



## Telecom Decision CRTC 2007-5

Ottawa, 2 February 2007

### Price cap regulation for Northwestel Inc.

Reference: 8663-C12-200600066

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**Appendix 1 – Classification of services**

**Appendix 2 – Northwestel Inc. Going-in revenue requirement**

*In this Decision, the Commission establishes a price cap regime for Northwestel Inc. (Northwestel) for a period of four years beginning in 2007. The Commission has developed a simplified framework that will provide the company with certainty over the price cap period and significantly reduce the regulatory burden for the company.*

*With respect to competition in Northwestel's operating territory, the Commission determines that resale of local services will be permitted; however, facilities-based local competition will not be permitted at this time. In the long-distance market, the Commission is forbearing from the regulation of toll services; however, toll-free services will continue to be regulated.*

*The Commission determines that Northwestel will receive \$18.9 million per year from the National Contribution Fund (NCF) for the initial price cap period in support of the provision of residential primary exchange service (PES) to high-cost serving areas and the ongoing costs associated with the recently completed service improvement plan.*

*The Commission denies Northwestel's request for funding from the NCF for its toll connect trunks and approves a switch connect rate of \$0.0415 per minute per end to recover the costs associated with switching, equal access, and toll connect trunks.*

*The Commission approves on a final basis Northwestel's proposed \$2.00 increase to the monthly rates for Individual-Line Residential PES, and \$5.00 increase to the monthly rates for Individual-Line Business PES and Multi-Line Business PES. In addition, the Commission approves Northwestel's proposal to increase the monthly rate for Toll-free Dedicated Access Line service to match the Business Line rate.*

*Based on an assessment of the going-in revenue requirement for Northwestel, the Commission determines that there will be a residual shortfall of \$0.3 million. The company is permitted to recover this shortfall during the initial price cap period.*

## **Background**

1. In *Review of regulatory framework*, Telecom Decision CRTC 94-19, 16 September 1994 (Decision 94-19), the Commission concluded, among other things, that it was in the public interest to develop a regulatory framework predicated on regulating prices rather than earnings. In transitioning to this framework, the Commission considered that it would be appropriate to split the rate bases of the incumbent telephone companies into Competitive and Utility segments as well as significantly reduce the subsidy to local access services paid by users of long distance services.
2. With respect to Northwestel Inc. (Northwestel), however, the Commission noted that there would be little benefit from splitting the company's rate base given that there was limited competition in its long distance, private line, and terminal equipment markets. Accordingly, the Commission determined that the company would remain under rate base/rate of return regulation.
3. In *Telephone service to high-cost serving areas*, Telecom Decision CRTC 99-16, 19 October 1999 (Decision 99-16), the Commission noted that the territory of Northwestel presented unique challenges because of its size, population density, and severe climate.

In light of this, the Commission considered that Northwestel might not have the means to achieve the Basic Service Objective (BSO)<sup>1</sup> without supplementary funding. The Commission directed Northwestel to propose the amount of supplemental funding it would require to meet the BSO, to recover its contribution requirement, and to provide the company with a reasonable opportunity to earn a fair return on common equity (ROE).

4. In *Changes to the contribution regime*, Decision CRTC 2000-745, 30 November 2000 (Decision 2000-745), the Commission introduced, effective 1 January 2001, a new regime to subsidize the high cost of residential local service in rural and remote areas. In that Decision, the Commission established a new national contribution collection mechanism based on revenues from telecommunications service providers that replaced the existing per-minute mechanism.<sup>2</sup> In addition, the Commission concluded that it was appropriate to calculate the subsidy requirement based on the Phase II costs of providing residential primary exchange service (PES) in high-cost serving areas (HCSAs). The Commission determined, however, that this regime would not apply to Northwestel and that the company would remain on a per-minute mechanism.
5. 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's territory. The competitive framework for Northwestel included a bundled, subsidized carrier access tariff (CAT) rate of \$0.07 per minute per end. The Commission determined that it would continue regulating Northwestel on a rate base/rate of return basis and set the company's ROE at 10.5 percent. The Commission approved a four-year service improvement plan (SIP) for the years 2001 to 2004 to extend and improve service in the North.
6. In Decision 2000-746, the Commission also approved supplemental funding for the company from the National Contribution Fund (NCF) of \$15.1 million for 2001 and determined that it would conduct annual reviews of the supplemental funding required by Northwestel. Since 2001, the Commission has conducted such reviews to, among other things, establish the appropriate level of funding required by Northwestel. For 2006, the Commission approved \$9.8 million in supplemental funding in *Northwestel Inc. – Supplemental funding requirement for 2006*, Telecom Decision CRTC 2006-10, 24 February 2006 (Decision 2006-10).

#### **Scope of the proceeding**

7. In *Review of regulatory framework for Northwestel Inc.*, Telecom Public Notice CRTC 2006-1, 17 January 2006 (Public Notice 2006-1), the Commission initiated a proceeding to review Northwestel's current regulatory framework and to consider the appropriate framework to be implemented in 2007. The Commission identified, among other things, the following issues:

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<sup>1</sup> In Decision 99-16, the Commission established the following Basic Service Objective (BSO) for incumbent local exchange carriers (ILECs): (i) individual line local service with touch-tone dialling, provided by a digital switch with capability to connect via low-speed data transmission to the Internet at local rates; (ii) enhanced calling features, including access to emergency services, Voice Message Relay service, and privacy protection features; (iii) access to operator and directory assistance services; (iv) access to the long distance network; and (v) a copy of a current local telephone directory.

<sup>2</sup> The per-minute mechanism required long distance competitors to pay contribution on long distance minutes within an ILEC territory in order to contribute towards subsidizing residential primary exchange services (PES).

- whether Northwestel's current rate base/rate of return regulatory framework should be replaced by a price cap regulatory framework, and, if so, what the appropriate parameters would be for the framework;
  - whether any changes would be required to the methodology used to determine the level of funding required from the NCF, and, if so, whether the cost-based subsidy approach established in Decision 2000-745 would be appropriate;
  - whether local competition should be permitted in Northwestel's operating territory; and
  - whether any changes would be required to the CAT.
8. The Commission stated that it would undertake a financial review to assess the company's financial position at the start of the new regulatory framework. The Commission further stated that the company was to provide its view as to whether rate changes should be implemented to provide the company with the opportunity to achieve an appropriate ROE at the start of the new regulatory regime in the event that the total funding requirement from the NCF was increased substantially.

**The proceeding**

9. Northwestel filed its evidence and the responses to the Commission's initial interrogatories on 20 March 2006.
10. In addition to Northwestel, the following interested parties filed submissions, interrogatories, interrogatory responses, comments, and/or arguments: the Yukon Government (YG); the Government of the Northwest Territories (GNWT), the Public Interest Advocacy Centre on behalf of the Consumers' Association of Canada and National Anti-Poverty Organization; (collectively, the Consumer Groups), the Utilities Consumers' Group (UCG); TELUS Communications Company (TCC); and Polar Group ICT Inc., operating as Polar Institute, Polarcom, Polaris, and YKNet (Polar Group).
11. A total of five letters and emails were received from members of the general public which addressed availability of basic and advanced services, the provision of 9-1-1 service, as well as Northwestel's proposed rate increases.
12. An oral hearing was held from 10 to 13 July 2006 in Whitehorse, Yukon, before Vice-Chairman Richard French (chairman of the hearing), and Commissioners Barbara Cram, Andrée Noël, Helen del Val, and Ronald Williams. The oral hearing began with comments from Mr. van Tighem, Mayor of Yellowknife; Mr. John Carter, Executive Director of the Northwest Territories Chamber of Commerce, Community Chambers of Commerce of Yellowknife, Inuvik, Norman Wells, Fort Smith, Fort Simpson, and Hay River; and Mr. Gord Stewart of the Canadian Chamber of Commerce (collectively, Yellowknife et al.), followed by cross-examination of the evidence by the parties.

13. Final arguments were filed by Northwestel, TCC, the YG, the GNWT, the Consumer Groups, the UCG, and Polar Group on 21 July 2006, and supplemented on 25, 28, and 31 July 2006 by TCC, the GNWT and the YG, respectively. Reply argument was filed by Northwestel. The record of the proceeding closed on 4 August 2006.
14. In *Follow-up to Review of regulatory framework for Northwestel Inc., Telecom Public Notice CRTC 2006-1, 17 January 2006 – Interim residential and business service rate increases*, Telecom Order CRTC 2006-332, 6 December 2006 (Order 2006-332), the Commission approved, on an interim basis, monthly rate increases of \$2.00 for Individual-Line Residential PES and \$5.00 for Individual-Line Business PES and Multi-line Business PES effective 1 January 2007. In addition, the Commission made all of Northwestel's remaining tariffed service rates interim effective 1 January 2007.

### **Structure of the Decision**

15. In this Decision, the Commission first addresses the regulatory framework for Northwestel, including the form of regulation that will be implemented for the company in 2007, the extent to which local competition will be introduced in Northwestel's operating territory, and the company's request for forbearance from the regulation of toll and toll-free services. The Commission then addresses the components and structure of the price cap framework for Northwestel, including the objectives, components, service basket structure, and length of the price cap period.
16. The Commission next considers Northwestel's proposed funding requirements from the NCF. The Commission addresses Northwestel's proposed subsidy for residential PES in HCSAs. This section also includes consideration of the company's proposal to replace its bundled CAT rate with a switch connect rate and to fund the recovery of the toll connect trunk component of the CAT from the NCF.
17. Subsequent sections of the Decision consider financial issues, including the going-in revenue requirement, capital plan, depreciation, proposed rate restructuring, and going-in ROE and then finally reporting requirements, quality of service (Q of S), and the provision of 9-1-1 service.

### **Regulatory framework**

#### **Form of regulation**

18. Northwestel proposed to implement a price cap regulatory framework beginning in 2007. The company submitted that implementation of its proposed framework, in its entirety, would provide residents of the North access to quality telecommunications services at reasonable prices, and afford the company a reasonable opportunity to earn a fair return on its investment.
19. Northwestel submitted that there were benefits in migrating to a price cap regulatory framework, including greater homogeneity across the Canadian regulatory landscape and the potential to realize administrative efficiencies. Northwestel stressed that the framework must advance the objectives of the *Telecommunications Act* (the Act), reduce regulatory complexity, and continue to reflect the regulatory bargain.

20. TCC submitted that price cap regulation would provide better incentives for the company to achieve efficiencies and was more compatible with the development of a competitive environment.
21. The GNWT indicated that a price cap regime would provide fundamental benefits as compared to traditional rate of return regulation. The GNWT suggested, however, that in order for customers to fully benefit from the price cap regime, it was essential that it be accompanied by appropriate regulatory intervention in those areas where competitive market forces would not result in the attainment of important goals such as universal availability of service.
22. The YG submitted that, while price cap regulation of Northwestel would provide some protection for users, it must also be accompanied with measures to address infrastructure investment and the development of advanced services.
23. The UCG submitted that the North could not rely entirely on market forces, and opposed the introduction of price cap regulation. The UCG suggested that, in light of the unique circumstances of the North, a split rate base (SRB) should be implemented at this time, or in the near future, as the next step toward future price cap regulation. The UCG submitted that such a framework should make Northwestel easier to regulate.
24. Polar Group submitted that any new regulatory framework must enable the investment and growth necessary to ensure that Yukoners continue to have access to affordable advanced telecommunications services. Polar Group argued that competition would be encouraged if rural markets were based on an open access network infrastructure where a single infrastructure served all of the service providers. Polar Group suggested that a new explicit subsidy model should be developed to isolate a subsidized core-infrastructure from the competitive service platform, which would have a wholesale pricing structure.
25. Northwestel replied that it would not be appropriate or productive to split the company's rate base between Utility and Competitive segments. The company indicated that under its proposal, all subsidies would be cost-based and service specific thereby eliminating the potential for cross-subsidies, which was a major reason given by the Commission for implementing an SRB framework in past decisions.

***Commission's analysis and determinations***

26. The Commission notes that most parties supported the transition to price cap regulation for Northwestel. The Commission considers that a price cap regime would encourage Northwestel to minimize costs and be more efficient and innovative in the provision of services. As well, under such a regime, the regulatory burden for Northwestel would be reduced and the company would be provided with greater pricing flexibility.
27. With respect to the UCG's submission, the Commission considers that, in Northwestel's circumstances, an SRB framework as a transition to price cap regulation is not required given that, as explained later in this Decision, local service in the HCSAs will be subsidized from the NCF rather than from long distance services, which was the case for the large ILECs when the SRB methodology was implemented. In addition, the Commission considers that splitting the rate base would result in a continuation of the current form of regulation with additional

complexity to ensure that the allocations of investments and costs between the Utility and Competitive segments were appropriate. Accordingly, the Commission considers that it would not be appropriate to use an SRB model in Northwestel's circumstances.

28. The Commission notes Polar Group's proposal to isolate a subsidized core-infrastructure from the competitor service platform was provided in final argument. The Commission also notes that Polar Group did not provide specifics as to how its proposal would be implemented; accordingly, the Commission and other parties were not able to examine the merits of the proposal.
29. In light of the above, the Commission finds that price cap regulation is the appropriate form of regulation to implement for Northwestel in 2007.

#### **Local competition**

30. Northwestel proposed that resale of its local exchange services should be permitted. Northwestel submitted that resale would allow competitors to incorporate these services into a value-added bundle for customers. Northwestel also submitted that resale of local exchange services would also allow national competitors to serve their national customers in the North. Northwestel added that the implementation issues for resale were relatively minor, such as the extension of certain obligations to resellers and the creation of ordering and billing processes within Northwestel's Carrier Services Group (CSG).
31. However, Northwestel opposed the introduction of facilities-based local competition in its territory. Northwestel indicated that there were practical, engineering impediments in implementing the Commission's model for local facilities-based competition.
32. Northwestel submitted that it did not currently have local number portability (LNP) functionality, which was required for facilities-based local competition. Northwestel submitted that the implementation of LNP would require, among other things, significant switch changes and other network and system changes that would cost in the tens of millions of dollars.
33. Northwestel submitted that, as the only full facilities-based interexchange carrier (IXC) in its territory, it would likely have to serve as the IXC for new local exchange carriers (LECs), which would require the implementation of DMS<sup>3</sup> 250 IXC functionality in its switching network. Northwestel also submitted that implementation of equal access would also be exacerbated by the fact that it uses different switching technologies within its operating territory.
34. Northwestel submitted that in order to introduce facilities-based local competition, even in a limited number of communities, it would also need to change certain of its operating systems, such as the billing system, assignment system, Call Centre management system, and repair systems.

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<sup>3</sup> DMS stands for Digital Multiplexing System.

35. Northwestel submitted that in the South there had been virtually no facilities-based local service entry in communities of comparable size and remoteness to those served by Northwestel, because the prospect for profitable, private facilities-based investment in those communities was non-existent.
36. Northwestel submitted that it already faced local competition from a variety of sources, including cellular service, voice over Internet Protocol (VoIP), private networks, satellite, cable providers, and Industry Canada's BroadBand Rural and Northern Development (BRAND) program and the National Satellite Initiative (NSI).
37. The YG submitted that opening the local market to competition and developing realistic access pricing to enable competitive entry were necessary elements of the price cap framework. The YG also submitted that the goal of competition in Northwestel's territory should be to develop infrastructure solutions that would provide an openly accessible platform for services and applications. The YG added that Northwestel's price cap framework should include the provision for competition at the service and application layers and enable this through policies that encourage access to the existing infrastructure.
38. The UCG submitted that it was highly unlikely that local competition would roll out into Northwestel's territory for many years to come, except perhaps in larger centres. The UCG further submitted that while both local and long distance competition were required in order for proper deregulation to roll out, this was very unlikely to happen in the North in the foreseeable future.
39. The Consumer Groups and the GNWT submitted that the Commission should allow local competition on the same basis as that imposed on the small incumbent local exchange carriers (SILECs).<sup>4</sup> The Consumer Groups indicated that any costs associated with the implementation of local competition should not be borne by Northwestel's ratepayers.
40. With respect to the BRAND program and the NSI, the YG recommended that a shared approach should be considered for the design, financing, and management of a common infrastructure that would carry competitive services. The UCG was concerned that a duplicate infrastructure in the Northwest Territories and Nunavut might adversely affect the revenue stream of Northwestel and thus the rates to Northwestel's customers.
41. In reply, Northwestel was of the view that the framework put in place for the SILECs would not be appropriate for its territory because its circumstances were fundamentally different from those of the SILECs, including the degree and complexity of its network and the uniqueness of its market.

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<sup>4</sup> In *Revised regulatory framework for the small incumbent local exchange carriers*, Telecom Decision CRTC 2006-14, 29 March 2006, the Commission established a framework for the implementation of facilities-based local competition in the SILECs' territories. A SILEC is required to file proposed tariffs for competitor services if the SILEC receives a *bona fide* request from a competitor. In addition, the SILEC is required to file with the Commission an implementation plan for the provision of facilities-based local competition.

### *Commission's analysis and determinations*

42. The Commission notes that in order to implement facilities-based local competition, Northwestel would be required to implement significant modifications and enhancements to its network. The Commission also notes that the associated costs would be substantial and that the company might not be able to recover these costs. In light of the above and the limited likelihood of competitive entry, the Commission concludes that it would not be appropriate to require Northwestel to implement facilities-based local competition in its territory at this time.
43. The Commission considers, however, that resale of Northwestel's local exchange services would allow competitors to offer local exchange services with other services and thus provide some form of competitive alternative. The Commission agrees that resale of local exchange services would also allow national competitors to include local exchange services in a value-added bundle to their customers in Northwestel's territory. The Commission notes that any implementation issues to allow the resale of local exchange services would be relatively minor.
44. Accordingly, the Commission directs Northwestel to file proposed tariffs to allow resale of its local exchange services and to create the necessary ordering and billing processes within its CSG within 60 days of the date of this Decision.
45. With respect to the parties' comments on the BRAND program and the NSI, the Commission notes that the focus of this proceeding was to address the framework for Northwestel's regulated services and, consequently, did not include a review of high-speed Internet services, which are unregulated. The Commission considers that its determinations in this proceeding, including not permitting facilities-based local competition and the approval of an explicit cost-based subsidy for the provision of service to HCSAs, which are addressed later in this Decision, will serve to mitigate most negative impacts on the company's revenues.

### **Toll competition**

46. The Commission's power to forbear from regulating a telecommunications service or class of services provided by a Canadian carrier originates from section 34 of the Act, which reads as follows:
  - 34.(1) The Commission may make a determination to refrain, in whole or in part and conditionally or unconditionally, from the exercise of any power or the performance of any duty under sections 24, 25, 27, 29 and 31 in relation to a telecommunications service or class of services provided by a Canadian carrier, where the Commission finds as a question of fact that to refrain would be consistent with the Canadian telecommunications policy objectives.
  - (2) Where the Commission finds as a question of fact that a telecommunications service or class of services provided by a Canadian carrier is or will be subject to competition sufficient to protect the interests of users, the Commission shall make a determination to refrain, to the extent that it considers appropriate,

conditionally or unconditionally, from the exercise of any power or the performance of any duty under sections 24, 25, 27, 29 and 31 in relation to the service or class of services.

(3) The Commission shall not make a determination to refrain under this section in relation to a telecommunications service or class of services if the Commission finds as a question of fact that to refrain would be likely to impair unduly the establishment or continuance of a competitive market for that service or class of services.

(4) The Commission shall declare that sections 24, 25, 27, 29 and 31 do not apply to a Canadian carrier to the extent that those sections are inconsistent with a determination of the Commission under this section.

47. In Decision 94-19, the Commission established the analytical framework for determining whether to forbear from regulation pursuant to section 34 of the Act. In that Decision, the Commission adopted the concept of market power as the standard by which to determine whether a market is, or is likely to be, workably competitive. The Commission also determined that it would use economic and competition law analysis to assess whether carriers possess market power.
48. In *Forbearance – Regulation of toll services provided by incumbent telephone companies*, Telecom Decision CRTC 97-19, 18 December 1997, as amended by Telecom Decision CRTC 97-19-1, 9 March 1998 (Decision 97-19), the Commission found it appropriate to forbear from the regulation of both the toll and toll-free markets of most large ILECs. In assessing whether the ILECs possessed market power, the Commission considered a number of factors in Decision 97-19: (i) market shares of the dominant and competing firms; (ii) demand conditions; (iii) supply conditions; (iv) likelihood of entry into the market; (v) barriers to entry; and (vi) evidence of rivalrous behaviour.
49. Northwestel requested forbearance from the regulation of toll and toll-free services under the same terms and conditions established for the other ILECs in Decision 97-19. Northwestel submitted that residential and business customers would benefit from toll forbearance because the company would be able to respond more quickly and with greater flexibility to competitors.
50. Northwestel submitted that the Commission should adopt the same service markets as approved in Decision 97-19 for determining whether forbearance is appropriate, namely (i) the toll market, which includes basic toll and discount toll services, and (ii) the toll-free market. Northwestel also submitted that, as found by the Commission in Decision 97-19, both the toll and toll-free markets were national in scope.
51. Northwestel submitted that, based on the six conditions set out in Decision 97-19, it would not have market power in either the toll or toll-free services markets. In addition, Northwestel submitted that the Commission should apply its market power assessment criteria less rigorously because of Northwestel's limited geographic coverage and smaller subscriber base.

52. Northwestel estimated that the competitor toll market share in 2006 would increase to 33.8 percent from 31.8 percent in 2005, with prepaid and calling card providers having the largest share. Northwestel submitted that it was under increasing pressure from cellular providers, who were increasing their reach and offering aggressively priced long distance rates and distance-insensitive calling plans. Northwestel added that it also faced stiff long distance competition from VoIP service providers.
53. With respect to demand conditions, Northwestel submitted that there were economically feasible and practical substitutes available. Northwestel further submitted that growing long distance traffic volumes and competitors' steadily increasing market share provided compelling evidence that customers were willing to switch to another supplier.
54. Northwestel indicated that there were no supply constraints on prepaid calling cards, and they were available throughout its territory. Northwestel submitted that increased competition from a variety and increasing number of toll providers, together with the related market share losses, showed that competitors could easily enter the toll market.
55. Northwestel argued that the degree of competitive entry clearly demonstrated the absence of material barriers to entry and that its market share loss resulting from the aggressive marketing activities of competitors indicated evidence of rivalrous behaviour.
56. Northwestel submitted that its network architecture did not allow it to provide specific information on the traffic volumes or the number of competing firms in the toll-free market. Northwestel further submitted that it could not provide data to assess whether the toll-free services market met the six conditions set out by the Commission in Decision 97-19 to assess market power.
57. Northwestel argued that the small amount of toll-free minutes justified a less rigorous application of these six conditions, in the same way that the Commission did for Sogetel inc. in Decision 97-19. Northwestel estimated that toll-free minutes represented less than 2.5 percent of the total toll and toll-free service minutes and there were only 393 toll-free service customers in its territory. Northwestel also submitted that toll-free services were available from a variety of national toll-free service providers, including VoIP-based service providers, at very aggressive rates.
58. TCC submitted that, based on market share losses, Northwestel faced a unique form of retail long distance competition from prepaid calling card providers which constrained its ability to raise prices of toll services. TCC submitted that the Commission should forbear from regulating Northwestel's retail toll service because Northwestel lacked market power, and forbearance would give Northwestel a reasonable opportunity to respond to competitive entry.
59. The YG submitted that, although Northwestel had lost market share in the prepaid card sector, customers not using prepaid cards would have nowhere else to go in the event toll rates went up after forbearance. The YG also submitted that the insufficient range of choices available to consumers justified not relieving Northwestel of regulatory oversight of its toll services.

60. The GNWT noted that Northwestel proposed the same model of long distance regulation that applied in the South and suggested that it should be contingent upon the Commission substantially lowering the CAT rate to stimulate competition. The UCG also supported lowering the CAT rate, arguing that it appeared to be the most logical solution to inspire more competitive forces in the long distance market and discourage bypass.
61. The GNWT submitted that the circumstances in the North were very different from the South, noting that there were no equal access facilities except in Whitehorse, Yellowknife, and Fort Nelson, and the two equal access service providers operating in Northwestel's territory only provided service to the large business market. The GNWT further noted that there were no facilities-based equal access service providers, and that the only real competitive alternative was prepaid calling cards.
62. The GNWT submitted that because of the huge distances separating northern communities from each other and from elsewhere, northerners were more dependent on long distance service. The GNWT further submitted that if toll forbearance were granted, tighter constraints should be imposed on changes to the basic rate schedule for toll services.
63. With regard to toll-free services, the GNWT submitted that the Commission should not forbear from those services given the very limited competition that existed in that market.
64. The Consumer Groups submitted that prior to granting toll forbearance, the Commission had to ensure itself that the level of equal access availability was sufficient to protect the interests of end-users. The Consumer Groups added that the Commission also had to ensure that long distance service providers offering service using prepaid calling cards had the appropriate safeguards available to ensure continued access by end-users, including reasonable rates, in Northwestel's territory following any granting of toll forbearance. The Consumer Groups submitted that Northwestel should be subject to the same forbearance terms and conditions as those imposed by the Commission on the other ILECs in Decision 97-19.
65. With respect to the GNWT's proposed additional constraints for the basic rate schedule, Northwestel submitted that the constraints imposed by the Commission in Decision 97-19 on other ILECs were sufficient to fully address the GNWT's concerns. Northwestel also submitted that it did not intend to increase individual rates in the basic long distance rate schedule other than as required to address situations such as the volatility of overseas termination costs. Northwestel further submitted that it had no plans to alter the time of day discounts to the basic schedule.

#### ***Commission's analysis and determinations***

##### *Market definition*

66. In Decision 97-19, the Commission found that the toll and toll-free markets were distinct from one another and that customers of toll-free services would not perceive other toll services as substitutes because of the significant costs they would incur to migrate customers to other toll services. The Commission finds that these market definitions, that is, (i) the toll market, including basic toll and discount toll services, and (ii) the toll-free market, are also appropriate for Northwestel.

*Toll services*

67. The Commission recognizes that long distance competition in the North, which is mainly coming from prepaid and calling cards, is not evolving in the same way as it did in the South. The Commission notes that Northwestel has been steadily losing toll market share over the years to a variety of toll service alternatives. The Commission considers that these alternatives will constrain Northwestel's ability to raise the price of its toll services in a forbore environment.
68. The Commission also considers that the record of the proceeding indicates that with respect to the toll services market, there is entry into the market; an ability and willingness of customers generally to switch to competitors; and rivalrous behaviour.
69. The Commission finds, pursuant to subsections 34(1), 34(2), and 34(3) of the Act, that
  - a) refraining from the exercise of its powers and the performance of its duties, to the extent specified below, with respect to Northwestel's toll services is consistent with the Canadian telecommunications policy objectives;
  - b) the market for Northwestel's toll services is sufficiently competitive to protect the interests of users, such that forbearance, to the extent specified below, is warranted; and
  - c) forbearance from the exercise of its powers and the performance of its duties, to the extent specified below, with respect to Northwestel's toll services would not impair the continuance of a competitive market for these services.
70. In light of the above, the Commission finds it appropriate to forbear from the regulation of toll services in Northwestel's territory to the extent specified below, effective the date of this Decision.
71. In Decision 97-19, the Commission set out the scope of forbearance with respect to the southern ILECs' toll services as it pertained to sections 24, 25, 27, 29, and 31 of the Act. In that Decision, the Commission also found that concerns regarding the extent of workable competition in areas of the ILECs' territories not served by equal access switches could be addressed through the exercise of its powers in the Act.
72. The Commission notes that the determinations in Decision 97-19 for the southern ILECs have been sufficient to ensure that the toll market remained competitive and to protect consumers from anti-competitive behaviour. The Commission considers that adopting the same determinations for toll forbearance for Northwestel would be appropriate and would satisfy the concerns raised by the Consumer Groups and the GNWT.
73. Accordingly, the Commission hereby forbears, with respect to Northwestel's toll services, including basic and discount services, to the same extent and subject to the same terms and conditions as set out in Decision 97-19 for the southern ILECs.

74. Northwestel is directed to issue, within 15 days of the date of this Decision, tariff pages removing toll services from the company's tariffs.

*Toll-free services*

75. The Commission considers that Northwestel has not provided specific information to assess whether the company lacks market power in the toll-free market. The Commission also considers that Northwestel has not demonstrated that toll-free customers in its territory require the service on a national basis rather than a regional or localized basis, or that competition is sufficient to protect the interests of all customers that require such services. The Commission further considers that there is insufficient information on the record of this proceeding on competitive toll-free providers, such as the number of providers, the competitiveness of their services, the availability of their services, and their geographic coverage.
76. In light of the above, the Commission denies Northwestel's request to forbear from the regulation of toll-free services.

**Price cap framework**

**Objectives**

77. Northwestel proposed the following objectives for its price cap framework:
- residents of the North require access to reasonably comparable services to those available elsewhere in Canada;
  - residents of the North should pay reasonably comparable prices to those elsewhere in Canada;
  - residents of the North require access to a full service provider that can understand and address their unique requirements;
  - residents of the North should benefit from the ability to choose between competitive alternatives, although not necessarily the same alternatives as elsewhere in Canada; and
  - Northwestel must be afforded a reasonable opportunity to earn a fair return and attract investment required to develop its infrastructure and services in order to meet the evolving requirements of the residents of the North.
78. Northwestel submitted that the objectives of its regulatory framework must be consistent with advancing the telecommunications policy objectives of the Act. Northwestel further submitted that the objectives must also recognize the company's investment to provide telecommunications services to the North, which was made under the regulatory bargain.

79. The Consumer Groups agreed with Northwestel that residents of the North should pay rates that are reasonably comparable to those elsewhere in Canada, and that this was consistent with the objectives of the Act. TCC submitted that the concept of affordability, a mandated objective of Canadian telecommunications policy, would mistakenly be displaced by the concept of comparability. TCC further argued that this new objective would apply not just to rates for residential local exchange services, but to rates for the entire range of Northwestel services.
80. The UCG suggested that this proceeding should persuade the Commission to uphold the telecommunications policy objectives established in section 7 of the Act.
81. The YG submitted that the new regulatory framework established for Northwestel should allow the company to continue as a viable northern-based telecommunications provider. The YG further submitted that this framework must enable the investment and growth necessary for growth in telecommunications facilities and ensure continued access to advanced telecommunications services that would result in net benefits. The YG indicated that the telecommunications services available should offer sufficient flexibility in availability, innovation, and pricing for Northwestel's customers to have comparable opportunities to those available to other Canadians. The YG also submitted that telecommunications users should have sufficient protection for the prices, value, and quality of the telecommunications services they require.
82. The YG submitted that the term "reasonably comparable" prices must be interpreted so that telecommunications users in the North would not be disadvantaged in terms of either access or price with respect to quality telecommunications services when compared to other parts of Canada.
83. In reply, Northwestel opposed TCC's view and argued that comparability was an important element in determining both the affordability and reasonableness of rates. Northwestel emphasized that the term "reasonably comparable" did not mean identical rates, noting that, in the North, many existing rates were higher than those in the South.

*Commission's analysis and determinations*

84. The Commission considers that most of Northwestel's proposed objectives and the views put forward by the other parties are reflected in the Canadian telecommunications policy objectives set out in section 7 of the Act.<sup>5</sup> However, some proposed objectives attempted to specifically recognize other elements or account for the unique circumstances in the North.

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<sup>5</sup> The policy objectives set out in section 7 of the Act include: (a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions; (b) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada; (c) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications; ... (f) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective; ... and (h) to respond to the economic and social requirements of users of telecommunications services.

85. The Commission considers, for example, that Northwestel's proposed objectives, that residents of the North require access to reasonably comparable services, and should pay reasonably comparable prices, to those services available elsewhere in Canada, fall within sections 7a) and b) of the Act. The Commission also considers that Northwestel's proposed objective, that residents of the North require access to a full service provider that can understand and address their unique requirements, reflect sections 7a) and h) of the Act. In addition, Northwestel's proposed objective, that residents of the North should benefit from the ability to choose between competitive alternatives, falls within sections 7c) and f) of the Act.
86. With respect to Northwestel's proposed objective that the company should be afforded a reasonable opportunity to earn a fair return and attract investment in order to meet the needs of the North, the Commission considers that this objective was achieved by conducting a revenue requirement review in this proceeding in order to set going-in rates prior to the implementation of the price cap regime. The Commission notes that the focus of price cap regulation is prices rather than earnings, and that the concept of earnings will no longer have a significant relevance in the price cap regime for Northwestel given the introduction of a Phase II-based subsidy requirement, as discussed later in this Decision.
87. The Commission considers that the price cap regime set out in this Decision recognizes the unique circumstances faced by Northwestel and that the objectives in the Act, as discussed above, are sufficiently flexible to accommodate these circumstances. In light of the above, the Commission finds that section 7 of the Act sets out the appropriate objectives for Northwestel's price cap regime.

### **Components of the framework**

#### *Inflation index and exogenous factor*

88. Northwestel proposed that the annual chain-weighted gross domestic product – price index (GDP-PI), published by Statistics Canada, be used as the inflation index since it represented the best publicly reported and verifiable statistical measure of the rate of inflation experienced broadly across the economy.
89. Northwestel indicated, however, that the GDP-PI might not adequately reflect input cost increases associated with large-scale resource sector projects specific to Northern Canada given the relatively small weighting of economic activity in the North compared to a national base. The company noted the Mackenzie Valley Gas Pipeline, as an example, which may be constructed in the 2008 to 2011 period and was anticipated to have a significant impact on labour demand and labour supply, reflecting higher employee retention costs as well as higher direct costs for other scarce resources.
90. Northwestel proposed that the best approach for addressing impacts of this nature was through the exogenous factor adjustments. Accordingly, Northwestel proposed the following criteria for exogenous factor adjustments:
  - they are legislative, judicial, or administrative actions which are beyond the control of the company; or

- they are events or actions which are specific to the telecommunications industry; or
  - they are events or actions which are specific to Northern Canada; and
  - they have a material impact on the company.
91. Northwestel submitted that given the company's small customer base and the unique nature of competition in the North, the assignment of an exogenous factor to the Competitor Services basket might be appropriate in some circumstances, and should be considered on a case-by-case basis.
92. The YG submitted that Northwestel's proposal to use the annual chain-weighted GDP-PI in the price cap framework was reasonable. The YG also submitted that Northwestel's proposal to recognize through the exogenous factor adjustment that the thin economic base of the North might be more susceptible to swings caused by major projects was appropriate. Further, the YG argued that given the evolving nature of the competitive environment, it would be more suitable to have competitor services subject to more direct and ongoing review by the Commission, rather than waiting until the impacts triggered the need for an exogenous adjustment.
93. TCC submitted that it was not clear as to why an adjustment to include events or actions specific to Northern Canada was either desirable or necessary. TCC argued that the additional criterion to reflect such events might also breach the integrity of the price cap methodology by opening the door to too many *ad hoc* requests for adjustments.

*Commission's analysis and determinations*

94. The Commission notes that no party objected to the company's proposed use of GDP-PI as the inflation index. The Commission further notes that this data is published by Statistics Canada and is readily available, and is used for all ILECs subject to price cap regulation. Accordingly, the Commission finds appropriate Northwestel's proposal to use the annual chain-weighted GDP-PI as the inflation index.
95. With respect to Northwestel's concerns regarding potential cost increases associated with large resource sector projects specific to Northern Canada, the Commission recognizes that such projects may have a significant adverse effect on the company's costs and that the company should be provided with the opportunity to recover these costs. Since these projects could directly affect the company's input costs, the Commission considers that it would be more appropriate to address such concerns through an adjustment to the inflation index, as opposed to the exogenous factor proposed by Northwestel.
96. Accordingly, should Northwestel experience significant increases to its input costs resulting from large resource sector projects specific to Northern Canada, the Commission finds that the company will be permitted to propose an adjustment to the inflation index to adjust for any such impact. In order for the Commission to consider an application for such an adjustment, the company must demonstrate that the increases are material in relation to the total company, and are expected to have a sustained impact on the company's input costs.

97. 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), and *Implementation of price regulation for Télébec and TELUS Quebec*, Telecom Decision CRTC 2002-43, 31 July 2002 (Decision 2002-43), the Commission set out the current criteria for an exogenous factor as a component of the price cap regime for the ILECs. Adjustments are considered for events or initiatives that satisfy 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 on the company.
98. The Commission notes that the intent of these criteria was to limit the exogenous factor to specific events that impacted the telecommunications sector. The Commission finds that the criteria for exogenous events as outlined in Decisions 2002-34 and 2002-43 will also apply to Northwestel.
99. The Commission finds that an adjustment for an exogenous event should be reviewed on an individual basis and assigned on a cost-causal basis to the appropriate service baskets discussed later in this Decision. The Commission directs Northwestel to file for approval of exogenous treatment for all actions or events that meet the criteria regardless of whether they impact the company positively or negatively.
100. In order to ensure fairness to all stakeholders, Northwestel is required to notify the Commission of any proposed exogenous adjustment within 60 days of the event's occurrence. Other parties who believe an exogenous adjustment is required should notify the Commission as soon as possible after they learn of the relevant facts.

#### ***Productivity offset***

101. Northwestel submitted that, consistent with Decision 2002-34 for the large ILECs, the company's basic productivity offset, or X-factor, should be based on service-specific marginal costs, with the intention of reflecting realistic future productivity gains.
102. Northwestel argued that, with respect to productivity gains, in order for the company to benefit from scale economies, centralization, and newer technologies it would require size and volumes which it did not have. The company indicated that it had implemented centralization and newer technologies to the extent possible.
103. Northwestel suggested that it was necessary to modify the service-specific marginal cost methodology employed by the large ILECs in recognition of its unique circumstances. Northwestel noted that, in order to more realistically reflect potential productivity gains, it had modified or normalized its marginal cost study in order to isolate the impact of non-reproducible factors, such as asset life changes, income tax rate reductions, and reductions to interest costs.

104. Northwestel submitted that the normalized marginal cost study, based on two data points (1998 and 2006), indicated a negative productivity offset of 2.9 percent, which implied rising costs or a productivity loss. Northwestel submitted that, while the methodology was valid, it was proposing a productivity offset of zero in light of (i) the volatility of comparing two isolated sample points pertaining to only a subset of its small base of operations, (ii) the productivity offsets approved for other telephone companies, (iii) the company's commitment to cost containment, and (iv) the company's desire to present a balanced and reasonable framework proposal.
105. TCC submitted that Northwestel's use of two years of data to calculate its productivity offset related to residential PES was insufficient, which would lead to an unreliable calculation and potentially unreliable conclusions. TCC indicated that a productivity offset required annual service-specific cost data taken over a number of years in order to examine a trend in costs.
106. TCC suggested that while the proposed productivity offset of zero seemed reasonable, it was problematic since it was made in the absence of any evidence and failed to meet the rigorous standards that must be applied in a rate-setting proceeding.
107. TCC proposed that the Commission direct, on an interim basis, that Northwestel set the productivity offset equal to inflation, pending the determination of the new X-factor pursuant to Northwestel's undertaking to provide further cost estimates.
108. The UCG and the Consumer Groups opposed Northwestel's proposed productivity offset. The Consumer Groups submitted that a more appropriate estimate of the company's productivity offset for the period of 1998 to 2006 was 0.7 percent. The Consumer Groups noted that this estimate removed Northwestel's normalization adjustments to its 1998 cost study results and isolated the impact of Northwestel's SIP program to derive an estimate of how the cost of residential service, on a non-SIP basis, changed over time.
109. The Consumer Groups expected that Northwestel would experience benefits resulting from economies of scope, given that Northwestel's digital subscriber line (DSL) high-speed Internet service made use of the underlying local loop. The Consumer Groups submitted that it would be reasonable to increase the productivity offset by approximately 0.5 percent to account for economies of scale in arriving at an appropriate productivity target. In addition, the Consumer Groups suggested that a consumer productivity dividend or stretch factor of 1.0 percent be included to reflect the results from the streamlining of regulation and increased incentives for Northwestel to be more efficient. The Consumer Groups concluded that a minimum target productivity offset in the range of 2.0 to 2.5 percent would be appropriate for Northwestel.
110. The YG submitted that it was important for consumers that the regulatory framework encourage Northwestel to improve productivity. The YG further submitted that the Consumer Groups' proposal for a stretch factor was inconsistent with the reality that basic service throughout the North required subsidy support.
111. Northwestel submitted that the Consumer Groups' suggested productivity offset of 0.7 percent, which excluded its adjustments, was overstated. Northwestel also submitted that, in light of its considerable challenges in making material net productivity gains, it did not support the

application of a stretch factor. Northwestel further submitted that the Consumer Groups' arbitrary adjustment of 0.5 percent to the X-factor due to economies of scope would offend both Phase II costing principles and established Commission practices.

112. Northwestel disagreed with TCC's proposal to set the productivity offset factor equal to inflation in the interim pending the determination of a new factor. Northwestel argued that it has challenges in achieving net productivity gains, because of the vastness of the area it serves, the lower population densities, the smaller exchanges separated by larger distances, and a larger proportion of fixed and common costs.

*Commission's analysis and determinations*

113. The Commission considers that an appropriate base upon which to determine the level of the productivity offset should ideally be represented by the change in annual service-specific marginal costs over an appropriate period of time. The Commission also considers that utilizing a sufficient number of data points permits the development of a trend and optimizes the reliability of the data to project expectations and would reduce the likelihood of errors caused by the possible anomalous results of any one data point.
114. The Commission considers that using the service-specific marginal cost data for only two years, as provided by Northwestel, does not permit the establishment of a reliable trend. In addition, without appropriate data from Northwestel on which to assess the determination of an appropriate productivity offset, the Commission is also not in a position to assess the Consumer Groups' proposal that the productivity offset should be in the range of 2.0 to 2.5 percent.
115. The Commission considers that Northwestel has not provided sufficient data in order to validate its calculation of a productivity offset of negative 2.9 percent, nor has the company provided any support for, or demonstrated that, a productivity offset of zero is appropriate. Accordingly, the Commission will not establish an explicit productivity offset for Northwestel at this time.
116. The company is directed to compile during the price cap period the appropriate costing data necessary to determine a productivity offset. This information will be considered during the review of Northwestel's price cap regime.
117. In light of this determination, the Commission has established a service basket structure and accompanying pricing constraints in order to promote incentives for operational efficiencies and provide adequate protection for consumers. The Commission notes that this approach will also provide the company with certainty, reduce the regulatory burden, and provide a degree of simplicity to the price cap regime. This basket structure is set out in the following section.

*Service basket structure*

118. Northwestel proposed a basket structure, set out below, which was similar to the basket structure approved for the large ILECs in Decisions 2002-34 and 2002-43, but simplified to reflect the company's unique circumstances.

*Basket A – Residential Access Services:* The basket would include residential PES and residential installation service charges. The services would be subject to a basket constraint of inflation (I) minus a productivity offset factor (X), when I is greater than X. A rate element constraint would limit increases for individual services to five percent.

*Basket B – Business Access Services:* The basket would include all business access services and the associated installation service charges. An overall constraint of I would apply to the basket and there would be a rate element constraint limiting increases for individual services to 10 percent per year.

*Basket C – Frozen/Fixed Services:* The basket would include such services as payphone services, message relay services, SIP service charges, construction payment plans, directory listings (residential, primary and non-published), call display blocking, emergency alerting services, toll denial, rates for the hearing impaired, and 9-1-1 public emergency reporting services. The rates would be fixed during the price cap period.

*Basket D – Competitor Services:* Competitor services rate changes would be subject to tariff applications which would provide costing or benchmarking to rates previously approved to support rate changes.

*Basket E – Other Capped Services:* The basket would include such services as private line services and other data services. The basket constraint would be I-X and there would be a rate element constraint limiting increases for individual services to 10 percent.

*Basket F – Special Capped Services:* The basket would include basic toll schedules, and residential calling features and voice messaging services. Special pricing constraints would apply. The basic toll services would be capped at the current total average rate of basic toll service. The constraint on the calling features and the voice messaging services would limit monthly rate increases on each service to \$1 per year or be benchmarked to an existing approved rate for another company.

*Basket G – Uncapped Competitive Retail Services:* All other services, including business optional services, Centrex and special assembly services, would not be capped.

119. TCC proposed that both the residential access revenues and the residential PES contribution should be included in the Residential Access Services basket and capped at the going-in level; that is, the constraint should be I equal to X. TCC noted that this would permit revenue increases from rate increases to be offset by a corresponding decrease in contribution. TCC submitted that the Commission should also mandate a series of staged increases to residential rates over the duration of the price cap period, which would be offset by reductions in contribution.
120. TCC submitted that the business local exchange rates should be capped at levels that assume that they are priced at Phase II costs plus a 25 percent mark-up, and Northwestel should not be allowed to increase rates until a productivity study was completed.

121. TCC proposed that the Commission cap all other service baskets at going-in levels until a proper productivity offset was developed and filed by Northwestel. TCC submitted that the Commission should impose, on an interim basis, a cap of  $I$  equal to  $X$  on the Other Capped Services basket, and that this basket should include local business services, but exclude toll services.
122. The Consumer Groups submitted that the pricing constraints on the proposed baskets should be adjusted to more evenly distribute the benefits of price cap regulation. The Consumer Groups proposed that the individual rate element limit for the Residential Access Services basket should be set at the lower of the rate of inflation or five percent. The Consumer Groups also proposed that enhanced calling features be subject to a constraint of inflation plus three percent per feature, and that the Business Access Services basket should be subject to a basket constraint of  $I$  minus  $X$  in recognition of the limited forces in the business access market in Northwestel's territory.
123. The Consumer Groups proposed that there be an additional constraint prohibiting any de-averaging of rates between rate groups because this would provide a degree of protection for ratepayers in one rate Band from experiencing rate increases while another rate Band experienced rate decreases.
124. The GNWT submitted that no increases should be permitted to business and residential local rates during the price cap period, noting that the local access rates were among the highest in Canada and increasing the rates annually by the rate of inflation may not be appropriate. The GNWT further submitted that the monthly rates for residential and business calling features could increase by up to one dollar in any given year, but should not be permitted to exceed the highest rate approved by the Commission.

*Commission's analysis and determinations*

125. The Commission considers that in light of the evidence provided by Northwestel, as well as the Commission's findings in this Decision with respect to the productivity offset, local competition, and the subsidy requirement, Northwestel's proposed basket structure would not be appropriate in these circumstances as it would provide the company too much flexibility to increase service rates, and would not provide the company with incentives to increase efficiencies.
126. The Commission's determinations with respect to the basket structure and pricing constraints, as well as the assignment of services to each of these baskets are addressed below and have taken into consideration other determinations made in this Decision. Given that the Commission was unable to determine an explicit productivity offset for Northwestel, the Commission has relied on the service basket structure and pricing constraints set out below to provide the company with the appropriate incentives to be efficient and to provide adequate protection to consumers. As stated earlier, the Commission considers that its approved basket structure will provide the company with adequate incentives to increase efficiencies, a degree of certainty, and a level of simplicity to the price cap framework, as well as substantially reduce the regulatory burden. The assignment of Northwestel's services to the baskets is provided in Appendix 1 to this Decision.

*Residential Services basket*

127. Given that the Commission was unable to establish a productivity offset for Northwestel in this proceeding, the Commission does not consider it appropriate to apply an I-X constraint to the Residential Services basket as proposed by Northwestel.
128. The Commission notes that Northwestel's residential PES rates are among the highest in the country and that several parties voiced concerns over the level of residential PES rates and the impact on consumers of permitting rates in this basket to increase. With the implementation of the new regulatory framework in this Decision, the company will be experiencing many changes in 2007, including the changes in its subsidy calculation and the replacement of the CAT with a cost-based switch connect rate. In light of the above, the Commission considers that freezing residential PES rates for the price cap period is appropriate and will provide the company with a degree of certainty and reduce the regulatory burden. In addition, maintaining residential PES rates and the subsidy at the same level during the period will likely provide an incentive for the company to be more cost-efficient.
129. The Commission finds that the residential services basket will include residential PES, both Individual-Line and Party-Line, including all mandatory services such as Touch-Tone. Residential installation service charges, which Northwestel proposed to assign to this basket, have been assigned to the Other Capped Services basket as discussed below.

*Business Services basket*

130. The Commission notes that interested parties' positions varied widely with respect to the constraints for the Business Services basket.
131. Given that the Commission was unable to establish a productivity offset for Northwestel in this proceeding, an I-X constraint applied to the Business Services basket, as proposed by the Consumer Groups, is not appropriate at this time.
132. With respect to the GNWT's proposal to freeze business rates, the Commission notes that Northwestel's business rates are less than Phase II costs plus a mark-up of 25 percent. The Commission notes that in *Pricing policy for services subject to price caps*, Telecom Order CRTC 99-494, 1 June 1999 (Order 99-494), it did not require ILECs subject to price cap regulation to file a rate reduction for a service below Phase II costs plus a mark-up of 25 percent. The Commission considers the policy established in Order 99-494 would be appropriate in the case of Northwestel and, accordingly, it would not be appropriate to freeze Northwestel's business rates at their current levels.
133. The Commission considers that the company should be provided with sufficient pricing flexibility should it wish to price its business services at a minimum of Phase II costs plus a 25 percent mark-up. However, given that the business market may not be sufficiently competitive to discipline rates in all circumstances, the Commission considers that it would be appropriate to protect business customers by limiting the extent to which a rate in the Business Services basket can increase. Accordingly, the Commission finds that the company's proposal of an overall constraint of inflation for the Business Services basket and a rate element constraint limiting increases for individual services to 10 percent per year would provide a sufficient level of discipline to the rates for services in this basket.

134. The Commission finds that this basket should include business PES for Individual-Line, Multi-Line and Party-Line, including mandatory local services. Business installation service charges, which Northwestel proposed to assign to this basket, have been assigned to the Other Capped Services basket as discussed below.

*Other Capped Services basket*

135. The Commission notes that most interested parties did not comment specifically on Northwestel's proposal for this basket.
136. Given that the Commission was unable to establish a productivity offset for Northwestel in this proceeding, the Commission does not consider it appropriate to apply an I-X constraint to the Other Capped Services basket.
137. Notwithstanding the absence of a productivity offset, the Commission considers that, it would be appropriate to constrain the prices of services in the Other Capped Services basket. Specifically, the Commission determines that the weighted-average price of all the services in Other Capped Services basket will not be allowed to increase over the price cap period. However, Northwestel will have the opportunity to restructure the rates for services in this basket on a revenue-neutral basis.
138. Where Northwestel proposes to introduce a new service, or file rate reductions to an existing service, the Commission determines that the proposed rates must be supported by an economic study and must satisfy an imputation test unless the proposed rates are equal to or above the rates approved for another ILEC for the same service. The Commission notes that this will prevent Northwestel from reducing the rates for services inappropriately.
139. The Commission considers that these constraints and pricing rules for the Other Capped Services basket will provide incentives to the company to increase efficiencies, provide some level of protection to customers, and will provide the company with sufficient pricing flexibility to restructure rates.
140. The Commission agrees with Northwestel's proposed assignment of private line services, other data services, and other administrative charges to the Other Capped Services basket.
141. Northwestel had also proposed that the residential installation service charges be placed in the Residential Services basket and that the business installation service charges be placed in the Business Services basket. The Commission notes that rates for some of the business and residential installation service charges are not compensatory. The Commission considers that assigning these services to the Other Capped Services basket will provide Northwestel with the ability to move these rates to compensatory levels. Accordingly, the Commission finds it appropriate to assign the installation service charges for both residential and business services to the Other Capped Services basket.
142. Given that the Commission has determined that facilities-based local competition will not be permitted at this time, the Commission considers it appropriate to assign residential and business optional services, voice messaging services and calling features, and Centrex service to the Other Capped Services basket, as opposed to the Uncapped Services basket as proposed by Northwestel, in order to provide adequate incentives to the company to increase efficiencies.

*Services with Frozen Rate Treatment*

143. The Commission considers that Northwestel's proposal to establish a basket containing services which address social obligation issues such as privacy, emergency, and special needs is appropriate. The Commission also considers that, similar to the treatment of these services for other ILECs, it is appropriate to freeze the rates for these services for the duration of the price cap period.
144. Accordingly, the Commission approves Northwestel's proposal to include services, such as payphone services, message relay services, SIP service charges, construction payment plans, directory listings (residential, primary and non-published), call display blocking, emergency alerting services, toll denial, rates for the hearing impaired, and 9-1-1 public emergency reporting services, in the Services with Frozen Rate Treatment basket.

*Competitor Services*

145. The Commission notes that Northwestel's competitor services include services used by local and toll competitors, including interconnection services required by wireless service carriers. The Commission considers that Northwestel's proposal to include these services in one basket is appropriate. The Commission further considers that, consistent with the treatment of the competitor services of other ILECs, no overall pricing constraint will apply to this basket. Applications for rate change for these services will be dealt with on a case-by-case basis.
146. The Commission finds that the Competitor Services basket will include all wholesale competitor services such as co-location, toll network interconnection services, and wireless interconnection services.

*Uncapped Services*

147. The Commission considers that it would be appropriate to establish an Uncapped Services basket and that this basket should include (i) toll-free services, given that there are competitive choices available but these services have not been forborne from regulation, (ii) special assembly services, given that they are generally developed with regard to long-term customer commitments, and (iii) services where the rates are calculated based on a Commission-approved formula, such as late payment charges.

*Special Capped services*

148. The Commission considers that there is no need to place basic toll services in a basket given that the Commission has determined that it will forbear from the regulation of these services and that the same terms and conditions set out in Decision 97-19 with respect to the basic toll schedule will apply to Northwestel.
149. In light of the determinations made in this Decision, there is no need for a Special Capped Services basket as proposed by Northwestel.

*Application of exogenous factors and adjustments to the inflation index*

150. With respect to the assignment of exogenous adjustments, the Commission notes that the services in the Services with Frozen Rate Treatment basket address social obligation issues. Accordingly, the Commission finds that it would not be appropriate to permit exogenous factor adjustments to the rates for services in this basket.
151. The Commission also finds that exogenous adjustments should not be assigned to the Competitor Services basket. The Commission considers that, if it were to be determined that all or part of an exogenous adjustment should be assigned to the Competitor Services basket, this event may affect the Phase II costs directly, which may require revised rates to be filed using Phase II costing methodology.
152. As discussed above, the Commission has determined that it is appropriate to permit Northwestel to propose an adjustment to the inflation index, if required, to address any impact on its input costs from large resource sector projects in the North. However, the Commission notes that there is no inflation factor associated with the Residential Services basket and the Other Capped Services basket.
153. The Commission considers that Northwestel should be allowed to propose a price cap adjustment to the Residential Services and Other Capped Services baskets, if required, to address any impact on its input costs from large resource sector projects in the North. However, the Commission considers that, similar to the treatment of exogenous adjustments, this adjustment should not be applied to the Services with Frozen Rate Treatment or Competitor Services basket.
154. The Commission considers that, in these circumstances, rate element constraints should apply to the Residential Services basket and the Other Capped Services basket. Accordingly, rate increases to the services in the Residential Services basket will be capped at 5 percent per year per rate element and rate increases to the services in the Other Capped Services basket will be capped at 10 percent per year per rate element.

*Comments on the assignment of services to the baskets*

155. Parties to this proceeding may file comments with the Commission on the service assignment set out in Appendix 1 to this Decision by 16 February 2007 and may submit reply comments by 5 March 2007. A party filing comments or reply comments must also serve a copy of its submission on all other parties to this proceeding. Documents must be received, not merely sent, by the dates indicated.

*Treatment of new services*

156. When Northwestel files a tariff application for a new service or service elements, the company will be required to submit a proposed price cap classification with the application.

### **Self-correcting mechanism and duration of the price cap regime**

157. Northwestel proposed that the initial period for its proposed price regulation regime should be four years, consistent with the approach taken with other carriers. Northwestel submitted that choosing a shorter period would undermine gains in administrative efficiency versus the company's current regulatory framework and the viability of productivity initiatives with longer payback periods.
158. Northwestel also proposed that, given the unique circumstances of the North, the company should have the ability to trigger a review during the period, upon application to the Commission. The company submitted that such an application would be warranted where (i) costing data in support of cost-based subsidies was demonstrated to be materially inaccurate, (ii) there was a material change in circumstances that undermined the ability of the company to advance the objectives of the proposed regulatory framework, and/or (iii) in the judgment of the company, the regulatory framework proved flawed to the point where the company was denied a reasonable opportunity to earn a fair return on its investment.
159. TCC and the YG agreed that the initial period of the price regulation regime should be set at four years. The YG submitted, however, that should streamlining and regulatory efficiency require a reduced level of reporting and monitoring, it would recommend a shorter term, such as two years.
160. The GNWT and the YG submitted that interested parties should also be permitted to apply to the Commission for a review of the price regulation regime prior to the end of the price cap period. The GNWT further submitted that such requests should only be granted where there were compelling reasons to do so.
161. The Consumer Groups submitted that an earnings sharing mechanism should be applied to more symmetrically balance the risks and rewards of the proposed framework. The Consumer Groups submitted that earnings above 50 basis points over the allowable ROE range should be shared equally between consumers and Northwestel's shareholders.
162. Northwestel replied that the sole purpose for determining the going-in ROE should be to determine the reasonableness of the proposed going-in rates. Northwestel further submitted that any form of earnings regulation would negate the regulatory streamlining benefits inherent in price regulation since most of the rate of return reporting requirements would have to be maintained.

### ***Commission's analysis and determinations***

163. The Commission considers that a four year-period for Northwestel's initial price cap regime is appropriate as it will allow the benefits of the price cap to be realized, and would reduce the cumulative effects of any possible error in setting the price cap parameters.
164. With respect to Northwestel's and the other parties' requests that they be able to apply for a review of the price cap regime under specific circumstances, the Commission considers that synonymous with price regulation is the notion of greater risk and rewards that are attached to business decisions made by the company. The Commission also notes that in previous

price cap regimes, the Commission determined that the optimal choice of timing for a review of the regime would be toward the end of the period rather than during the period. This gives the best opportunity of examining how well the plan was working and to modify the regulatory framework as necessary. Similarly, in the case of Northwestel, the Commission will conduct a review of Northwestel's price cap regime in the final year of the plan.

165. With respect to the implementation of earnings sharing as a self-correcting mechanism, the Commission considers such a mechanism could reduce the company's incentive to optimize efficiency and pursue productivity improvements. In addition, the Commission considers that such a mechanism would not lend itself to reducing the regulatory burden, which is inherent in price cap regulation. Accordingly, the Commission finds that an earnings sharing mechanism is not appropriate for Northwestel's price cap regime.

### **Implementation**

166. The Commission finds reasonable Northwestel's proposal to file by 31 March of each year annual updates to its price cap indices.
167. The Commission notes that for service groups subject to upward pricing constraints, compliance with the applicable overall upward pricing constraint would be demonstrated by comparing a price index of actual price changes with a price index of allowable price changes. The allowable average price changes would be indicated by a service band limit (SBL) while the actual average price changes would be indicated by a service band index (SBI). The SBL and SBI are set at 100 at the start of the new regime for each service category. The SBL is updated each year, based on the applicable basket constraint and/or the average annual rate of change in the inflation factor in the previous calendar year. The base period for determining the revenue weights for the SBI updates in any 12-month period will be the last full calendar year prior to these updates.
168. In light of the above, the Commission finds that the SBLs and SBIs for Northwestel's capped services baskets will be set at 100 effective 31 March 2007. Northwestel is directed to file the SBL and SBI, with supporting calculations, formulae and spreadsheets, for each basket of services, as applicable, on 31 March 2007. Further, on an annual basis on 31 March for the remainder of the price cap period, Northwestel is to file updates to the SBLs and SBIs, with supporting calculations, formulae and spreadsheets, for each basket, as applicable.

### **Funding from the NCF**

169. Northwestel requested \$43.2 million in funding from the NCF for cost-based subsidies as follows:
  - \$17.2 million for residential PES subsidy;
  - \$10.8 million for toll connecting trunks;
  - \$11.4 million for the non-access portion of its recently completed SIP; and

- \$3.8 million associated with the proposed change to its depreciation reserve deficiency (DRD) recovery methodology.

Each of these components will be addressed separately in the following sections.

#### **Calculation of the subsidy for residential PES**

170. In Decision 2000-745, the Commission changed the methodology for calculating the subsidies for the large ILECs in HCSAs to a subsidy per residential network access service (NAS) basis. The basic components of this calculation are (a) the cost of providing the service plus a 15 percent mark-up to cover fixed and common costs less (b) the residential local rate charged to customers plus a fixed implicit contribution target amount of \$5.00 per NAS per month.
171. Issues related to Northwestel's proposed residential subsidy calculation are discussed in the following sections.

#### ***The band structure for residential PES***

172. In *Restructured bands, revised loop rates and related issues*, Decision CRTC 2001-238, 27 April 2001, as amended by Decision CRTC 2001-238-1, 28 May 2001, and Decision CRTC 2001-238-2, 7 August 2001 (Decision 2001-238), the Commission established a uniform approach to identifying high-cost bands in the territories of the large ILECs.
173. The high-cost bands established for the large ILECs were defined as follows:
- Band E: wire centres or exchanges with less than or equal to 1,500 total NAS;
  - Band F: wire centres or exchanges with greater than 1,500 and less than 8,000 total NAS, and where the average loop length was greater than four kilometres; and
  - Band G: remote wire centres or exchanges (e.g. without year-round road access or found in remote parts of a company's serving territory).
174. Northwestel submitted that one of the fundamental principles of price cap regulation was to reduce the regulatory burden. Accordingly, although Northwestel was able to identify and assign wire centres consistent with the Band structure set out in Decision 2001-238, except for the loop length criteria, the company's proposed banding structure included all of its wire centres in one Band (Band H) given that it did not currently have detailed costing information at the disaggregated Band levels. Northwestel's proposed monthly residential PES cost for this Band was \$57.42, which included the access portion of its recently completed SIP.
175. In response to a Commission interrogatory, the company provided residential PES and loop costs for its wire centres in Yellowknife and Whitehorse in one band (Band D), with the remaining wire centres aggregated into another band (hereafter referred to as Band H1). Under this two-band proposal, the company estimated the monthly residential PES costs to be \$40.03 for Band D and \$68.94 for Band H1, with no change to the company's proposed total subsidy requirement when compared to the one-band proposal.

176. TCC submitted that it would be possible for Northwestel to assign exchanges to bands based on the current banding definitions used by the southern ILECs.

*Commission's analysis and determinations*

177. The Commission notes that based on information provided by the company, the estimated residential PES cost per NAS for Band H1 is about 75 percent higher than that in Band D. This cost difference suggests that a two-Band structure would be more reflective of the costs of providing residential PES to subscribers in these areas than Northwestel's one-Band proposal. Accordingly, the Commission considers that the level of residential PES cost difference between Bands H1 and D, as estimated by the company, supports the splitting of residential PES into two bands.
178. The Commission further considers that if Northwestel had the appropriate detailed information, the wire centres included in Band H1 could be further split into Bands E, F, and G, consistent with the determinations of Decision 2001-238. The Commission also notes that Bands E, F, and G for the ILECs were classified as HCSA bands in Decision 2001-238.
179. The Commission considers that while the aggregation of all HCSA wire centres into Band H1 would represent a modification to the HCSA banding structure approved for other ILECs, this would reduce the regulatory burden for the company. Accordingly, the Commission considers that Northwestel's Band H1, as described, is appropriately classified as an HCSA band.
180. The Commission also notes that under a two-band structure, Northwestel's wire centres in Yellowknife and Whitehorse would be grouped into one band and would consist of wire centres having total NAS greater than 8,000, similar to the non-HCSA Bands C or D of the southern ILECs as set out in Decision 2001-238.
181. In light of the above, the Commission finds that a two-Band structure should be applied for Northwestel. Accordingly, the Commission approves two bands for Northwestel: (1) Band D, consisting of all wire centres in Whitehorse and Yellowknife, and (2) Band H1, consisting of all other wire centres.

*The costing methodology for residential PES*

182. Northwestel's proposed costs reflected company-specific data using a prospective incremental costing methodology and reflected the following modifications to the costing criteria set out in Decision 2001-238:
- expenses were determined on a company-wide basis except for expenses for pole rentals, which were available based on a geographic location from billing records;
  - proposed capital costs for outside plant and central office equipment (COE) were differentiated by geographic location and exchange size for the Yukon, the Northwest Territories, Nunavut, and British Columbia using location sampling for outside plant facilities and NAS weighting by type of switching equipment for COE; these costs were then aggregated on a total company basis;

- the SIP NAS average capital expenditure information was included;
- average working fill factors (AWFFs)<sup>6</sup> of 41 percent for loop distribution plant, 70 percent for feeder plant, 75 percent for large switching wire centres, and 65 percent for small switching wire centres were used; and
- company-average costs were used to estimate functional operating expenses and maintenance.

183. Northwestel submitted that its residential PES cost study included costs associated with its customer care and billing system referred to as the Service Management System (SMS) under the cost category "cost causal to service". Due to difficulties in estimating the prospective incremental SMS costs, Northwestel primarily relied on the cost of its original investment in 1999. The company indicated that the replacement capital costs for the SMS included costs associated with the "customer" and "billing" components.<sup>7</sup>

184. The company proposed, as noted above, an AWFF of 41 percent for distribution in its residential PES cost study. Northwestel submitted that its distribution AWFF was a result of standard provisioning practices of 2.5 distribution pairs per lot, and that this principle allowed for an average of two loops per lot and an additional amount for spares and bad order pairs. Northwestel also indicated that not all distribution pairs are available at every terminal so that its practice allowed for certain locations to have more than two pairs as long as others nearby had less. Further, the company submitted that unused capacity was an operational necessity.

185. The only interested party that made specific comments on Northwestel's costing methodology for residential PES was the UCG which submitted that the SIP costs should be excluded from the company's cost per NAS.

*Commission's analysis and determinations*

186. As noted above, the company estimated the monthly residential PES costs to be \$40.03 and \$68.94 for Bands D and H1, respectively.

187. With regards to the UCG's submission that SIP costs should be excluded from the residential PES costs for the subsidy calculation, the Commission considers that all incremental costs, including SIP costs, related to the provision of PES should be included in Northwestel's residential PES costs as these costs are causal to the provision of PES.

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<sup>6</sup> The average working fill factors (AWFF) provides the average level of utilization of a facility relative to the maximum capacity of that facility.

<sup>7</sup> "Customer" includes, among other things, customer care, fulfillment and ordering. "Billing" includes, among other things, mediation, Primary Interexchange Carrier/Customer Account Record Exchange (PIC/CARE), settlements, and traffic reporting.

188. The Commission notes that Northwestel's proposed loop and residential PES expenses causal to demand included several cost components such as maintenance and service provisioning, and that these cost components were generally higher than those proposed by the southern ILECs in the proceeding leading to Decision 2001-238. However, the Commission considers this difference to be reasonable given the unique challenges that Northwestel faces and the fact that its costs were not available at disaggregated Band levels.
189. With respect to Northwestel's AWWFs, the Commission considers that Northwestel's provisioning flexibility may be limited as it serves a large number of very small communities. The Commission considers that Northwestel's AWWF for distribution is reasonable as it was based on provisioning practices adopted to suit its specific needs. The Commission also considers that Northwestel's company-average AWWFs for loop feeder plant and large and small switching wire centres are reasonable.
190. The Commission notes that the billing functionalities supported by the SMS include Primary Interexchange Carrier/Customer Account Record Exchange (PIC/CARE), settlements, ordering, and toll processing, and are in part recovered through charges for PIC, service charges, and toll rates. The Commission also notes that, under the approved two-Band scenario, Northwestel's SMS costs were estimated at \$11.74 and \$11.69 per NAS per month for Bands D and H1, respectively.
191. The Commission notes that Northwestel's residential PES cost study includes the initial costs associated with the SMS and the costs of the annual updates incurred prior to the beginning of the study period, as well as annual SMS updates during the five-year study period. The Commission considers that the SMS costs incurred by Northwestel prior to the beginning of the study period are sunk costs and do not represent prospective incremental costs that should be included in Northwestel's residential PES cost study. Accordingly, the Commission disallows, for the purpose of estimating the residential PES costs used for the calculation of the funding requirement, the SMS costs associated with past investments that were included in the cost study.
192. The Commission considers that Northwestel's subsequent SMS modification costs estimated during the study period represent prospective incremental billing costs. Accordingly, the Commission has estimated prospective incremental SMS costs for residential PES based on the percentage of residential NAS relative to total NAS and the average SMS modification costs in the study period indicated in Northwestel's submission. Based on its findings, the Commission estimates that the SMS cost is \$1.97 per NAS per month for both Bands D and H1.
193. Based on the above, the Commission approves \$30.25 for Band D and \$59.21 for Band H1 as Northwestel's residential PES cost per NAS per month.

*Mark-up for fixed and common costs*

194. In Decision 2000-745, the Commission considered that a minimum level of mark-up should be used in setting the subsidy requirement within each HCSA and determined that a mark-up of 15 percent would provide a sufficient level of contribution to recognize the ILECs' fixed and common costs.

195. Northwestel proposed that its mark-up for fixed and common costs should be 25 percent given (a) the characteristics of its operating territory (e.g. low population per square kilometre), (b) its higher proportion of fixed and common costs as compared to other telephone companies, (c) limited opportunities for incremental efficiency gains, (d) a lower mark-up could not be offset from higher mark-ups elsewhere, and (e) at any lower rate, the company would not have a reasonable opportunity to earn a fair rate of return. Northwestel indicated that while it was not feasible to provide a detailed quantitative analysis on a total company basis to support a 25 percent mark-up, it was able to provide examples of its fixed and common costs.
196. TCC opposed the use of a 25 percent mark-up because Northwestel had not filed a cost study to support it. The UCG submitted that adding a 25 percent mark-up would appear to be double-dipping that could not be rationalized. The Consumer Groups submitted that the information provided by Northwestel regarding fixed and common costs raised the possibility that some costs would be recovered twice, once directly through the associated Phase II costs and again through the mark-up.

*Commission's analysis and determinations*

197. The Commission notes that the company provided a list of the assets used to develop its power, building, and land cost factors, and that these factors were used in Northwestel's Phase II cost studies to estimate the costs for batteries, generating plant, inverters and converter power, buildings, and land. The Commission also notes that the company's submission indicated that some of these assets were included as Phase III fixed and common costs. Further, conduit costs, which were also identified as Phase III fixed and common costs, were included in the company's Phase II PES costs through the use of a unit cost for conduit.
198. Finally, the Commission notes that Northwestel provided examples of fixed and common costs based on Phase III methodology, such as depreciation expenses associated with its fixed structures, common operating expenses, and financial expenses attributed to fixed structure and fixed common investment. The Commission considers that the inclusion of all these expenses in the development of the mark-up is inappropriate given that a portion of these fixed structure costs, common operating expenses, and financial expenses are also included in the company's Phase II cost studies.
199. In light of the above, the Commission is not persuaded that Northwestel requires a 25 percent mark-up to recover its fixed and common costs. Accordingly, the Commission determines that a 15 percent mark-up will provide an adequate level of contribution to recover Northwestel's fixed and common costs for the purpose of setting the subsidy requirement for Northwestel's HCSAs.

*Implicit contribution from other local services*

200. In Decision 2000-745 and subsequent decisions, the Commission determined that a fixed implicit contribution target amount of \$5.00 per NAS per month would be used in the subsidy calculation. This implicit contribution target recognizes revenues from other local services. In that Decision, the Commission considered that ILECs received intangible benefits as universal service providers.

201. Northwestel indicated that its net contribution from optional local services, after removing the associated costs, was only \$1.62 per NAS per month and submitted that this amount should be used as its implicit contribution amount. In support of its proposed implicit contribution amount, Northwestel submitted that (a) its cost of providing optional local services was far greater than that of the large ILECs due to the smaller base of customers over which it had to recover the costs, (b) it did not provide optional local services in all communities, and (c) based upon the marketing effort and focus already applied, there was no material opportunity to increase margins and/or penetration. Northwestel also provided, in confidence, the corresponding net contribution from optional local services under a two-Band scenario.
202. TCC noted that, in Decision 2000-745, the Commission ruled out different implicit subsidies among ILECs, and determined that the implicit subsidy was supposed to be a target to attain and was not a reflection of actual revenues. TCC submitted, however, that the full \$5.00 should only be imputed where all services are available, there should be no imputation where none are available, and an amount less than \$5.00 should be used where the full suite of optional services was not available.

*Commission's analysis and determinations*

203. The Commission notes that the company generates \$5.20 per NAS per month in revenue from optional local services across all of the residential NAS in its operating territory. The Commission also notes that the implicit contribution target, established in Decision 2000-745 and subsequent decisions, recognizes revenues from other local services, including optional local services. The Commission considers that as the universal service provider in its operating territory, Northwestel receives similar intangible benefits as the southern ILECs. Accordingly, the Commission finds that the implicit contribution target amount to be used in Northwestel's subsidy calculation will include revenues from other local services.
204. As outlined above, the Commission has approved a two-Band structure for Northwestel, Bands D and H1. The Commission notes that the net contribution from optional local services in Band D is greater than the company's proposed implicit contribution of \$1.62 per NAS per month. Given that Whitehorse and Yellowknife have access to all other local services, the Commission finds that a \$5.00 per NAS per month deemed implicit contribution amount would be appropriate for Band D.
205. With respect to Band H1, access to all optional local services was not extended to smaller communities as part of the SIP because of the relatively high cost. Therefore, the Commission considers that a deemed implicit contribution amount of less than \$5.00 per NAS per month should be used for this band. Based on Northwestel's residential optional local service revenues and the estimated availability of these services in its territory, the Commission finds that the appropriate deemed implicit contribution amount for Band H1 is \$4 per NAS per month.
206. Therefore, the Commission approves a deemed per-NAS per-month implicit revenue amount for Northwestel of \$5.00 for Band D and \$4 for Band H1.

### *Subsidy amount*

207. In Decision 2000-745, the Commission introduced a per residential NAS subsidy calculation, which resulted in most LECs being required to file monthly residential NAS information with the Central Fund Administrator (CFA). When the Commission approved the procedures for the operation of the NCF,<sup>8</sup> LECs that file monthly NAS information with the CFA were also required to file an annual NAS audit report with the CFA auditor attesting to the accuracy of the monthly residential NAS information filed with the CFA.
208. In Decisions 2002-34 and 2002-43, the Commission determined that the large ILECs would be required to adjust the cost components of their subsidy calculations each year upward for inflation and downward for a productivity offset of 3.5 percent. The Commission also determined that the large ILECs would be permitted to recover the costs associated with the revenue-percent charge on the residential local exchange service rates used in their subsidy calculations from the NCF.
209. In *Revised regulatory framework for the small incumbent local exchange carriers*, Telecom Decision CRTC 2006-14, 29 March 2006, the Commission established fixed subsidy amounts (i.e. no annual inflation or productivity adjustments) for the SILECs, thereby eliminating the need to file monthly NAS information with the CFA and incur the cost of the related NAS audit. The Commission also determined that the SILECs, who were also required contributors, would be permitted to recover the costs associated with the revenue-percent charge on the residential local exchange service rates used in their subsidy calculations from the NCF.
210. Northwestel submitted that (a) it supported the Decision 2000-745 annual subsidy filing process, and (b) its monthly subsidy could either be determined based upon monthly NAS information filed with the CFA, the annual subsidy filing with the Commission, or its going-in NAS levels. For the annual adjustments to its subsidy calculation, Northwestel proposed that the appropriate inflation measure was the GDP-PI and that its productivity offset be set at zero.
211. TCC submitted that Northwestel's subsidy amount should be included in the Residential Services basket and that this basket should be capped at the going-in level until a proper productivity study could be done.

### *Commission's analysis and determinations*

212. Consistent with previous decisions, the Commission determines that Northwestel should be permitted to recover the costs associated with the revenue-percent charge on the residential local exchange service rates used in its subsidy calculations from the NCF.
213. As determined earlier in this Decision, there will be no explicit productivity offset factor established for Northwestel, and the company's residential local exchange service rates will be frozen for the duration of the price cap period. Accordingly, the Commission finds that

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<sup>8</sup> The most recent procedures were approved by the Commission in *Revised procedures for the operation of the National Contribution Fund*, Telecom Decision CRTC 2005-59, 7 October 2005.

no inflation and/or productivity factors will be applied to the cost component of Northwestel's subsidy calculations, and that the residential PES cost component of Northwestel's subsidy calculation will be frozen.

214. As set out earlier in this Decision, the Commission determined that facilities-based local competition will not be permitted in Northwestel's territory at this time. Accordingly, the Commission will not require Northwestel to file monthly NAS information with the CFA and the related annual NAS audit with the CFA auditor and/or annual NAS information with the Commission.
215. The Commission notes that based on a Band D residential PES cost of \$30.25, a 15 percent mark-up, the cost recovery of the revenue-percent charge, the approved residential monthly rate of \$31.33 (which is discussed later in this Decision), and a deemed implicit contribution amount of \$5.00 per NAS per month from other local residential services, residential PESs in Northwestel's Band D are not eligible to receive funding from the NCF. The Commission concludes that, consistent with the southern ILECs' classification for bands containing wire centres that are greater than 8,000 total NAS, Northwestel's Band D is not a HCSA band.
216. Based upon a Band H1 residential PES cost of \$59.21, a 15 percent mark-up for fixed and common costs, the cost recovery of the revenue-percent charge, the approved residential monthly rate of \$31.33, and a deemed implicit contribution amount of \$4 per NAS per month from other local residential services, the Commission calculates that Northwestel would be entitled to \$8.8 million per year in subsidy for the years 2007 through 2010.
217. Therefore, the Commission approves on a final basis a Northwestel annual residential PES subsidy of \$8.8 million per year for each of the years 2007 to 2010.

**Proposed toll connect trunk cost recovery**

218. Northwestel proposed to replace its CAT<sup>9</sup> rate of \$0.07 per minute per end with a switch connect rate of \$0.00825 per minute per end in order to recover its switching costs, including a mark-up of 25 percent, and its equal access costs. Under its proposal, Northwestel's toll connect trunk costs (i.e. between its Class 4 and Class 5 switches) would not be recovered through this switch connect rate but would instead be recovered through an annual subsidy of \$10.8 million from the NCF. Northwestel indicated that its toll connect trunk costs included the costs of providing and maintaining the associated facilities, such as satellite earth stations, radio systems, fibre facilities, and operating expenses, using prospective incremental costs.
219. Northwestel submitted that, in Decision 99-16, the Commission noted that the company might not be able to propose a cost-based switching and aggregation rate that would be sustainable and thus might not be able to recover the associated costs in a competitive long distance environment. Northwestel submitted that there had not been any material change in the unique circumstances regarding the provision of toll connect trunks in its territory. Northwestel further submitted that these facilities continued to be integral to meeting the BSO in the North.

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<sup>9</sup> Northwestel's current CAT rate recovers several cost components including switching costs, equal access costs, toll connect trunk costs and a contribution component.

220. In response to a Commission interrogatory, Northwestel indicated that if its switch connect rate was revised to include the recovery of toll connect trunk costs, its proposed rate would increase to \$0.0415 per minute per end. Northwestel submitted that both its current CAT rate of \$0.07 and a switch connect rate of \$0.0415 were based on the averaging of costs across all minutes, forcing recovery of toll connect costs on minutes that would not necessarily traverse its toll connect trunk facilities.
221. Northwestel submitted that trying to recover toll connect costs through an average per-minute based rate would impose toll connect costs on large centres, namely Whitehorse, Yellowknife, and Fort Nelson, where toll connect costs were typically not incurred. Northwestel submitted that it faced competition from large national carriers offering a rate of \$0.03 per minute per end in its three largest centres, which accounted for half of the company's toll traffic, and that it was difficult for it to compete in these large centres.
222. The GNWT and the YG supported Northwestel's proposed switch connect rate of \$0.00825 and its proposed recovery of toll connect costs from the NCF, instead of via an implicit subsidy in the current CAT rate. Yellowknife et al. agreed with the proposed CAT rate, and submitted that it had to be eventually eliminated so that pure equal access competition might be considered by potential market entrants.
223. The UCG submitted that in order to inspire competition in long distance and discourage bypass revenues to forces such as the Internet, lowering the CAT rate in increments appeared to be the most logical solution.
224. The Consumer Groups and TCC did not agree with Northwestel's proposal to recover the toll connect costs from the NCF and suggested instead that the switch connect rate should include toll connect costs. TCC argued that Northwestel's proposal to recover its toll connect costs from the NCF could not be justified on the basis of non-facilities-based competition. TCC supported the use of a switch connect rate that included the toll connect trunk of \$0.0415 per minute per end.

*Commission's analysis and determinations*

225. The Commission notes that toll interconnection rates for the ILECs and SILECs are designed to recover all incremental costs of toll interconnection plus an appropriate mark-up, and that there is no subsidy provided by the NCF with respect to these interconnection services.
226. The Commission notes that Northwestel's proposed method of recovering its toll switching costs (based on Phase II costs and a mark-up) and equal access costs through a switch connect rate of \$0.00825 per minute per end is consistent with the approach used by other ILECs. However, the Commission is concerned with Northwestel's proposed method of recovering its toll connect trunk costs from the NCF.
227. The Commission notes that Northwestel's proposal to recover its toll connect trunk charges from the NCF would be different from the method used for southern ILECs and SILECs, which recovers these costs directly from toll service providers. The Commission considers that Northwestel's proposal would likely lead to artificially low toll interconnection rates that could not be sustained without ongoing subsidies from the NCF. That would in turn lead to

a reduction in toll rates in Northwestel's territory that would be partly funded by the NCF. Accordingly, the Commission considers that Northwestel's proposed switch connect rate of \$0.00825 per minute per end is not appropriate.

228. The Commission notes that a switch connect rate of \$0.0415 per minute per end would be cost-based and would include a 25 percent mark-up, consistent with the mark-up for the SILECs' competitor services. Additionally, the Commission notes that the uniform switch connect rate of \$0.0415 per minute per end would be a significant reduction from the current CAT rate of \$0.07 per minute per end. This approach will in the Commission's view remove the implicit subsidies from the current CAT rate and will eliminate the requirement for any funding from the NCF.
229. The Commission notes that the switch connect rate of \$0.0415 could result in toll rates not declining as much as they would otherwise since toll traffic originating and terminating in locations such as Whitehorse and Yellowknife typically do not use toll connect trunks. However, the Commission considers this approach will result in reasonable toll rates across Northwestel's entire territory.
230. Accordingly, the Commission denies Northwestel's request to recover its toll connect trunk costs from the NCF. Further, the Commission approves effective 1 January 2007 a switch connect rate of \$0.0415 per minute per end applicable to all toll minutes in Northwestel's territory. The Commission directs Northwestel to provide all customers affected by the rate reductions with rebates retroactive to 1 January 2007. The Commission has adjusted the going-in revenue requirement to reflect this determination.

#### **Funding for the recently completed SIP**

231. Northwestel indicated that the total SIP capital expenditures of \$85.4 million included expenditures of \$58.7 million for the non-access portion of the SIP (Internet, transport, switching, and toll).<sup>10</sup> Northwestel indicated that it had completed the SIP roll-out in 2005.
232. Northwestel proposed a supplemental funding amount associated with the non-access portion of the SIP of \$11.4 million on an ongoing basis, which was supported by a Phase II cost study and included a 25 percent mark-up. Northwestel submitted that funding for the current SIP was the essence of the regulatory bargain with the Commission.
233. The Consumer Groups submitted that Northwestel's proposal represented a significant departure from the purpose of the NCF, and that NCF funding should only be available to support the provision of residential service in HCSAs. The GNWT and the YG submitted that the current SIP required supplemental funding from the NCF.

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<sup>10</sup> Expenditures of \$26.7 million for the access portion of the SIP were included in the calculation of the residential PES costs discussed earlier in this Decision.

### *Commission's analysis and determinations*

234. The Commission finds that the total SIP expenditures of \$85.4 million are reasonable. With respect to Northwestel's request for explicit funding from the NCF for the non-access portion of the SIP, the Commission has previously approved this program, and finds that continued funding from the NCF is appropriate.
235. In response to a Commission interrogatory, Northwestel provided a revised Phase II cost study using a study period equal to the weighted-average plant lives of the associated equipment, which resulted in a reduced funding requirement of \$8.8 million (excluding mark-up). Northwestel agreed that this revision would be appropriate.
236. Consistent with its determination earlier in this Decision for the mark-up for fixed and common costs, the Commission finds that a 15 percent mark-up would be appropriate for the current SIP.
237. In light of the foregoing, the Commission approves an annual SIP funding requirement of \$10.1 million from the NCF.

### **Impact of the proposed change to the DRD methodology**

238. Northwestel proposed that the impact of any change in DRD<sup>11</sup> methodology should be recovered from the NCF. Northwestel submitted that, given the relative magnitude of the incremental revenue requirement associated with the change in DRD methodology, it was not reasonable to recover the adjustment through going-in rates. Northwestel also submitted that recovery from the NCF was consistent with precedents set out in *Regulatory framework for the small incumbent telephone companies*, Decision CRTC 2001-756, 14 December 2001 (Decision 2001-756) and Decision 2002-43, where the Commission approved NCF subsidies to assist the respective companies in transitioning to new regimes.
239. The Consumer Groups, noting Northwestel's proposal to expand the funding from the NCF to cover items such as DRDs, submitted that NCF funding should only be available to support the provision of residential service in HCSAs.

### *Commission's analysis and determinations*

240. The Commission notes that, in Decisions 2001-756 and 2002-43, the SILECs and Société en commandite Télébec respectively, were provided transitional subsidies to allow them time to adjust to the lower subsidy amounts that they were receiving as a result of implementing the cost-based subsidy regime set out in Decision 2000-745. The Commission considers that these circumstances were different than the present case, given that Northwestel is proposing to recover the impact of the change in DRD methodology from the NCF as opposed to transitioning to a lower subsidy.

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<sup>11</sup> A DRD arises if the currently estimated useful life of a class of assets is less than that used to determine past depreciation expenses. As a result, the accumulated depreciation is lower than it would have been if the depreciation expense had been determined on the basis of the currently estimated useful life.

241. The Commission notes that no ILEC is receiving subsidy from the NCF to recover the impact related to the change in DRD methodology.
242. In light of the above, the Commission considers that it would not be appropriate for Northwestel to recover the impact of the change in DRD methodology from the NCF. Rather, the Commission finds that any amount related to the change in DRD methodology should be recovered as part of Northwestel's going-in revenue requirement.

#### **Total funding from the NCF**

243. Based on the Commission's determinations in this Decision, Northwestel will receive \$18.9 million in annual funding from the NCF for each of the years 2007 to 2010.
244. The Commission directs the CFA to remit a monthly subsidy amount equivalent to 1/12th of \$18.9 million, on a final basis, effective 1 January 2007, and on an interim basis, effective 1 January 2011.

#### **Financial issues**

##### **Going-in revenue requirement methodology**

245. Northwestel submitted that the Commission had generally tested the reasonableness of going-in rates, for carriers transitioning to price caps, by reviewing a company's going-in revenue requirement. Northwestel also submitted that the revenue requirement had been described as the amount of revenues that a regulated company needed in a given year to recover its operating expenses and capital and financing costs, including a reasonable return on shareholders' equity.
246. Under Northwestel's proposal, the going-in revenue requirement, which was based on a 2007 financial forecast, would also include the revenue reduction resulting from market share loss and rate restructuring, increases in depreciation expense, and forecast increases in its operating expenses using the total implied productivity (TIP) methodology. Northwestel argued that given the magnitude of the changes associated with the implementation of the proposed regulatory framework, it would be impractical to recast a 2006 forecast with the same degree of internal validity as the proposed 2007 forecast. Northwestel indicated that significant rate restructuring would be required to reduce its dependence on embedded cross-subsidies and to implement cost-based subsidies.
247. TCC submitted that, in order to transition Northwestel to a price cap regime, the Commission must determine (a) Northwestel's going-in revenue requirement, (b) the amount of revenues that must be generated from rates and the amount to be received from the NCF, and (c) how Northwestel's rates for regulated services might change over time.
248. TCC submitted that some sort of review must be done to set the overall reasonableness of Northwestel's revenue requirement proposal; failing that, the Commission runs the risk of developing a regime that may set the revenue requirement at a level that either over-compensates Northwestel, to the detriment of customers, or under-compensates it, treating shareholders unfairly. TCC submitted that the revenue requirement step demanded that the Commission

conduct a comprehensive financial review of the regulated company's forecasts for its operations, noting that there was concern that Northwestel's most-recent revenue requirement determination occurred almost six years ago.

249. The UCG submitted, among other things, that Northwestel did not present sufficient evidence to adequately demonstrate its case for revenue requirement.

*Commission's analysis and determinations*

250. The Commission notes that a revenue requirement proceeding is a process to determine that the rates charged by a regulated company are just and reasonable. The Commission also notes Northwestel's argument that it would be impractical to recast the 2006 forecast with the same degree of internal validity as the 2007 forecast. The Commission considers that the issue is not one of choosing the appropriate forecast but the appropriate methodology to determine going-in rates for the initiation of the price cap framework.
251. The Commission notes that Northwestel's proposed methodology to calculate its going-in revenue requirement is different from the method used for other ILECs in *Implementation of price cap regulation and related issues*, Telecom Decision CRTC 98-2, 5 March 1998, as amended by Telecom Decision CRTC 98-2-1, 20 March 1998 and in Decision 2002-43. In these Decisions, the starting point for the determination of the going-in revenue requirement for the first price cap year was the contribution requirement from the previous year. While adjustments for the revenues and expenses were made to the going-in revenue requirements of the ILECs, the Commission notes that no adjustments were made for the revenue impact of demand changes or expense forecasts for inflation or productivity changes for the first price cap year. Indeed, the companies were not required to provide the revenue/expense forecasts for the first price cap year. More specifically, revenue, expense, and earnings forecasts were not considered relevant under the price cap framework.
252. The Commission considers that Northwestel's proposed methodology to calculate the going-in revenue requirement would, in fact, be similar to a price cap framework with a rate of return regulation overlay, as the impact of the company's 2007 forecast to earn an ROE of 10.5 percent would be reflected in the going-in revenue requirement. The Commission considers that the revenue gains or losses resulting from the forecasted demand changes that may occur after the implementation of the price cap regime should be excluded from the going-in revenue requirement. Accordingly, the Commission finds that Northwestel's going-in revenue requirement approach is inappropriate.
253. Consistent with previous decisions, the Commission concludes that Northwestel's 2006 approved supplemental funding is the appropriate starting point for the determination of the company's going-in revenue requirement. With respect to adjustments to the going-in revenue requirement, the Commission finds that the financial impact of price changes implemented at the initiation of the price cap regime should be included; however, financial impacts that may occur after the implementation of the price cap regime should be excluded. The Commission's determinations on these matters are set out below.

*Impacts of demand forecasts*

254. The Commission notes that the company forecasted that its proposed rate restructuring would have resulted in significant losses in demand in 2007. The Commission considers that it would not be consistent with the going-in revenue requirement methodology to allow the company to recover the revenue losses resulting from the forecasted demand changes from its going-in rates. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by \$4.1 million.

*Other changes not related to rate changes*

255. The Commission notes that Northwestel forecasted other revenues, not related to rates, to decrease in 2007 by approximately \$1.6 million. The Commission further notes that the company forecasted that its other income and expenses would result in a net increase in expense of approximately \$144,000, resulting in a net increase to the going-in revenue requirement of \$1.8 million. The Commission considers that, consistent with the going-in revenue requirement methodology outlined above, these forecast changes should not be included in the going-in revenue requirement. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by \$1.8 million.

*Operating expenses*

256. Using the TIP methodology, Northwestel forecasted that its operating expenses for 2007 would increase by approximately \$1.1 million. Consistent with the going-in revenue requirement methodology outlined above, the Commission considers that this forecast change should not be included in the going-in revenue requirement. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by \$1.1 million.

*Payments to the NCF*

257. Northwestel originally estimated that it would be required to pay \$1.0 million into the NCF given the subsidy amount it requested to receive from the NCF. As a result of its determination in this Decision that the amount of subsidy received by the company from the NCF is to be reduced to \$18.9 million, the Commission determines that the company will be required to pay \$1.2 million into the NCF. Accordingly, the Commission has increased the company's proposed going-in revenue requirement by \$0.2 million.

*Pension expense*

258. The Commission notes that, in Decision 2006-10, the supplemental funding requirement for 2006 included \$3.1 million for pension expense. Northwestel proposed that its forecast pension expense for 2007 be reduced to \$2.2 million, which would reduce the going-in revenue requirement by approximately \$847,000. Consistent with the revenue requirement methodology outlined above, the Commission considers that this forecast change should not be included in the going-in revenue requirement. Accordingly, the Commission has increased the proposed going-in revenue requirement by \$847,000.

## **Capital plan**

259. Northwestel indicated that the company's 2006 view of its capital plan for the years 2006 and 2007 was \$75.1 million compared to \$89.4 million for the same years in the 2004 View. Northwestel indicated that its forecast had decreased by \$14.3 million pursuant to *Northwestel Inc. – Supplemental funding requirements for 2004 and 2005*, Telecom Decision CRTC 2005-54, 15 September 2005 (Decision 2005-54), in which the Commission directed Northwestel to review the forecasted capital expenditures for 2006 and 2007 with a view to reducing the total for each year, given that the SIP would have been completed.
260. Northwestel noted that growth in expenditures for local, toll, and data comprised 57.5 percent, while modernization, replacement, and support comprised 19.1, 8.1, and 15.3 percent of the total expenditures in the 2006 View, respectively.
261. Northwestel noted that in developing its baseline forecast of capital expenditures for the proposed price cap period, it had taken the following issues into consideration: expected demand for existing services; strategic projects to meet demand for new enhanced services; ongoing upgrades required to maintain the network; maintaining the company's Q of S; implementing projects aimed at efficiency improvements; and financial and shareholder constraints for prudent capital spending.

## ***Commission's analysis and determinations***

262. The Commission notes that Northwestel has complied with the Commission's directions in Decision 2005-54. Specifically, Northwestel reduced the total forecasted capital expenditures for each year. Based on the evidence, the Commission considers that the company has satisfactorily explained all significant variances between its 2004 and 2006 Views. Therefore, the Commission concludes that Northwestel's 2006 capital plan is reasonable.

## **Proposed new SIP**

263. Northwestel proposed a new SIP that would include replacement of microwave radio systems and obsolete switching systems. Northwestel submitted that while it generally met the BSO, these projects were being proposed to pre-empt network risk associated with continuing to meet the BSO.
264. Northwestel submitted that the proposed projects were uneconomic and, given their magnitude and the company's other challenges, the associated costs could not be absorbed by Northwestel in the foreseeable future. Requiring Northwestel to do so would not provide a reasonable opportunity to earn a fair return on investment.
265. Northwestel also submitted that it was concerned about the availability of a replacement for, and the costs associated with, replacing the Hughes Telephony Earth Station satellite network. The company submitted that a new SIP would be required in future to replace this network.
266. Northwestel proposed to spend \$23.4 million in capital expenditures in the period 2008 to 2010 for its proposed SIP. Northwestel submitted that an additional annual subsidy of \$0.6 million in 2008, \$2.0 million in 2009, \$3.6 million in 2010, and \$4.34 million in 2011

onwards would be required from the NCF. Northwestel submitted that funding of the carrying costs for the proposed projects through the NCF was consistent with the treatment of its existing SIP.

267. Yellowknife et al., the GNWT, and the YG generally supported the proposed new SIP and its associated funding from the NCF.
268. The Consumer Groups submitted that the expansion of funding to cover items such as non-access related SIP expenditures represented a significant departure from the purpose of the fund. TCC submitted that some of the uses of NCF funds did not qualify under the principles that up to now have covered the use of those funds, and that some of the proposed uses were not consistent with Commission policy. TCC noted that the original purpose of the SIP in Northwestel's serving territory was "to achieve the BSO over time, including upgrading the quality of long distance service." TCC submitted that Northwestel's proposal for a new SIP to replace obsolete and unsupported equipment was outside the scope envisioned by the Commission for Northwestel's SIP in Decision 99-16.

#### *Commission's analysis and determinations*

269. The Commission notes that Northwestel has acknowledged that it generally meets the BSO and that the proposed investments will not extend service to unserved or underserved customers. The Commission also notes that SIPs are generally used to assist a company to meet the BSO, not to replace obsolete or non-standard facilities. Accordingly, the Commission considers that Northwestel's proposed new SIP is a modernization/replacement plan, which should be part of the capital plan.
270. The Commission considers that the company currently receives adequate compensation for the ongoing maintenance and depreciation of the switches and transport systems in question, since these costs are included in its rates. The modernization/replacement plan covers routine replacement of these switches and transport systems, not new additions to the network to cover growth or the provision of new services. Therefore, the Commission considers that there would be no material change in the company's operating costs should the company decide to replace the plant in question. The Commission also considers that Northwestel has the flexibility to manage its modernization/replacement programs over time to include the expenditures in question and still have an opportunity to earn a reasonable ROE.
271. In light of the foregoing, the Commission denies Northwestel's request for supplemental funding from the NCF for its proposed plan.

#### **Depreciation**

##### *Proposed changes to depreciation life characteristics*

272. Northwestel proposed to change the depreciation life characteristics for five of its asset codes (accounts). Specifically, the five accounts were: Account 60 – Cable – Aerial/Underground; Account 650 – Batteries; Account 660 – Generating Units; Account 830 – Permanent Buildings; and Account 880 – Towers.

273. For Account 60 – Cable – Aerial/Underground, Northwestel submitted that, in support of its proposed reduction in the average service life (ASL) from 26 to 20 years, the Commission had approved an ASL of 22 years for this account throughout the period 1996 to 2001. The company submitted that the existence of significant investment in obsolete cable plant should be considered in assessing the appropriate ASL for this account. Northwestel indicated that an estimated \$15 million would be generated by the retirement of "in-place" obsolete copper cable pairs resulting in a reduction of seven years in the historical life indications. The company indicated that it did not, however, include the impact of the retirement of "in-place" obsolete copper cable pairs in its historical analysis. The company further submitted that the amount of copper plant expected to be deployed would steadily decrease and that existing copper plant would increasingly be taken out of service in favour of fibre plant and other facilities that would better enable high bandwidth services.
274. Northwestel indicated that it continued to use fibre and digital loop carriers in place of copper feeder plant and expected to replace, over time, copper feeder plant with fibre-fed digital loop carriers or other compression technology as part of a strategy to enable the network to support more broadband services.
275. For the remaining four accounts, Northwestel provided the following rationale to support the proposed changes to depreciation life characteristics:
- For Account 650 – Batteries, the company proposed to use an Iowa R-5 survivor curve, and to reduce the ASL from 14 to 12 years as the historical life analysis and survivor curve fitting resulted in lives in the range of 11 to 12 years for the 2002 to 2004 experience band. The company noted that actual retirements were \$610,000 in 2005.
  - For Account 660 – Generating Units, Northwestel proposed to use an Iowa R-3 survivor curve, and to reduce the ASL from 20 to 18 years. This reduction in the ASL was supported by historical life analysis and survivor curve fitting that resulted in lives in the range of 18 to 19 years for the 2001 to 2004 experience band. In support of its proposal, Northwestel noted that actual retirements were \$1.95 million in 2004 and \$931,000 in 2005.
  - For Account 830 – Permanent Buildings, Northwestel proposed to use an Iowa S-2 survivor curve, and to reduce the ASL from 40 to 35 years based on historical life analysis and survivor curve fitting that resulted in lives in the range of 35 to 37 years for the 2000 to 2004 experience band. The company noted that its strategy of disposing of surplus real estate was continuing as demonstrated by the retirements in 2000 in Whitehorse and Iqaluit. The company further noted that expected retirements included small switching buildings and others affected by asbestos.
  - For Account 880 – Towers, Northwestel proposed to use an Iowa R-3 survivor curve, and to reduce the ASL from 35 to 25 years. This reduction in the ASL of this account was based on historical life analysis

and survivor curve fitting that resulted in lives in the range of 23 to 24 years for the 2003 to 2004 experience band. The company noted that actual retirements were \$1.1 million in 2004 and \$899,000 in 2005.

276. TCC argued that the company had not made a compelling case for re-examining the approved ASL for Account 60. TCC submitted that one of the fundamental bases for the stranding of assets was facilities-based competition and that this was inapplicable in Northwestel's territory. In this regard, TCC noted that the competitive environment in Northwestel's territory was very different than in the South, and that the company itself had indicated during the proceeding that there had been virtually no facilities-based entry into the northern market after six years of long distance competition.

*Commission's analysis and determinations*

277. In its consideration of Northwestel's proposed changes in depreciation life characteristic, the Commission focused on two main factors in analyzing Northwestel's depreciation studies: historical retirement patterns and future expectations.
278. The Commission notes that it has consistently taken into account historical analysis along with future expectations in approving depreciation life characteristics. The Commission also notes that this can create a divergence between the ASL resulting from a purely historical analysis, and the ASL established after due consideration is given to future expectations. In the case of Account 60, the Commission has accepted a divergence of several years as reasonable, given the anticipated impact of new technologies and new services on the future of copper cable.
279. The Commission also notes that over the past several years, the divergence between historical and approved service lives ranged from 2 to 13 years for Northwestel's Account 60. Further, the Commission notes that the depreciation study submitted in this proceeding indicates an historical life of 25 to 27 years for this account for which an ASL of 26 years is currently approved.
280. With respect to TCC's position, the Commission considers that in addition to facilities-based local competition, technological change also poses a significant risk of stranded investment in cable plant. In the Commission's opinion, fibre-based digital transmission technology will continue to move further into the network as service demand and technology develop, shortening the service life of paired copper plant, particularly in the access plant.
281. In light of the above, the Commission is of the view that the ASL of 20 years and the Iowa R-3 survivor curve proposed by Northwestel are reasonable since retaining the currently approved ASL of 26 years would not recognize the impact of future expectations on the company's cable plant. Furthermore, the divergence of five to seven years that would result compares favourably with the divergences approved for Account 60 in the past for Northwestel. In light of the foregoing, the Commission finds the proposed ASL of 20 years is reasonable and approves Northwestel's proposal for Account 60.
282. With respect to the other four accounts discussed above, the Commission has considered the historical life analysis presented by the company and the increased retirements cited for each account. The Commission finds the company's proposals for these four accounts to be reasonable. Accordingly, the Commission approves the proposed depreciation life characteristics for these four accounts.

*Financial impact of changes in depreciation life characteristics*

283. As a result of the approved depreciation life characteristics for the five accounts noted above, the Commission estimates the additional depreciation expense to be included in the going-in revenue requirement to be \$1.4 million. This amount is based on the implementation of the straight-line method of recovery of the DRD, averaged over the four-year price cap period, discussed below. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by \$1.0 million.

***The appropriate method to recover the DRD***

284. In *Price cap regulation and related issues*, Telecom Decision CRTC 97-9, 1 May 1997 (Decision 97-9), the Commission determined that the DRD should be amortized, for regulatory purposes, using the core composite average remaining service life of each company's assets as of that date. Using this approach, the amortization of the DRD would be on a straight-line basis for regulatory purposes, thus ensuring that the amount included in the going-in rates would not change during the four-year price cap period.
285. Northwestel estimated that the DRD would be at \$36.8 million on 1 January 2007. Northwestel submitted that under the currently approved Phase I methodology, the DRD amortization for the year 2007 would amount to \$3.3 million. Northwestel estimated that the straight-line method approved for the large ILECs in Decision 97-9 would result in an amortization amount of \$7.1 million for each of the years 2007 and 2008, \$4.4 million for 2009, and \$4.1 million for 2010.
286. Northwestel indicated that the drop in the amount of the DRD recovery, calculated according to the Decision 97-9 method, during the last two years of the price cap period was due to the average remaining life for some of its accounts being less than four years.
287. During the oral hearing, Northwestel agreed that, by adopting the Decision 97-9 straight-line method of amortizing the DRD and by averaging the resulting DRD recovery amounts over the price cap period, the amount that would be included in the going-in rates would not change during the price cap period. In light of the foregoing, the Commission finds that it is appropriate for Northwestel to use the straight-line method of amortization of the DRD adopted for the large ILECs in Decision 97-9, and also to average the DRD amortization expense over the four-year price cap period.
288. As a result of adopting the straight-line method of recovering the DRD, and averaging the DRD amortization expense over the initial four-year price cap period, the Commission determines that the overall DRD recovery expense to be included in the going-in revenue requirement is \$2.8 million. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by \$0.9 million.

### *Other depreciation-related issues*

#### *SMS*

289. Northwestel estimated that its SMS computer software would be fully amortized by the end of 2006. Consistent with its proposal to use the 2007 forecast to set the going-in revenue requirement, Northwestel proposed to discontinue the amortization of the SMS software, thereby reducing the going-in revenue requirement by approximately \$2.4 million for 2007.
290. The Commission notes that the SMS software will be fully amortized after the implementation of the price cap regime for Northwestel. Consistent with the going-in revenue requirement methodology outlined above, the Commission considers that this forecast change should not be included in the going-in revenue requirement, and accordingly has increased the company's proposed going-in revenue requirement by \$2.4 million.

#### *Depreciation and amortization expense (other than the DRD)*

291. The Commission considers that the depreciation and amortization expense approved in Decision 2006-10 should not be changed except for changes approved in this Decision to establish the company's going-in revenue requirement. Consistent with the going-in revenue requirement methodology outlined above, the Commission determines that the proposed changes to depreciation expense resulting from changes to plant in service and changes to amortization expense proposed for 2007 should be disallowed. Accordingly, the Commission has reduced the company's proposed going-in revenue requirement by approximately \$879,000.

#### *Depreciation – Summary*

292. Based on its determinations in the Depreciation section of this Decision, the Commission has reduced the company's proposed going-in revenue requirement by \$0.4 million.

#### **Rate restructuring**

293. Northwestel proposed, effective 1 January 2007, monthly rate increases of (i) \$2.00 on Individual-Line Residential PES; and (ii) \$5.00 on Individual-Line and Multi-Line Business PES. Northwestel submitted that even with the proposed increase to residential PES, the rates would remain below cost.
294. Northwestel also proposed the introduction of new long distance calling plans for both residential and business customers. Further, Northwestel proposed to increase the monthly rate for Toll-Free Dedicated Access Line service to match the proposed new Individual-Line Business PES rate, and remove the monthly Non-dedicated Access rate of \$8.00 (toll-free subscription fee). Northwestel also proposed to decrease the Toll-Free Usage Rate per-minute from \$0.18 to \$0.08, and to decrease the Digital Private Line service rates, the Settlement Transport rate, the Teleconferencing Service rates, and the Wireless Service Provider – Network Access rates.

295. TCC submitted that the Commission should approve the proposed increase of \$2.00 to the residential PES service rate and the \$5.00 increase to the local business rates. TCC further submitted that Northwestel should be directed to conduct a study to evaluate the affordability of local residential rates.
296. TCC and the Consumer Groups argued that Northwestel should not be permitted to reduce rates for other services unless it demonstrated that the proposed rates were greater than the associated Phase II costs and imputation test.
297. TCC did not take issue with Northwestel's decision to re-price its toll plans in response to competitive pressures, but argued that Northwestel should not have access to subsidies to offset consequent revenue reductions.
298. The Consumer Groups, the GNWT, and the UCG submitted that residential and business rates should not be increased further and should remain at their current level. Yellowknife et al. submitted that they were not in support of any increase to the business monthly line charge. Yellowknife et al. also submitted that they were concerned with the proposed rate increases which, when combined with the introduction of a 9-1-1 service fee, would have a serious negative effect, especially with respect to business customers.
299. The YG, the Consumer Groups, and the UCG expressed concern about the affordability impacts of local rate increases. The YG agreed with Northwestel that rates for digital lines should be further decreased and that the types of telecommunication services and rates in the Yukon should be comparable to those enjoyed by a majority of the Canadian population.
300. The GNWT submitted that the Commission should approve Northwestel's proposed new calling plans and should direct Northwestel to make significant reductions to the basic toll schedule for the benefit of both business and residential customers.
301. The Polar Group submitted that the rates available to Yukon Internet service providers incorporated data transport charges that were far in excess of the rate that was charged in the South. The Polar Group argued that a wholesale structure had to be developed in order to facilitate the future delivery of innovative, efficient, and sustainable true competition at the service delivery level. The Polar Group suggested that the southern rate base structure for both wholesale and retail, including all interconnection charges and tariffs, should be adopted.

#### ***Commission's analysis and determinations***

##### *Residential PES*

302. The Commission, in setting residential rates, has taken into consideration, among other things, the policy objective set out in section 7b) of the Act. The Commission finds it appropriate to establish the residential PES rates for Northwestel according to the same cost-based standards used for other ILECs.
303. Northwestel proposed an Individual-Line Residential PES going-in rate for that service of \$31.33 per month, representing a \$2.00 increase to the current monthly rate. As noted earlier in this Decision, the Commission gave interim approval to this proposed rate increase in Order 2006-332.

304. With respect to the issue of affordability, the Commission notes that the statistics provided by Northwestel indicate that very few customers cited affordability as the reason for service disconnection. The Commission also notes that Northwestel's cost of providing residential PES service in Band H1 is still higher than its proposed rate of \$31.33, which has been approved on an interim basis, while in Band D the cost of providing residential PES service is above the previously approved rate of \$29.33. The Commission considers that the \$2.00 increase is reasonable as it will move the rates in Band D above cost and in Band H1 closer to cost. Accordingly, the Commission approves on a final basis the monthly residential PES rate increase of \$2.00, effective 1 January 2007.

*Business PES*

305. Northwestel has proposed to establish the going-in rates at \$54.70 for its Individual-Line Business PES and at \$63.00 for its Multi-Line Business PES, resulting from a \$5.00 increase over the current rates. Northwestel submitted that the proposed rates recovered the cost plus a reasonable mark-up which was less than 25 percent. In Order 2006-332, the Commission gave interim approval to these proposed rate increases.
306. As discussed previously, the Commission considers that the company should be provided with sufficient pricing flexibility should it wish to price its business services at a minimum at Phase II costs plus a 25 percent mark-up. The interim increases noted above are a step towards achieving this policy. Accordingly, the Commission approves on a final basis the monthly business rate increases of \$5.00, effective 1 January 2007.

*Long distance calling plans*

307. Given that the Commission is forbearing from regulating Northwestel's toll services, the Commission considers that it is unnecessary to dispose of the company's current proposals related to toll services.

*Toll-free services, digital services, wireless access services, and the settlement transport rate*

308. The Commission considers that Northwestel's proposal to increase the monthly rate for Toll-Free Dedicated Access Line service to match the Individual-Line Business PES rate is reasonable as these line access services are the same. Further, this will allow Northwestel to recover its costs associated with this Toll-Free Dedicated Access Line service.
309. Northwestel also proposed to remove the monthly Toll-Free Non-dedicated Access rate and decrease the Toll-Free Usage Rate, the Digital Private Line service rates, the Settlement Transport rate, the Teleconferencing Service rates, and the Wireless Service Provider – Network Access rates. The Commission notes that as a result of its determinations in this Decision, the level of subsidy available to Northwestel will be significantly reduced from the level proposed by the company. The Commission considers that it would not be appropriate to increase contribution from the NCF in order to allow Northwestel to reduce its rates for these services.
310. The Commission notes that the company may choose to propose such rate changes during the price cap regime. The Commission also notes that the transport rate is negotiated with other carriers, and that Northwestel could choose to renegotiate this rate.

311. In light of the above, the Commission approves effective 1 January 2007 the increase to the monthly rate for Toll-Free Dedicated Access Line service and denies the proposed rate reductions to the Toll-Free Non-dedicated Access rate, the Toll-Free Usage Rate, the Digital Private Line service rates, the Settlement Transport rate, the Teleconferencing Service rates, and the Wireless Service Provider – Network Access rates.

*Other rate issues*

312. As noted earlier, in Order 2006-332, the Commission made all of Northwestel's tariffed service rates interim effective 1 January 2007. The Commission gives final approval, effective 1 January 2007, to the rates made interim as a result of Order 2006-332, as modified by this Decision. The status of tariffs granted interim approval in other Commission decisions or orders is not affected by the above determination. Such tariffs are to continue in effect on an interim basis until the Commission issues final determinations with respect to them.

**Going-in return on equity**

313. Northwestel proposed that its going-in revenue requirement be assessed using a 10.5 percent ROE, the midpoint of its currently approved ROE range.<sup>12</sup>
314. The UCG argued that Northwestel should continue to be regulated under a rate base/rate of return regime, using an ROE of 9.5 to 10 percent. The UCG considered this range to be at par with that approved for Canadian regulated electric monopolies in recent decisions.
315. TCC noted that Northwestel was requesting approval of an ROE of 10.5 percent, even though the company filed the prepared testimony of Kathleen McShane that supported an ROE at the upper end of a range from 11.25 to 11.75 percent. TCC considered that Ms. McShane's observations about the business and financial risk faced by the company may not have taken into account changes to the company's risk profile associated with its proposal to increase the amount it draws from public funds.
316. The Consumer Groups considered that the increased level of explicit funding under Northwestel's proposed framework would significantly reduce Northwestel's level of business risk, since these funds would be guaranteed to the company. The Consumer Groups also submitted that the risk-free rate, one of the key components in determining the appropriate ROE using the equity risk premium approach, had changed since the last full review of the company's approved ROE. The Consumer Groups noted that the risk-free rate, measured as the yield on a long-term Canada bond, was 6.2 percent in 2000, and that the rate for Government of Canada long-term bonds as of 30 June 2006 was 4.6 percent, a decrease of 1.6 percent. The Consumer Groups were of the view that the ROE used to establish Northwestel's revenue requirement in the current proceeding should be reduced by at least 1.6 percent to reflect this decline in the risk-free rate.

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<sup>12</sup> In Decision 2000-746, the Commission last established an ROE range for Northwestel of 10.0 to 11.0 percent.

317. Northwestel replied that the Consumer Groups' assertion that the risk-free rate of return had decreased by 1.6 percent (or 160 basis points) was incorrect. The company noted that the 6.2 percent indicated in Decision 2000-746 would have been a forecast rate for long-term Canada bond yields, and that the comparable forecast rate provided on the record of this proceeding was 5.25 percent. Northwestel noted that this reflected a 95 basis point decline since 2000, and not the 160 basis point change in yield claimed by the Consumer Groups. Further, Northwestel submitted that the Consumer Groups' recommendation to adjust the company's ROE on the basis of a single element was fundamentally flawed, and that it was also not valid to presume that all other considerations had remained static for six years.
318. In response to the suggestion by TCC and the Consumer Groups that Northwestel's business risk would decline under the company's proposal to replace its implicit subsidization with an equal level of explicit subsidization, Northwestel confirmed that its proposed explicit subsidies were taken into account in Ms. McShane's risk analysis.

#### *Commission's analysis and determinations*

319. The Commission notes that the UCG provided no details in support of its statement that 10.5 percent is at par with that approved for regulated Canadian electric monopolies, nor did the UCG provide any comparisons of key financial and business indicators which would impact the ROE levels for different companies.
320. With regard to the Consumer Groups' submission that Government of Canada long-term bond rates have declined and that this decrease should be reflected as an equivalent basis point reduction to the company's ROE level, the Commission concurs with Northwestel's view that adjusting the ROE on the basis of a single consideration in isolation would not be appropriate.
321. The Commission considers that since 2000 there have been offsetting factors in the determinants usually considered in assessing the reasonableness of an ROE level. As an example, decreases in long-term interest rates would normally be offset to some extent by associated increases in a regulated company's risk premium.
322. Having considered the factors discussed above, the Commission finds no compelling evidence to support changes to the company's currently approved ROE level. Accordingly, the Commission has calculated Northwestel's going-in revenue requirement using an ROE of 10.5 percent.

#### **Calculation of the going-in revenue requirement**

323. Northwestel proposed that its total annual subsidy from the NCF should be \$43.2 million. As a result of its determinations in this Decision, the Commission concludes that the annual subsidy from the NCF is \$18.9 million. The Commission estimates the going-in revenue requirement to be approximately \$19.2 million, which results in a shortfall of \$0.3 million. A detailed schedule of the company's proposed going-in revenue requirement, along with the Commission's approved going-in revenue requirement, are summarized in Appendix 2.

324. The Commission considers that this shortfall of \$0.3 million qualifies as an exogenous factor based on the criteria set out in this Decision. Consequently, the company may propose an exogenous adjustment to the Business Services and/or the Other Capped Services baskets, as appropriate, in its 31 March 2007 price cap filing to recover this amount.

## **Other issues**

### **Reporting requirements**

325. Northwestel submitted that should the Commission approve the proposed price cap framework, the company should no longer be required to file the four-year capital plan, the annual Phase III Manual updates and Phase III results, any changes to depreciation life characteristics, and its annual financial forecasts and results.
326. In addition, Northwestel submitted that the revenue deferral account and the annual proceeding to clear the funds accumulated in that account should be abolished.
327. Northwestel indicated that it would file the following (new filings):
- annual price cap filings to update the respective indices to be made annually at the end of March;
  - the annual telecommunications survey and contribution filing, including non-audited financial statements and ownership/affiliate information;
  - annual updates to the total subsidy requirement, including details associated with any approved SIPs that are in progress;
  - any exogenous adjustment; and
  - applications to recover the DRD.
328. The company indicated that it would continue to file Q of S indicators on a quarterly basis, as well as international telecommunications service agreements and ownership and control information as required.
329. In addition, Northwestel noted that the Commission also used a number of other mechanisms to monitor phone companies including comprehensive survey reports filed in confidence with the Commission annually.
330. The Consumer Groups, the GNWT, and the YG opposed Northwestel's proposal to eliminate the filing of the capital plan. The Consumer Groups and the GNWT submitted that some form of capital plan was essential to ensure that adequate investment levels were maintained. The YG submitted that the company should continue to file the capital plan because the Q of S measures that were the backstop in the event that underinvestment occurred were not going to be sufficient if there was an issue with investment because of long construction and investment cycles.

### *Commission's analysis and determinations*

331. The Commission notes that financial results need to be available for the purpose of reviewing the price cap regime and that sufficient information must be reported in order to ensure that the objectives of the price cap regime are being met.
332. The Commission finds that the company's revenue deferral account and the annual proceeding to clear the funds accumulated in that account will no longer be required effective in 2007. As a result, the company is required to file its financial statements for 2006 to support its application for clearing the revenue deferral account for that year.
333. Subsequent to 2006, the Commission considers that no further financial reporting will be required as the financial information provided as part of the Commission's annual monitoring process will be sufficient to monitor the financial performance of the company. The Commission finds that updates to the company's Phase III Manual, its Phase III results, and the reporting of changes to depreciation life characteristics are no longer required beginning in 2007 with the implementation of the price cap regime.
334. With respect to concerns raised as to the possibility of the company under-investing in a price cap regime, the Commission is satisfied that the Q of S indicators in place will serve to ensure that adequate investment takes place. Conversely, with the implementation of the price cap regime adopted in this Decision, the company will have little incentive to over-invest. Accordingly, the Commission finds that the company is no longer required to file an annual capital plan.
335. In light of the Commission's determination that the DRD would not be recovered directly from the NCF, there is no requirement for the company to file applications for the recovery of the DRD. In addition, since the Commission has determined in this Decision that the subsidy amount from the NCF will be fixed for the price cap period, the company will not have to file annual updates to the total subsidy requirement.
336. With respect to the other proposed regulatory filings listed above, the Commission agrees with the company's proposal, and finds that they are required under the price cap regime established in this Decision.

### **Quality of service**

337. Northwestel submitted that it did not experience any significant Q of S problems in 2004 and 2005, and that throughout this period it generally met or exceeded its Q of S indicators except for indicator 2.1C<sup>13</sup> in 2005. Furthermore, Northwestel indicated that it had not encountered any significant Q of S issues in the first quarter of 2006. Northwestel submitted that where problems had been experienced in meeting indicators, the company was taking a number of steps to rectify the situation.

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<sup>13</sup> *Out-of-service trouble reports cleared "remote"*, with a standard of 90 percent or higher within five working days.

338. The Consumer Groups, the GNWT, and the YG submitted that the Commission's retail rate adjustment mechanism<sup>14</sup> should apply to Northwestel. The GNWT submitted that the mechanism should also include wholesale customers. The YG also suggested that the Commission should consider including customer satisfaction measures.
339. In response, Northwestel submitted that all parties and the Commission recognized that the company's Q of S had been and continued to be high. Northwestel suggested that the imposition of a Q of S penalty mechanism in the absence of any demonstrated need would be contrary to both the letter and the spirit of the proposed policy direction to the Commission and the *Telecommunications Policy Review Panel: Final Report 2006*, March 2006.
340. Northwestel submitted that the current degree of oversight given to its Q of S performance was far greater than that applied to any other carrier. Reporting was done on an individual community levels, and where an indicator was missed, it was explained and/or action plans for resolution were submitted. Northwestel indicated that if its Q of S deteriorated consistently below the standards prescribed by the Commission, absent a suitable explanation and justification, the Commission would need to act.

#### *Commission's analysis and determinations*

341. The Commission considers that the degree of oversight is greater for Northwestel than for the large ILECs. The Commission notes that Northwestel tracks its Q of S on a community basis, whereas the large ILECs track on an urban, rural or company-wide basis depending upon the specific indicator. The Commission is satisfied with the current tracking system and will monitor the company's efforts to rectify current Q of S issues.
342. In light of the above, the Commission finds that it will not gather customer satisfaction data nor introduce a customer rebate plan at this time. However, as noted earlier in this Decision, the company will continue to be required to file quarterly Q of S reports.

#### **Provision of 9-1-1 service**

343. The GNWT raised the issue of the provision of 9-1-1 service to those communities in the Northwest Territories that currently do not have this service.
344. In its responses, Northwestel submitted that, in Decision 99-16, the Commission had not considered the delivery of 9-1-1 services as being necessary to complete the requirement for "access to emergency numbers" as part of the BSO. Northwestel submitted that, as such, the Commission did not make the roll-out of 9-1-1 services a part of the company's original SIP approved in Decision 2000-746.

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<sup>14</sup> See *Retail quality of service rate adjustment plan and related issues*, Telecom Decision CRTC 2005-17, 24 March 2005.

345. Northwestel noted that the responsibility for delivering 9-1-1 service in a specific community resided with the governments and agencies responsible for the financial and daily operational requirements of this service. Northwestel indicated that it was an integral and active participant by being involved in consultation with governments and helping them to determine the feasibility of providing 9-1-1 services. Northwestel indicated that it also helped to design, provision, and maintain the underlying network where it had been determined that 9-1-1 was feasible and a government was willing to take on the responsibility of delivering the service. Northwestel indicated that, for these reasons, it had not submitted a proposal to deliver 9-1-1 service as part of its proposed new SIP.
346. The company indicated that it would continue to collaborate and consult with all parties involved with the delivery of 9-1-1 service as part of the company's standard business operation and practices.
347. Yellowknife et al. requested that the Commission approve NCF funding for the provision of 9-1-1 service in the Northwest Territories.
348. The GNWT recommended that the Commission direct Northwestel, after consulting with territorial governments and other involved groups, including municipal governments, to file with the Commission, within 180 days, a study of the feasibility of extending 9-1-1 service throughout its serving territory. The GNWT submitted that the study results should be provided for a variety of different scenarios, including alternative possible locations of 9-1-1 call answering bureaus.
349. In response to Yellowknife et al.'s submission, Northwestel indicated that it had almost no work remaining to provide 9-1-1 to the City of Yellowknife. Northwestel submitted that the City of Yellowknife's steering committee needed to develop a plan to set up the call centre and determine who would pay for it. This plan would be similar to those carried out in the South.
350. In terms of the Northwest Territories, Northwestel submitted that the task was more complicated, with cost being a major factor. The company submitted that an estimate of costs to provision service in any community or region must be based on a detailed design in consideration of numerous variables. Northwestel submitted that the costs for service would vary significantly depending on the operational requirements, location of the Public Safety Answering Point, network availability and upgrades, records maintenance, and billing and collection services.

*Commission's analysis and determinations*

351. The Commission notes that the provision of 9-1-1 service is not included in the BSO. Further, the Commission notes that funding of 9-1-1 service comes from telephone companies' subscribers, municipal governments, and provinces, but in no case has this service been included in a SIP. The Commission also notes that access to emergency services can be accomplished through the use of seven digit telephone numbers. The Commission denies Yellowknife et al.'s request for funding from the NCF for the provision of 9-1-1 service.

352. With respect to the GNWT's request for Northwestel to file a feasibility study, the Commission considers that Northwestel has provided a significant amount of information regarding the provision of 9-1-1 service on the record of this proceeding. Furthermore, Northwestel has demonstrated that it is prepared to fully co-operate with any municipal and territorial government for the provision of 9-1-1 service. Accordingly, the GNWT's request that Northwestel file a study regarding 9-1-1 is denied. The Commission encourages the parties to establish a steering committee similar to that established for the City of Yellowknife.
353. The Commission also encourages the City of Yellowknife and Northwestel to continue with the current 9-1-1 steering committee.

Secretary General

*This document is available in alternative format upon request, and may also be examined in PDF format or in HTML at the following Internet site: <http://www.crtc.gc.ca>*

## Classification of Services

### Northwestel Inc.

#### Residential Services basket

Tariff	Item no.	Description
3001	202	Extended Area Service
3001	207	Individual-Line service
3001	207	Two-party and Multi-party Line service
3001	901, 903	Suspension of services
3001	1408	Ruraltel
3001	1734	Additional Line Promotion
3003	601, 602	Rural Radio Telephone Service
3006	201	Manual Mobile service

#### Business Services basket

3001	202	Extended Area Service
3001	207	Individual-Line service
3001	207	Multi-Line service
3001	207	Two-party and Multi-party Line service
3001	901, 903	Suspension of services
3001	1408	Ruraltel
3003	601, 602	Rural Radio Telephone Service
3006	201	Manual Mobile service

#### Other Capped Services Basket

3000	Section 4	Sale of Northwestel Tariffs
3001	104	Non-sufficient Funds Cheque Charge
3001	207	Centrex II Service Access Rates
3001	220	Digital Exchange Access
3001	302 b	Non Recurring Charges
3001	302 c	Diagnostic Maintenance Service
3001	305	Installation, Maintenance, Move, Rearrangements, Escort and Repair Service
3001	307	Construction on Public Thoroughfares
3001	308	Interior Construction – Two-party and Multi-party
3001	308.1	Inside Wire and Jacks
3001	401	Directory Listings Primary – Business
3001	402	Monthly Rates for Extra Listings
3001	402	Directory Web Listings
3001	404	Omission of Primary Listings – Business
3001	405	Local Directory Assistance Service
3001	406	Long Distance Directory Assistance (LDDA)

**Other Capped Services Basket (cont'd)**

<b>Tariff</b>	<b>Item no.</b>	<b>Description</b>
3001	407	Prestige Number Service
3001	701	Voice Channel Mileage
3001	705	Foreign Exchange Service
3001	806	Direct-in-Dial (DID) Service
3001	807	Centrex options/Features
3001	807	Centrex Customer Group Engineering Service
3001	808	Centrex Equipment – rental
3001	809	Meridian Business Services – Features
3001	813	Supplemental Equipment for PBX Service
3001	816, 817	Mitel SX-50 and Meridian 1
3001	1101-1102	Key Telephone Systems Intercommunication Circuit
3001	1201	Secretarial Answering Unit Service
3001	1202	Automatic Call Answering and Recording Equipment
3001	1203	Voice Messaging Service (Residential)
3001	1203	Voice Messaging Service (Business)
3001	1204	Integrated Voice Messaging Access
3001	1205	Centrex Voice Messaging Service
3001	1301	Connection of Customer Provided Equipment
3001	1304	Voice Recorder Connecting Equipment
3001	1305	Broadcast Coupler Equipment
3001	1306	Automatic Dialing-Announcing Device (ADAD)
3001	1307	Customer Provided Equipment
3001	1308	Alarm Sending Equipment
3001	1402	Auxiliary Signals
3001	1403	Supplemental Equipment, Miscellaneous Equipment and Service
3001	1405	Supplemental Equipment, Synchronous Modems, Stand-Alone Terminals
3001	1406	Supplemental Equipment, Emergency Alerting Services
3001	1407	Enhanced Calling Features – Residential
3001	1407	Enhanced Calling Features – Business
3001	1413	Set replacement
3001	1501	Maintenance and repair Business Equipment
3001	1502	Maintenance and repair Business Equipment – Vintage 2000
3001	1503	Maintenance and repair IP PBX Business Equipment
3001	1601	Data56 Service
3002	204	Operator Number Identification
3002	303	900 Service
3002	305	Reverse-a-call service
3002	306	Remote Call Forwarding
3002	311	FaxCom Service
3002	400	Ship Service
3002	406	Ship service Radio Link and Inmarsat Charges

**Other Capped Services Basket (cont'd)**

<b>Tariff</b>	<b>Item no.</b>	<b>Description</b>
3002	501	Teleconferencing Service
3002	502	Video Conferencing Services
3003	201	Voice Local
3003	202	Voice Grade Channels
3003	205	Mileage Charges Temporary Service
3003	207	Signal Transmission
3003	301-304	Data Transmission Service Arrangement
3003	401, 403, 404	Teleprinter Service
3003	701	Full-Period Private-Line Telephone Service
3003	903	Satellite Service
3003	1001	Program Transmission Equipment
3003	1003	Program Transmission Local Channels
3003	1111	Digital Private Line Services – Digital Network Access (DNA)
3003	1112	Digital Private Line Transmission Services
3003	1113	Digital Private Line Transmission Services Managed Private Line
3003	1114	Digital Private Line Extension Access Service
3003	1115	Digital Private Line Extension Features
3003	1117	Digital Private Line North Customer Volume Pricing Plan
3003	1118	Ethernet Metropolitan Area Network (MAN) Service
3003	1119	10 Mbps LAN Interconnection Service
3003	1120	Fractional DS-1 Access
3006	203	Manual Mobile Equipment
3006	203	Horn Relay
3008	502, 601, 701	Public Message Service
3010	401	Direct Line Advertising
3010	721	Audio Feed (Conference Bridge interface)

**Services with Frozen Rate Treatment basket**

3001	501	Public Telephone Services
3001	502	Customer requested Public Telephone service
3001	503	Charge-a-call Telephone service
3001	504	Payphone Analogue Cellular Network service
3001	505	Semi-public Payphone
3001	209	Relay services
3001	307	SIP – Service Charges
3001	307	Construction Payment Plan
3001	401	Directory Listings – Residential
3001	404	Omission of Primary Listing – Residence
3001	1406	Emergency Alerting Services
3001	1407	Call Display Blocking
3001	1410	Toll Denial

**Services with Frozen Rate Treatment basket (cont'd)**

<b>Tariff</b>	<b>Item no.</b>	<b>Description</b>
3002	207.1	Rate for Certified Hearing and Speech Impaired Users
3002	207.2	Rates for Certified Hearing and Speech Impaired Users in the Eastern Northwest Territories
3010	722	9-1-1 public Emergency Reporting Service

**Competitor Services basket**

*Wireless Services*

3001	1309	Interconnection of Intra Exchange systems
3001	1310	Switched Access – Public Mobile Radio Systems
3001	1311	Wireless Telephone Numbers
3001	1311	Digital Access Channel
3001	1311	Analogue Access Channel
3001	1311	WSP Link
3001	1311	WSP Network Access – Line Side Access
3001	1311	WSP Network Access – Trunk-side Access
3001	1311	Number Block Routing
3001	1311	Wireless Telephone Numbers
3001	1311	Digital Access Channel
3001	1311	CCS7 Interconnection Rates

*Co-location Services*

3010	702	Occupancy at Radio Sites
3010	706	Interconnection with the Equipment and Facilities of Telesat Canada
3010	713	Use of Support Structures by Cable Television Undertakings and Telecommunications Carriers
3010	721	Audio Feed (Conference Bridge interface)
3010	725	56 Kbps and 32 Kbps ADPCM Digital Circuit
3010	735	Centrex Automatic Call Distribution
3010	745	Central Office Co-location for ADSL Transmission Equipment
3010	746	Interconnecting Carrier – Service Order Charge
3010	746	Entrance Conduit
3010	746	Floor Space
3010	746	Power Consumption
3010	746	Riser Space
3010	746	Application Charge
3010	746	Power Delivery
3010	746	Project Management Fee
3010	746	Site Preparation Fee
3010	746, 750	Escort

*Co-location Services (cont'd)*

3010	746	Cable Pulling/Splicing
3010	750	Service Order Charge
3010	750	Co-location for ISP's Floor Space
3010	750	Power Consumption
3010	750	Application Charge
3010	750	Power Delivery
3010	750	Project Management Fee
3010	750	Site Preparation Fee
3010	750	Construction Fee

*Interconnection Services*

21480	40	Interconnecting Circuits with Trunk-side Access
21480	40	Inward Order
21480	40	Change Order
21480	40	Bundled CAT
21480	40	Satellite Proxy Transport
21480	40	800/888 Toll-free Carrier Identification Charge
21480	40	Account Set-up Charge
21480	40	Changes to CARE Profile
21480	40	User Handbook
21480	40	PIC Processing Charge
21480	40	Unauthorized PIC Change Charge
21480	40	BTN Detail Charge
21480	40	Verification Record Charge
21480	41	Operator Services
21480	50	Standby Circuits
21480	80	Facilities for Dedicated Access Lines
21480	90	Compensation per Call
21480	200	Billing and Collection Service
21480	200	Processing Charge...billed to a customer
21480	200	Processing Charge...returned prior to billing
21480	200	Processing Charge...returned or charged back to the IXC

*Other Competitive Wholesale Services*

3001	408	Customized Master File
3001	408	Directory File Service
3001	408	Master File
3001	408	Update File
3001	408	Set-up Fee
3001	409	Electronic Directory Database Access (EDDA) Service
3003	1120	Fractional DS-1 Access
3003	1122	ADSL Access service

**Uncapped Services basket**

<b>Tariff</b>	<b>Item no.</b>	<b>Description</b>
3001	104	Late Payment Charges
3002	302	Toll Free Service

*Special Services – Customer Specific Arrangement*

3010	601	Ancillary Services and Service Features
3010	701	Miscellaneous Services and Service Features
3010	708	Private VHF Radio Repeater Station
3010	710	Digital Radio Facilities
3010	711	Partial Cable Distribution System
3010	714	Eastern Northwest Territories Rate Stability Plan Contracts
3010	716	Customer Designed Private Packet Network
3010	720	Digital Circuit
3010	727	CSU/DSU for DSI Circuit
3010	729	Comprehensive Communications Package at Ekati (Koala)
3010	733	Voice Grade Channels for YTG
3010	741	MAN for Indian and Northern Affairs
3010	742	Upper Halfway Digital Circuit
3010	743	Municipal Area Data Network Switch
3010	744	Occasional Use Broadcasting service
3010	751	Digital High Speed Satellite circuit for a specific customer

**Northwestel Inc.**  
**Going-in revenue requirement**  
**(\$ millions)**

	<b>Company's Proposal</b>	<b>Commission Adjustments</b>	<b>Commission's View</b>
<b>A Subsidy from the National Contribution Fund</b>			
Residential primary exchange services subsidy	(17.2)	8.4	(8.8)
Toll connecting subsidy	(10.8)	10.8	–
SIP subsidy not related to access	(11.4)	1.3	(10.1)
Depreciation reserve deficiency	(3.8)	3.8	–
<b>Toll subsidy from National Contribution Fund</b>	<b>(43.2)</b>	<b>24.2</b>	<b>(18.9)</b>
<b>B Supplemental funding approved in Decision 2006-10</b>	<b>9.8</b>	<b>–</b>	<b>9.8</b>
<b>C Incremental revenue requirement</b>			
Toll, settlement, and CAT rate restructuring	24.4	(17.8)	6.7
Local access rate increases	(2.7)	–	(2.7)
Rate restructuring demand changes	4.1	(4.1)	–
Other changes not related to rates	1.8	(1.8)	–
Increase in operating expenses	1.1	(1.1)	–
Contribution charges (NCF)	1.0	0.3	1.2
Depreciation and amortization	4.6	(0.4)	4.2
Adjustment to pension expense	(0.8)	0.8	–
<b>Total incremental revenue requirement</b>	<b>33.4</b>	<b>(24.0)</b>	<b>9.4</b>
<b>D Going-in revenue requirement (B+C)</b>	<b>43.2</b>	<b>(24.0)</b>	<b>19.2</b>
<b>E Residual going-in revenue requirement (surplus) shortfall (A+D)</b>	<b>(0.0)</b>	<b>0.3</b>	<b>0.3</b>

Figures may not add due to rounding.