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

Telecom Decision CRTC 2007-11

Ottawa, 19 February 2007

Follow-up to Decision 2002-43 – TELUS Communications Company's request to recover the start-up costs for local competition and local number portability within its incumbent serving territory in Quebec

Reference: 8678-T66-200606403

In this Decision, the Commission approves an application by TELUS Communications Company to recover certain costs associated with the implementation of local competition and local number portability within its incumbent serving territory in Quebec through draw-downs from the company's deferral account for Quebec.

1. The Commission received an application by TELUS Communications Company (TCC),[1] dated 15 May 2006, pursuant to Part VII of the *CRTC Telecommunications Rules of Procedure*, in which the company proposed using an exogenous factor to recover its estimated local competition and local number portability (LNP) start-up costs within its incumbent serving territory in Quebec.

2. The total estimated costs were $3.353 million, consisting of $1.379 million for local competition and $1.974 million for LNP. TCC proposed an adjustment to the deferral account to mitigate rate increases for residential services that could result from the approval of the exogenous factor. In support of its application, TCC submitted a Phase II cost study based on a period of 15 years.

Background

3. In *Local competition start-up costs proceeding, Telecom Public Notice CRTC 98-10*, Telecom Order CRTC 99-239, 12 March 1999 (Order 99-239), the Commission determined that for large incumbent local exchange carriers (ILECs),[2] local competition and LNP start-up costs (the start-up costs) should be calculated on a revenue requirement basis. Under the revenue requirement approach, the capital costs would be recovered through an annual depreciation expense.

4. The Commission also concluded that these costs should be allocated between capped and uncapped services on the basis of retail switched exchange network access services (NAS), with non-residential NAS weighted by a factor of 1.5. The Commission considered that costs allocated to capped Utility services would be recovered by way of an exogenous factor.

5. In *Local competition start-up and LNP costs established*, Order CRTC 2000-143, 23 February 2000 (Order 2000-143), the Commission approved start-up costs for ex-Stentor telephone companies.

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[1] All references to TCC in this Decision refer to TCC's operations within its incumbent serving territory in Quebec.
[2] Order 99-239 did not apply to Société en commandite Télébec and TCC.

6. In *Commission approves terms and conditions for local exchange and local payphone competition in the territories of TELUS Communications (Québec) Inc. and Télébec ltée*, Order CRTC 2001-761, 3 October 2001 (Order 2001-761), the Commission determined that TELUS Communications (Québec) Inc., now TCC, and Télébec, now Société en commandite Télébec (Télébec), (collectively, the Companies) would each be responsible for recovering its own local competition implementation costs and that such costs would not be recovered from the Central Fund, now known as the National Contribution Fund. The Commission also determined that in order to control the size of these costs, the Companies should incur expenses only as required.

7. In *Implementation of price regulation for Télébec and TELUS Québec*, Telecom Decision CRTC 2002-43, 31 July 2002 (Decision 2002-43), the Commission determined that an exogenous factor would be included in the price cap formula for the Companies. The Commission further noted that an exogenous factor reflected the impact associated with events not captured by the other elements of the price cap formula. It also noted that adjustments would be considered for events or initiatives that satisfied the following criteria:

    a) they are legislative, judicial, or administrative actions which are beyond the control of the company;

    b) they are addressed specifically to the telecommunications industry; and

    c) they have a material impact as measured against the total company.

8. In Decision 2002-43, the Commission was of the preliminary view that the methodology used by the other large ILECs to recover start-up costs, as set out in Order 99-239, would be appropriate for the Companies. The Commission considered that, in their submissions regarding an exogenous factor, the Companies should include the amount of the start-up costs, as well as the method of recovery, calculated using the methodology set out in Order 99-239. In addition, in Decision 2002-43 the Commission directed the Companies to distinguish between recurring and non-recurring costs.

9. More recently, in *Follow-up to Decision 2002-43 – Société en commandite Télébec's request to recover the start-up costs for local competition and local number portability*, Telecom Decision CRTC 2005-76, 22 December 2005 (Decision 2005-76), the Commission approved an application by Télébec in which the company proposed using an exogenous factor to recover the start-up costs.

10. In Decision 2005-76, the Commission approved the following for Télébec:

    - an exogenous factor of $1,074,900 per year for the recovery of non-recurring costs over four years, starting 1 August 2005;

    - an exogenous factor of $560,700 for the recovery of recurring costs each year, starting 1 August 2005; and

    - the recovery of these amounts through draw-downs from Télébec's deferral account as long as there are sufficient funds in the account.

11. In *Disposition of funds in the deferral accounts*, Telecom Decision CRTC 2006-9, 16 February 2006 (Decision 2006-9), the Commission estimated that Télébec would have a recurring shortfall in its deferral account at the end of the fourth year of the current price cap period. The Commission also considered that Télébec should be allowed to recover the recurring shortfall in its deferral account through an exogenous adjustment since the shortfall had resulted from Commission-mandated actions. Accordingly, the Commission directed Télébec to file an exogenous factor proposal for the recovery of the recurring shortfall in its deferral account coincident with its 2006 annual price cap filing.

The application

12. TCC noted that local competition had been allowed in its territory in Quebec since 1 September 2002 and that Bell Canada, Cogeco Cable Canada Inc. (Cogeco) and Videotron Ltd. (Videotron) had registered as competitive local exchange carriers (CLECs) in its Quebec territory. TCC added that this competition had initially appeared in the form of local service resellers and, more recently, through the arrival of voice over Internet Protocol (VoIP) services.

13. TCC specified that Bell Canada had been reselling Centrex services for more than two years and had been active as a CLEC in the Rimouski, Ste-Marie, St-Georges, Hauterive and Baie-Comeau exchanges since late 2005. TCC also stated that Cogeco had been active as a CLEC since February 2006 in the Rimouski, Mont-Joli, Ste-Marie, Baie-Comeau, Hauterive, Port-Cartier, Matane and Sept-Îles exchanges. With the arrival of VoIP services and the imminent arrival of other telephone service providers such as Videotron, TCC added that it expected that local competition would intensify very rapidly in its incumbent territory in Quebec.

14. TCC submitted that in compliance with Order 2001-761 and Decision 2002-43, it proposed to recover its start-up costs by applying an exogenous factor. TCC also submitted that these costs met all the criteria that define an exogenous event.

15. TCC requested that the non-recurring costs resulting from the establishment of local competition and LNP be fully recovered from the accumulated deferral account balance, and that the recurring costs be recovered from the recurring amount in the deferral account. Consequently, TCC requested that the Commission approve the following:

- the recovery of its costs for the deployment of local competition and LNP in the amount of $3,353,100;

- that the non-recurring costs for the implementation of local competition and LNP of $3,013,000 be fully recovered from the accumulated deferral account balance as at 31 July 2006; and

- that the recurring costs of $340,000 be recovered from the recurring amount in the deferral account.

Process

16. The Commission addressed an interrogatory to TCC on 11 August 2006. TCC filed a response to the Commission's interrogatory on 2 October 2006 and submitted additional information on 20 October 2006.

17. The Commission received no comments with respect to TCC's application.

Commission's analysis and determinations

18. The Commission notes that in Order 2001-761, it was of the preliminary view that the terms and conditions for local exchange and local payphone competition that apply in the large ILEC territories should also apply in the case of TCC and Télébec. The Commission also notes that in the same Order, it found that competition in the local exchange and local payphone markets should be permitted in Télébec's and TCC's Quebec operating territories as of 1 September 2002.

19. The Commission notes that the establishment of local competition and LNP in TCC's incumbent serving territory in Quebec stems from the Commission's directives in Order 2001-761. The Commission considers that the start-up costs meet the first two criteria for exogenous events since they result from a legislative, judicial, or administrative action that was beyond the control of the company and was addressed specifically to the telecommunications industry.

20. The Commission notes that TCC estimated the start-up costs at $3,353,100. Given the magnitude of the costs associated with such an initiative, and consistent with Order 99-239, the Commission considers that the start-up costs incurred by TCC have a material impact in relation to the total company and that they meet the third criterion for an exogenous event.

21. Accordingly, the Commission considers that the start-up costs qualify for exogenous treatment.

TCC's Phase II cost study

22. The Commission has examined TCC's Phase II start-up costs and notes that they are similar in nature to those approved for the other large ILECs in Order 2000-143 and for Télébec in Decision 2005-76. However, the Commission has made adjustments to certain amounts submitted by TCC in order to express the amounts that would be paid in the future in terms of net present worth, and to reclassify certain costs as non-recurring, in particular the costs associated with maintenance incurred prior to 2006.

23. Accordingly, the Commission considers that the adjusted costs below are reasonable:

- total non-recurring costs: $3,042,975; and
- total annual recurring costs: $26,790.

24. The Commission notes that TCC included start-up costs incurred since 2001 in its cost study. In this regard, the Commission notes that in *Inquiry into Telecommunications Carriers' Costing and Accounting Procedures – Phase II: Information Requirements for New Service Tariff Filings*, Telecom Decision CRTC 79-16, 28 August 1979, it indicated that historical costs must not be considered in Phase II cost studies. The Commission also notes that in Decision 2002-43, it decided that Télébec, and TCC for its Quebec territory, should recover the costs in question by means of an exogenous factor.

25. The Commission notes, however, that in paragraph 41 of TCC's submission, in which the company indicated that since CLECs had been present in TCC's territory only since late 2005, it considered that a proposal to recover costs before then would have been premature, even if funds had already been committed in response to the Commission's requests. TCC indicated that the expenditures before late 2005 would not have met the third criterion in paragraph 252 of Decision 2002-43 defining an exogenous event, namely that events or initiatives must have a material impact on the company.

26. The Commission accepts TCC's reasoning that the start-up costs incurred by the company since 2001 qualify for exogenous treatment.

27. The Commission notes that, in its filing for approval of an exogenous factor to recover start-up costs, TCC included costs associated with uncapped services and proposed drawing from its deferral account to recover all the costs, as long as the deferral account contained sufficient funds. The Commission also notes that the costs submitted by TCC for uncapped services related exclusively to business services and were estimated to be $435,890.

28. According to TCC, including costs associated with uncapped services and drawing from its deferral account to recover all the costs would allow it to avoid, as much as possible, any rate increases that might result from the approval of the exogenous factor. The Commission notes that this approach would allow the recovery of all start-up costs through TCC's deferral account for Quebec, whether the costs are related to capped or uncapped services.

29. As noted above, in Decision 2002-43 the Commission considered that in their submissions regarding an exogenous factor, the Companies should include the amount of the start-up costs, as well as the method of recovery, calculated using the methodology set out in Order 99-239. The Commission further notes that in Order 99-239, it also concluded that these costs should be allocated between capped and uncapped services on the basis of retail switched exchange NAS, with non-residential NAS weighted by a factor of 1.5. The costs allocated to capped Utility services would be recovered by way of an exogenous factor.

30. However, the Commission notes that in Decision 2005-76, it approved two exogenous factors for Télébec, one to recover non-recurring costs and one to recover recurring costs. The Commission also approved the recovery of these costs through draw-downs from the deferral account, with a portion of the costs (about $1 million) being related to uncapped business services. The Commission was concerned that Télébec subscribers, who were already paying the highest local service rates in Canada, could be faced with a local rate hike if an exogenous adjustment were included in the price cap formula. Accordingly, the Commission considered it preferable to avoid additional rate increases to the extent possible.

31. The Commission notes that TCC's local business service rates in Quebec are similar to Télébec's, although generally a little lower. The Commission also notes that most of the $435,890 related to uncapped services represents non-recurring costs. Consequently, the Commission considers that it would be reasonable for TCC to recover these costs through draw-downs from the deferral account, rather than through rate hikes.

TCC's proposal for cost recovery

32. The Commission notes that on 15 May 2006, TCC filed its revised deferral account schedule, in compliance with the Commission's direction in Decision 2006-9. The revised schedule shows, for the deferral account, an accumulated balance of $5.8 million and a recurring amount of $1.5 million as at 31 July 2006, and the Commission notes that it has not approved any withdrawals from that account since then. Therefore, the Commission considers that there are sufficient funds in the deferral account for TCC to recover the start-up costs that it filed in its application.

33. The Commission therefore considers that TCC should draw down from its deferral account for Quebec to recover these costs and **approves** the following for TCC:

- an exogenous factor of $3,042,975 for the recovery of non-recurring costs;
- an exogenous factor of $26,790 for the recovery of recurring costs each year; and
- the recovery of these amounts through draw-downs from TCC's deferral account for Quebec.

Secretary General