Telecom Decision CRTC 2007-32

Ottawa, 10 May 2007

Bell Aliant Regional Communications, Limited Partnership – Part VII application seeking exogenous treatment of deferral account shortfall

Reference: 8678-B54-200612425

In this Decision, the Commission finds that the annual recurring shortfall in Bell Aliant Regional Communications, Limited Partnership's (Bell Aliant) deferral account meets the criteria for an exogenous event.

The Commission approves Bell Aliant's proposal to first draw down the accumulated balance in its deferral account to the extent that funds are available in order to reduce the annual recurring shortfall in its deferral account and directs Bell Aliant to file updated calculations for its deferral account within 90 days of this Decision.

The Commission approves Bell Aliant's proposal to treat the remaining annual recurring shortfall as an exogenous adjustment and directs Bell Aliant to allocate the remaining recurring shortfall proportionately, by revenue weight, to all baskets of regulated services, except the following: the Services with Frozen Rate Treatment basket, the Pay Telephones basket, and the Competitor Services basket.

The Commission directs Bell Aliant to file the allocation of its exogenous factor with its first annual price cap filing under the new price regulation regime.

Introduction

1. The Commission received an application by Bell Aliant Regional Communications, Limited Partnership (Bell Aliant), dated 4 October 2006 and amended 18 October 2006, pursuant to Part VII of the *CRTC Telecommunications Rules of Procedure*. In the application, Bell Aliant requested that the Commission approve the recovery of the annual recurring shortfall in the deferral account of the former Aliant Telecom Inc.[1] (Bell Aliant's deferral account). Bell Aliant proposed to recover the funds, in part, from a draw down of the accumulated balance in its deferral account, to the extent that funds were available, and the remainder as an exogenous adjustment under the current price cap regime.

Process

2. MTS Allstream Inc. (MTS Allstream) filed comments dated 17 November 2006. The record closed when Bell Aliant filed its reply comments dated 14 December 2006.

[1] On 7 July 2006, Bell Canada's regional wireline telecommunications operations in Ontario and Quebec were combined with, among other things, the wireline telecommunications operations of Aliant Telecom Inc., Société en commandite Télébec, and NorthernTel, Limited Partnership to form Bell Aliant Regional Communications, Limited Partnership.

The application

3. Bell Aliant noted that, as of 1 June 2006, the annual recurring shortfall in its deferral account was $3.154 million. Bell Aliant proposed to reduce this amount by drawing down the accumulated balance in its deferral account to the extent that funds were available. Bell Aliant submitted that its proposal to reduce the accumulated deferral account balance in order to mitigate price increases remained the most appropriate use of the accumulated deferral account balance.

4. Bell Aliant noted, however, that there were insufficient accumulated funds to offset the ongoing impact of the annual recurring shortfall. Bell Aliant estimated that, as of 31 May 2006, the accumulated balance in its deferral account was $8.289 million. Bell Aliant also noted that it had filed initiatives[2] pursuant to *Disposition of funds in the deferral accounts*, Telecom Decision CRTC 2006-9, 16 February 2006 (Decision 2006-9), in which it had allocated five percent of the $8.289 million (i.e. $414 thousand) to improve access to telecommunications services by persons with disabilities. Bell Aliant indicated that, as a result, the remaining accumulated balance in its deferral account was $7.875 million.

5. Bell Aliant proposed to convert the annual recurring shortfall ($3.154 million) to its net present worth (NPW) by dividing this perpetual cash flow by the company's after tax weighted average cost of capital (ATWACC) of 7.38 percent. Bell Aliant noted that this would result in a NPW of $42.7 million for the annual recurring shortfall.

6. Bell Aliant submitted that, accordingly, the company would continue to have a net shortfall, expressed on a present-worth basis in the amount of $34.8 million,[3] which it would need to recover through other means than a draw down from its deferral account. Bell Aliant noted that converting this amount into a recurring annual amount using the company's ATWACC would result in an annual recurring shortfall of $2.570 million.

7. Bell Aliant proposed to recover the annual recurring shortfall of $2.570 million through an exogenous adjustment to the service basket limits (SBLs) for residential, business, and other capped services. Bell Aliant submitted that this approach would be consistent with the treatment of exogenous events in the first price cap period, prior to the introduction of the deferral account mechanism.

8. Bell Aliant noted that in *Regulatory framework for second price cap period*, Telecom Decision CRTC 2002-34, 30 May 2002, as amended by Telecom Decision CRTC 2002-34-1, 15 July 2002 (Decision 2002-34), the Commission had determined that the ILECs were to be compensated for their respective revenue losses associated with the rate reductions for Competitor Services and the introduction of Competitor Digital Network (CDN) services. Bell Aliant submitted that the Commission had based this determination on the assumption that the ILECs' deferral accounts would have sufficient funds to enable such compensation. Bell Aliant also submitted that, given the estimated revenue losses associated with the reduction to rates for Competitor Services and the introduction of CDN services, the amounts that had

[2] dated 1 September 2006.
[3] i.e. the difference between $42.7 million and $7.875 million.

been added to its deferral account were insufficient to permit the company to recover these revenue losses. Bell Aliant considered that, consequently, recovery of such losses must occur through some other means.

9. Bell Aliant submitted that its proposal met the criteria for an exogenous event pursuant to Decision 2002-34, for the following reasons:

   a) *it is legislative, judicial or administrative in nature, beyond the control of the company*: Bell Aliant submitted that the recurring shortfall in its deferral account was the direct result of Commission-approved draw downs from its deferral account, namely those associated with the Commission's decision to lower the mark-up of Category I competitor services to 15 percent and the creation of CDN service. Bell Aliant submitted that these regulatory directives and the resultant financial impacts on the company were beyond its control and satisfied the first criterion.

   b) *it must be specific to the telecommunications industry*: Bell Aliant submitted that the annual recurring shortfall in its deferral account was the product of regulatory rulings that were unique to the telecommunications industry and specific to the incumbent telecommunications providers.

   c) *it must have a material impact on the company*: Bell Aliant submitted that the net amount of $34.8 million owing to the company due to the deferral account and the various transactions of additions and draw downs, expressed as the NPW of the annual recurring shortfall, was material for the company.

10. Bell Aliant noted that in the case of residential services in non-high-cost serving areas (non-HCSAs), it had already transferred the value of the I-X adjustment (i.e. the applicable inflation minus productivity offset constraints) to its deferral account. Bell Aliant also noted that it had already reduced prices for services in the Other Capped Services basket by the value of I-X. Bell Aliant submitted that, in its calculations, it included an exogenous factor to take these implicit and explicit price reductions into account.

MTS Allstream's comments

11. MTS Allstream opposed Bell Aliant's application. MTS Allstream submitted that price changes to CDN services did not entitle Bell Aliant to deferral account funds that did not exist. MTS Allstream submitted that the deferral account was not created to ensure that the ILECs were made whole by recovering lost revenues anytime there was a rate correction, nor was it intended as a means of guaranteeing a particular margin to the ILECs.

12. MTS Allstream noted that, rather than proposing specific rate increases for any particular service, Bell Aliant had allocated the $2.57 million annual recurring shortfall proportionally across the baskets indicated in its application. MTS Allstream also noted that Bell Aliant had not provided information on exactly which services or sub-services would be impacted, or how and when it planned to recover each annual shortfall allocated to the baskets indicated in its application.

13. MTS Allstream submitted that, without more specific information, neither interested parties nor the Commission would be able to properly analyze Bell Aliant's proposal and its impact on consumers and the competitive landscape. Further, MTS Allstream submitted that, as Bell Aliant had provided no information that would allow the Commission to validate the general appropriateness of service rate increases, let alone specific service rate increases, the Commission should deny Bell Aliant's proposal outright.

14. MTS Allstream noted that, in Decision 2006-9, the Commission had expressed concern that, "in the absence of any specific guidelines, the ILECs may target rate reductions solely in specific geographic markets or subscriber segments where competition exists, or where competitors will soon be entering." MTS Allstream submitted that the Commission had, accordingly, directed all the ILECs, with the exception of Société en commandite Télébec (Télébec), to file proposed changes to monthly rates for residential primary exchange services and optional services in the non-HCSAs basket in order to eliminate the recurring amounts in their deferral accounts. MTS Allstream submitted that the Commission should have the same concerns with any rate increases as it had for rate decreases. MTS Allstream also argued that granting Bell Aliant blanket approval for unspecified rate increases would allow the company to target rate increases to specific geographic markets or subscriber segments where competition did not exist, where competitors were not expected to soon enter, or where it would otherwise be damaging to competition.

Bell Aliant's reply comments

15. Bell Aliant submitted that MTS Allstream had made two incorrect assumptions in its comments: first, that it was not entitled to be compensated for the revenue losses associated with reductions in services for competitors, including the introduction of the CDN services; and second, that Bell Aliant's proposal seeking approval of its exogenous factor calculations, absent specific pricing proposals, was somehow deficient and had precluded proper Commission evaluation of possible pricing changes.

16. With respect to the recovery of funds related to the reduction of prices for services for competitors, Bell Aliant submitted that it was clear from the Commission's decision that had set out the parameters of Competitor Digital Network Access (CDNA) service, the deferral account, and the consideration of exogenous factors that the ILECs were to be compensated for the creation of CDNA service.

17. Bell Aliant further noted that the Commission had reiterated in *Competitor Digital Network Services*, Telecom Decision CRTC 2005-6, 3 February 2005, as amended by Telecom Decision CRTC 2005-6-1, 28 April 2006 (Decision 2005-6), that the ILECs were entitled to be compensated for these revenue reductions, which were attributable to Commission-mandated actions.

18. Bell Aliant noted that, due to the demand for CDN and CDNA services, it did not have sufficient funds in its deferral account to fully recover the revenue reductions that had resulted from these Commission-mandated initiatives. Bell Aliant submitted that the fact that there were insufficient funds in the deferral account to offset these draw downs did not mean that it was

not entitled to be compensated for its revenue reductions; however, this did mean that Bell Aliant was entitled to compensation through other mechanisms such as an exogenous adjustment to the company's price cap indices.

19. Bell Aliant noted that, in Decision 2006-9, the Commission had stated 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. Bell Aliant submitted that Télébec's situation was not meaningfully different from its situation as both companies had a shortfall due to Commission-mandated actions.

20. With respect to MTS Allstream's comment that the approval of the exogenous factor precluded the Commission's consideration of any pricing proposal that might result from the increased room available in the baskets, Bell Aliant submitted that once its request for an exogenous factor is approved, the company will still need to file its proposed pricing changes and to demonstrate that those changes are compliant with all price cap rules, including the SBL and the rate element constraints. Bell Aliant submitted that there would be sufficient opportunity in those subsequent applications for public review and comment to ensure that any pricing proposal it would make was fully compliant with the price cap rules.

Commission's analysis and determinations

21. For the following reasons, the Commission considers that Bell Aliant has demonstrated that the annual recurring shortfall in its company's deferral account meets the criteria for consideration as an exogenous factor:

a) The negative recurring amount in Bell Aliant's deferral account is a result of, among other things, price decreases mandated in various Commission decisions related to the introduction of CDNA and CDN services where the Commission has directed the ILECs to recover resulting revenue losses through draw-downs from their deferral accounts.

b) These decisions were imposed by the Commission on the telecommunications industry, specifically on the ILECs.

c) The estimated annual recurring amount in the company's deferral account is negative \$3.154 million (equivalent to negative \$42.7 million NPW). The Commission considers that this amount is material to the company.

22. The Commission notes that Bell Aliant proposed to reduce the annual recurring shortfall in its deferral account by first drawing down the accumulated balance to the extent that funds were available. The Commission notes that, in Decision 2002-34, it stated that the deferral accounts could be drawn down to mitigate rate increases for residential service that could result from the Commission's approval of exogenous factors or when inflation exceeded productivity improvements. Accordingly, the Commission considers that Bell Aliant's proposal to first draw down the accumulated balance in its deferral account to the extent that funds are available is reasonable as it would mitigate rate increases that Bell Aliant would be allowed under an exogenous adjustment, consistent with Decision 2002-34.

23. The Commission notes that the application of the proposed exogenous adjustment will allow Bell Aliant to increase rates to recover the shortfall in the deferral account. The Commission notes that Bell Aliant must file its proposed rate changes with the Commission and demonstrate that the proposed rate changes are compliant with all price cap rules, including the SBL and the rate element constraints. The Commission notes that interested parties will have an opportunity to comment on the proposed rate changes when Bell Aliant files its proposed rate changes, and the Commission will be able to properly analyze the impact of the proposed rate changes at that time.

24. The Commission notes that Bell Aliant's proposed allocation of the exogenous adjustment is premised on the basket structure approved in Decision 2002-34, but that this regulatory regime will end on 31 May 2007. The Commission considers that, in these circumstances, it would be appropriate to allow Bell Aliant to recover the remaining annual recurring shortfall in its deferral account through an exogenous factor adjustment within the regime established in *Price cap framework for large incumbent local exchange carriers*, Telecom Decision CRTC 2007-27, 30 April 2007 (Decision 2007-27).

25. In Decision 2007-27, the Commission assigned regulated services to baskets as follows:

- Residential Services in Non-HCSAs basket
- Residential Services in High-Cost Serving Areas (HCSAs) basket
- Single- and Multi-Line Business Local Exchange Services basket
- Services with Frozen Rate Treatment basket
- Pay Telephones basket
- Other Capped Services basket
- Competitor Services basket
- Uncapped Services

26. As the revenue shortfall in Bell Aliant's deferral account is not attributable to particular regulated retail services, the Commission considers that the exogenous factor adjustment should be allocated over as broad a base of revenues as possible. The Commission notes that, in Decision 2007-27, it determined that exogenous factors should not be assigned to the Services with Frozen Rate Treatment basket and the Competitor Services basket. The Commission further notes that, in Decision 2007-27, it determined that all ILECs would be allowed to increase the local call charge for a cash call up to a maximum rate of $0.50, and to increase collect, third number, calling card or commercial credit card charges up to a maximum rate of $1.00. The Commission therefore considers that it would not be appropriate to assign exogenous factors that would allow additional pricing flexibility on rates in the Pay Telephones basket. Accordingly, the Commission considers that the exogenous adjustment should be allocated across all remaining regulated services, weighted by revenues, including the Uncapped Services.

27. In light of the above, the Commission:

- directs Bell Aliant to file updated calculations for its deferral account taking into account the impact of Decision 2007-27 and its proposed allocation for initiatives to improve access to telecommunications services by persons with disabilities within 90 days;

- approves Bell Aliant's proposal to reduce the annual recurring shortfall in its deferral account through the subtraction of the accumulated amount from the NPW of the recurring amount;

- approves Bell Aliant's proposal to treat the remaining annual recurring shortfall as an exogenous adjustment;

- directs Bell Aliant to allocate the remaining annual recurring shortfall proportionately, by revenue weight, to all baskets of regulated services, except the Services with Frozen Rate Treatment basket, the Pay Telephones basket, and the Competitor Services basket; and

- directs Bell Aliant to file the allocation of its exogenous factor with its first annual price cap filing under the new price regulation regime.

Secretary General