particular debts. The Commission considers, however, that it would be appropriate for Northwestel to investigate whether any of its high-cost debt issues could be refinanced with lower-cost debt. Accordingly, the Commission directs Northwestel to review its high-cost, long-term debt issues to assess whether any of its higher-cost, long-term debt could be refinanced. The Commission also directs Northwestel to provide the results of that review, including an assessment of the annual financial impact of refinancing this debt, in the upcoming regulatory framework review proceeding.

Average common equity and the associated return for 2005

126. In Decision 2000-746, the Commission calculated Northwestel's opening common equity as the sum of the common equity, retained earnings, and contributed surplus, excluding the contributed surplus related to the purchase of the company's common shares from Canadian National Railway Company by BCE Inc. on 1 December 1988.

127. Northwestel calculated the average common equity for 2004 and 2005 on the basis of the closing regulated common equity from the previous year.

Commission's analysis and determination

128. The Commission notes that the use of the company's methodology for calculating the average common equity for 2004 and 2005 has resulted in an average common equity that was higher than the average common equity that would have resulted from using the methodology described by the Commission in Decision 2000-746. The Commission notes that using the Decision 2000-746 methodology to determine the average common equity for 2004 does not result in a significant difference with Northwestel's result for 2004. However, the average common equity calculated using the Decision 2000-746 methodology results in a lower supplemental funding of approximately $100,000 for 2005. Accordingly, the Commission determines that it is appropriate to reduce Northwestel's supplemental funding for 2005 by $100,000.

Supplemental funding requirements for 2004 and 2005 and CFA issues

Appropriate amount of supplemental funding for 2004 and 2005

129. In Decision 2004-64, the Commission approved, on an interim basis, supplemental funding for 2004 in the amount of $9.6 million, effective 1 January 2004.

130. In *Final 2004 revenue-percent charge and related matters*, Telecom Decision CRTC 2004-81, 9 December 2004, the Commission approved, on an interim basis, the continued use of $9.6 million as the annual supplemental funding for Northwestel for 2004 and 2005, until a final determination had been made with respect to the proceeding initiated by Public Notice 2004-6. The Commission directed the Central Fund Administrator (CFA) to remit, on an

interim basis, effective 1 January 2005, monthly subsidy payments to Northwestel equivalent to one-twelfth of the approved annual supplemental funding, not taking into account any repayment adjustments.

131. In this proceeding, Northwestel submitted that it would require supplemental funding of approximately $9.3 million for each of 2004 and 2005. The company noted that its supplemental funding calculation for these years incorporated the Commission's determinations in Decisions 2004-64 and 2004-64-1 and was calculated on a basis consistent with prior years' calculations.

Commission's analysis and determinations

132. As a result of its determinations in this Decision, the Commission concludes that Northwestel's supplemental funding for 2004 should be $9.3 million, as proposed by the company, and that its supplemental funding for 2005 should be reduced to $9.1 million. Accordingly, the Commission **approves**, **on a final basis**, $9.3 and $9.1 million of supplemental funding for 2004 and 2005, respectively, for Northwestel.

Northwestel 2004 and 2005 supplemental funding
($ million)

	2004	**2005**
Total supplemental funding proposed by Northwestel	**9.3**	**9.3**
Commission adjustments:		
Financial adjustments		(0.1)
Planned and pending tariff filings		(0.1)
Total adjustments		**(0.2)**
Total supplemental funding for 2004 and 2005	**9.3**	**9.1**

Directions to the CFA for 2004 and 2005

Commission's analysis and determinations

133. The Commission notes that, based on the approved final supplemental funding of $9.3 million for 2004 and $9.1 million for 2005, Northwestel received $0.3 million more in supplemental funding from the CFA in 2004, and would receive $0.5 million more in supplemental funding from the CFA in 2005, than it is entitled to receive.

134. In view of the relatively small amount of the supplemental funding overpayment for 2004, the Commission directs Northwestel to remit to the CFA, as a one-time payment, the $0.3 million excess supplemental funding that it received for 2004, **within 10 days from the date of this Decision**. In addition, the Commission directs the CFA to evenly reduce the monthly payments of supplemental funding for the remainder of 2005, so that the total amount of supplemental funding that Northwestel will receive for 2005 will be $9.1 million.

Quality of service

135. In Decision 2000-746, the Commission recognized the difficult operating environments in some of Northwestel's exchanges and approved Northwestel's definition of 'remote community.' In that Decision, the Commission also directed Northwestel to report on a new Q of S indicator, *2.1C Out-of-service trouble reports cleared 'remote,'* with a standard of 90 percent or higher of out-of-service reports cleared within five working days (indicator 2.1C). Further, the Commission directed the company to continue community-level reporting for all Q of S indicators.

136. In Decision 2004-64, the Commission noted that Northwestel continued to meet all of the Q of S indicators on a consistent basis in 2003, except for indicator 2.1C. The Commission also noted that, since May 2003, the average success rate for indicator 2.1C had increased to 92 percent in communities where Community Technicians (CTs) had replaced Nunavut Power Corporation technicians. The Commission considered that Northwestel should continue in the direction it had taken to meet the indicator 2.1C standard, particularly its ongoing recruitment and training of CTs, in order to provide technicians in all remote communities that were unmanned at that time.

137. In Decision 2004-64, the Commission found that Northwestel's Q of S results were acceptable and noted that it would continue to monitor the company's results in conjunction with the next annual supplemental funding review.

138. Northwestel submitted that, in general, it had successfully achieved all of the Q of S standards throughout the first three quarters of 2004. The company reported that there had been significant improvements in the results for indicator 2.1C in 2004.

139. In argument, Northwestel submitted that the average result for indicator 2.1C for 2003 was 89 percent, and for the first three quarters of 2004, the average was 93 percent. Northwestel also reported that, in the first nine months of 2004, it had missed the standard for this indicator only once, in the month of July, and had still achieved 89.4 percent of trouble reports cleared within five days for that month. Northwestel noted that the improvements to the company's performance indicator 2.1C were primarily as a result of the continued roll-out of the CT program. Northwestel indicated that it had hired CTs for 22 communities in 2003 and 2004.

140. Northwestel added that it continued to face challenges in relation to the characteristics of remote northern communities, including geography, availability of resources, weather, low order volumes, and scheduling complexities. Northwestel noted that conflicting priorities for the CTs contributed to the company's ongoing difficulty in consistently achieving the standard for indicator 2.1C. Northwestel also submitted that difficulties in recruiting and retaining local part-time technicians could contribute to a community temporarily missing the standard for indicator 2.1C. Northwestel indicated that despite these challenges, it would continue to strive to meet the standard for indicator 2.1C.

141. The Consumer Groups indicated that they supported Northwestel's efforts to meet its Q of S obligations and submitted that Northwestel should continue its efforts to deliver service at, or above, the minimum standards considered acceptable by the Commission and the public.

142. The YG submitted that it found Northwestel's Q of S results to be acceptable. The YG submitted that if in the absence of competitive alternatives the incumbent's Q of S should fall below standards acceptable to consumers, it would be necessary to build incentives into the regulatory regime.

143. In reply argument, Northwestel submitted that it would be challenging to meet the Q of S standards on a going-forward basis if its TIP methodology did not reflect the realities faced by the company.

Commission's analysis and determinations

144. The Commission recognizes Northwestel's efforts to meet the Commission's directives regarding Q of S and considers that the company's results are acceptable, even though the company missed the standard for indicator 2.1C for one month in 2004. The Commission expects Northwestel to meet the standard for indicator 2.1C on a going-forward basis, and will continue to monitor the company's Q of S results. The Commission may address incentives, adjustments, or penalties relating to the Q of S standards within the upcoming regulatory framework proceeding.

Regulatory framework matters

145. In Decision 2004-64, the Commission stated that it expected to undertake a review of Northwestel's 2006 supplemental funding requirement and its regulatory framework following the review of the company's supplemental funding for 2004 and 2005. However, the Commission did not state whether the 2006 supplemental funding and the review of the regulatory framework were to be addressed in one proceeding or in two separate proceedings.

146. Northwestel indicated that it was concerned about the timeliness of the release of the Commission's decisions with respect to its supplemental funding requirement and the resulting impact on the company's decisions regarding its operating expenses.

147. The YG submitted that market and economic factors in the North made the continuation of supplemental funding necessary in order to support Northwestel's SIP and to maintain the appropriate level of basic funding. The YG submitted that the economic development of the North was significantly affected by telecommunications and that the adoption of a successful competitive policy for the North was a critical requirement for economic development. The YG also submitted that, although it accepted the rationale for restricting the scope of this proceeding, it was concerned that businesses and consumers in the Yukon had not been well served by the Commission's determinations to defer consideration of the fundamental underpinning of Northwestel's economic, competitive, and regulatory environments until the review of the regulatory framework.

Commission's analysis and determinations

148. In Public Notice 2004-6, the Commission initiated a process to review the 2004 and 2005 supplemental funding in one proceeding. The Commission is of the view that, with this proceeding, the timeliness of the Decision regarding the final determination of the amount of supplemental funding will have improved significantly for 2005.

149. The Commission considers that in order to allow it to issue decisions relating to the 2006 supplemental funding amount and the company's regulatory framework on a timely basis, it must address these matters in separate proceedings. The Commission also considers that the proceeding to determine the 2006 supplemental funding amount should follow a streamlined approach.

150. Accordingly, the Commission:

- directs Northwestel to file an application for its 2006 supplemental funding by **17 October 2005**. The application should be supported by the financial statements for 2004 and the forecasted financial statements for 2005 and 2006;
- directs interested parties to file comments on Northwestel's application, serving a copy on the company, by **4 November 2005**; and
- directs Northwestel to file reply comments, serving a copy on those who filed comments, by **14 November 2005.**

151. The Commission will issue a public notice shortly to initiate a proceeding to review Northwestel's regulatory framework, including other related issues such as competition and the sustainability of the $0.07 CAT rate.

Secretary General

Appendix 1

Northwestel Inc. - 2004 Depreciation life characteristics			
Account	**Description**	**Survivor curve**	**ASL**
60	Cable - Aerial/Underground	Iowa R-3	26 years
120	Cable - Fibre Optic	Iowa S-3	25 years
140	General & Administrative Software	Square	3 years
160	Data Switching Systems	Iowa S-4	10 years
180	Toll Telephone Equipment	Iowa L-1	12 years
190	C.O. Internet Equipment	Iowa S-4	8 years
350	OCS Furniture	Iowa R-4	15 years
520	Centrex	Iowa L-4	12 years
540	M/W Analogue Radio 2 GHz & above	Iowa L-3	11 years
550	Light Route Analogue Radio - Under 2 GHz	Iowa L-3	14 years
570	Satellite Earth Stations	Iowa R-4	9 years
580	Satellite Antenna Systems	Iowa R-4	15 years

Appendix 2

Northwestel Inc. - 2005 Depreciation life characteristics			
Account	**Description**	**Survivor curve**	**ASL**
80	Duct Systems	Iowa R-5	40 years
150	Computers - Administration	Iowa S-4	6 years
170	Telephone Exchange Equipment	Iowa L-4	12 years
230	Carrier Telephone Equipment	Iowa R-2	10 years
340	Test Equipment	Iowa R-4	10 years
630	Basic Power Installations	Iowa R-4	22 years
640	Rectifiers	Iowa O-1	18 years
650	Batteries	Iowa R-5	14 years
660	Generating Units	Iowa R-3	20 years
670	Inverters & Converters	Iowa R-3	18 years
900	Air Conditioning Systems	Iowa R-3	20 years