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

Telecom Decision CRTC 2007-89

Ottawa, 14 September 2007

Télébec, Limited Partnership – Part VII application seeking recovery of price cap deferral account shortfall

Reference: 8678-T78-200609654
Tariff Notice 350

In this Decision, the Commission denies Télébec, Limited Partnership's (Télébec) proposal to recover part of its price cap deferral account shortfall by means of a subsidy from the National Contribution Fund and proposed adjustments to the subsidy calculation process that would result in an increase in the company's total subsidy requirement. The Commission also denies Télébec's proposal to recover the remainder of that shortfall through the rate increases proposed in Tariff Notice 350 other than the proposed increases to Pay telephone rates, which the Commission approves herein on a final basis.

The Commission directs Télébec to amortize the cumulative shortfall in its price cap deferral account in equal amounts over four years. The Commission also directs the company to allocate its entire shortfall, by revenue weight, to all service baskets except the Services with Frozen Rate Treatment basket, the Pay Telephone basket, and the Competitor Services basket. The Commission further directs Télébec to file updates to its service basket limits reflecting the exogenous factor allocation set out in this Decision by 28 September 2007.

Introduction

1. In Telecom Decision 2006-9, the Commission considered that Télébec, Limited Partnership (Télébec) would experience a shortfall in its price cap deferral account (deferral account) at the end of the fourth year of the then current price cap period. The Commission also considered that Télébec should be allowed to recover the shortfall in its deferral account through an exogenous adjustment since the shortfall resulted from Commission-mandated actions. Accordingly, the Commission directed Télébec to file an exogenous factor proposal for the recovery of the shortfall in its deferral account.

2. The Commission received an application by Télébec, dated 14 July 2006 and amended on 15 June 2007,[1] (Part VII application) in which the company proposed to recover the shortfall in its deferral account. In its application, Télébec indicated that it would have a cumulative shortfall of $2.709 million as of 30 July 2007 and an annual recurring shortfall of $3.046 million in its deferral account as of 1 August 2007.

[1] Télébec filed its revised proposal as part of its comments in a proceeding initiated by Telecom Decision 2007-27. A Commission letter, dated 13 July 2007, informed Télébec that those portions of the company's comments that related to the shortfall in its deferral account would be included on the record of the proceeding that led to this Decision.

3. Télébec proposed to recover the cumulative shortfall in its deferral account from the National Contribution Fund (NCF). The company also proposed to recover (i) $2.183 million of the recurring shortfall through adjustments to the subsidy calculation process, which would result in increased transfers from the NCF, and (ii) $863,000 of the recurring shortfall through rate increases to tariffed services.

4. On 13 July 2007, Télébec filed Tariff Notice 350 seeking to implement the rate increases to tariffed services that were set out in its Part VII application.

5. The Commission received no comments on these applications. The record of these proceedings closed on 13 July 2007.

6. The Commission considers that Télébec's applications raise the following issues:

   I. The quantum of the shortfall in Télébec's deferral account

   II. The appropriateness of Télébec's proposal to recover part of the shortfall via the NCF

   III. The allocation of the exogenous factor

   IV. The appropriateness of Télébec's proposed rate increases

I. The quantum of the shortfall in Télébec's deferral account

7. In Telecom Decision 2006-9, the Commission estimated that Télébec would have a recurring shortfall of $1.4 million and an accumulated balance of $0.5 million in its deferral account at the end of the fourth year of the current price cap period. The Commission further expected that Télébec's recurring shortfall would increase to $3.3 million by the end of the extension year of the then current price cap period.

8. Télébec estimated that, during the period of 1 August 2006 to 31 July 2007, it would have added $1.835 million to, and withdrawn $4.881 million from, its deferral account, in conformity with the Commission's determinations in previous decisions. Télébec submitted that, accordingly, the company would have a cumulative shortfall in its deferral account of $2.709 million as of 31 July 2007 and an annual recurring shortfall in its deferral account of $3.046 million as of 1 August 2007.

Commission's analysis and determinations

9. The Commission has reviewed the data that Télébec provided in its Part VII application and agrees that Télébec had a cumulative shortfall in its deferral account of $2.709 million as of 31 July 2007 and an annual recurring shortfall in its deferral account of $3.046 million as of 1 August 2007.

II. The appropriateness of Télébec's proposal to recover part of the shortfall via the NCF

10. Télébec submitted that it would be inappropriate to recover the shortfall in its deferral account via an exogenous adjustment on the basis that any mechanism adopted for the recovery of the shortfall based on significant rate increases would decrease the company's competitiveness and its customer base.

11. Télébec proposed to recover its cumulative shortfall of $2.709 million as a special subsidy from the NCF on the basis that the amount of the cumulative shortfall was equal to the amount of the company's going-in revenue requirement shortfall. Télébec submitted that this proposal would obviate the need for time-limited exogenous adjustments.

12. Télébec submitted that two annual deferral account draw-downs were responsible for most of the estimated recurring shortfall of $3.046 million. Télébec indicated that these two draw-downs, which were specific to the company and addressed its going-in revenue requirement shortfall, were: (i) an annual draw-down of $1.9 million related to the depletion of the going-in revenue deferral account, and (ii) an annual draw-down of $820,000 related to compensation for the company's going-in revenue requirement shortfall recalculated as a result of Telecom Decision 2005-4.[2]

13. Télébec proposed to recover $2.183 million of its recurring shortfall through adjustments to the subsidy calculation process. In this regard, Télébec proposed that it use the highest residential primary exchange service (PES) rate approved for another large incumbent local exchange carrier (ILEC) in calculating its subsidy requirement per network access service (NAS) in high-cost serving areas (HCSAs),[3] which is higher than its actual rates. Télébec noted that if its proposal was approved, the company's annual subsidy requirement would increase by $2.183 million for 2007. Télébec however noted that its annual subsidy requirement would decrease on a yearly basis as the large ILECs' rates used for subsidy calculation purposes (the imputed rates) would increase by an inflation factor on an annual basis until the imputed rates reached $30.

14. Télébec argued that its proposal was both reasonable and acceptable on the basis that (i) the proposal took into account its particular financial and regulatory situation; (ii) the proposed subsidy was limited to those withdrawals from its deferral account that were unique to the company; and (iii) the proposal would serve to minimize the expected adverse competitive impacts that would accrue if Télébec were to recover the shortfall solely by increasing its basic local service rates.

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[2] The other draw-downs, accounting for the balance of the company's recurring deferral account shortfall, are set out below in paragraph 17.

[3] Télébec submitted that the highest primary exchange service (PES) rate approved for another ILEC corresponded to the monthly rate of $28.50 approved for each of TELUS Communications Company's rate bands E, F and G in the province of Alberta.

Commission's analysis and determinations

15. Subsection 46.5(1) of the *Telecommunications Act* states that

> The Commission may require any telecommunications service providers to contribute, subject to any conditions that the Commission may set, to a fund to support continuing access by Canadians to basic telecommunications services.

16. The Commission notes that it established the contribution regime, which includes the NCF, to support continuing access by Canadians to basic telecommunications services via the subsidization of the high cost of providing residential local service in rural and remote areas. The Commission also notes that it introduced a new subsidy requirement calculation in Telecom Decision 2000-745 to ensure that the contribution regime provided an appropriate amount of subsidy to maintain affordable residential PES in those rural and remote areas.

17. The Commission notes that the draw-downs from Télébec's deferral account were approved by the Commission to finance initiatives related to the recovery of (i) local number portability (LNP) and local competition start-up costs; (ii) costs incurred for teletypewriter (TTY) upgrades to pay telephones; (iii) costs incurred to implement service improvements plans (SIPs) in non-HCSAs; (iv) $1.9 million per annum associated with the expiration of the amortization of Télébec's revenue deferral account; and (v) $820,000 per annum to recover the going-in revenue requirement shortfall at the time of Télébec's transition to price cap regulation.[4]

18. In the Commission's view, the above-noted initiatives, which led to the shortfall in Télébec's deferral account, are not related to the delivery of affordable residential PES service in HCSAs. The Commission finds that, accordingly, it would be inappropriate to approve Télébec's request to recover part of the shortfall in its deferral account via a special subsidy from the NCF or via adjustments to the subsidy calculation process that would result in increased subsidies from the NCF.

19. In light of the above, the Commission **denies** Télébec's proposal to recover part of the shortfall in its deferral account via a special subsidy from the NCF as well as its proposal to recover part of the shortfall via adjustments to the subsidy calculation process that would result in increased subsidies from the NCF.

20. The Commission reiterates that in Telecom Decision 2006-9 it considered that Télébec should be allowed to recover its deferral account shortfall by means of an exogenous factor. The Commission remains of that view.

III. The allocation of the exogenous factor

21. Télébec submitted that should an exogenous factor be adopted, its application should be limited to basic residential local services in non-HCSAs on the basis that the funds in the deferral account were generated from the rates charged to residential customers in non-HCSAs. Télébec, however, argued that any rate increase would exacerbate the significant

[4] The Commission addressed and approved these draw-downs in Telecom Decisions 2004-77, 2005-4, 2005-75, 2005-76 and 2006-9.

gap between its PES rates and those of its competitors, which would reduce demand for the company's PES and other telephone services as well as further contribute to Télébec's market share erosion. With specific reference to the company's recurring shortfall in its deferral account, Télébec submitted that the per residential NAS rate increase would need to be significantly higher than the $4.45 that corresponds to the monthly *pro rata* non-HCSA residential NAS share of this shortfall.

Commission's analysis and determinations

22. The Commission notes that it has included an exogenous factor as a component of price cap regulation in order to capture the economic impacts associated with events or initiatives not captured by other elements of the price cap formula. The Commission also notes that its customary approach to allocating exogenous amounts is to allocate the costs associated with an exogenous event between service baskets on the basis of cost causality. Accordingly, where feasible, the Commission has sought to apportion the costs associated with an exogenous event in such a manner as to reflect the relative weight of the service baskets in relation to either the generation of costs or the level of benefit accruing from the underlying event.

23. The Commission notes that exogenous adjustments provide a company with both the possibility of amending rates for capped services and some flexibility in deciding which specific services within a service basket will experience rate adjustments.

24. The Commission is of the view that Télébec's position regarding the allocation of its deferral account shortfall fails to reflect accurately the nature of the initiatives funded from the company's deferral account as well as the range of beneficiaries of the initiatives.

25. In this regard, the Commission remarks that the costs associated with the roll-out of LNP and local competition were funded from Télébec's deferral account. The Commission notes that local competition and LNP were introduced in order to further encourage the delivery of quality telecommunications services at reasonable rates. The Commission considers that it is clear that both business and residential customers have benefited from local competition and LNP. Moreover, the Commission considers that while the competitive delivery of telecommunications services in HCSAs has not developed at the same pace as the competitive delivery of telecommunications services in non-HCSAs, the benefits of local competition and LNP are not confined to residential subscribers in non-HCSAs.

26. With regard to the deferral account draw-downs approved for the recovery of costs incurred for TTY upgrades to pay telephones, the Commission notes that in Telecom Decision 2005-75 it stated that the recovery of these costs by means of draw-downs from the company's deferral account was consistent with Telecom Decision 2002-43 by reason of the fact that TTY upgrades would benefit consumers in general.

27. With regard to the annual $1.9 million draw-downs approved in Telecom Decision 2006-9, the Commission notes that these draw-downs were approved in order to compensate Télébec for the revenue requirement shortfall that the company would have otherwise experienced after it had fully amortized the amounts accumulated in its now-defunct revenue deferral account. The Commission notes that these accumulated amounts were rolled-over in 2002 when

Télébec became subject to price cap regulation and were amortized equally over the four-year price cap period initiated by Telecom Decision 2002-43 for the purpose of establishing the company's going-in revenue requirement.

28. The Commission notes that the accumulated amounts in the revenue deferral account were thus set up against the totality of the company's revenues and expenses rather than being assigned to specific services or service baskets. As such, the Commission considers that the annual $1.9 million draw-downs cannot be ascribed to a specific service basket. The Commission considers that, instead, the annual $1.9 million draw-downs have served to mitigate potential rate increases across various service baskets.

29. With respect to the deferral account draw-downs of $820,000 approved in Telecom Decision 2005-4, the Commission notes that these draw-downs were authorized to compensate Télébec for a going-in revenue requirement shortfall that the company had experienced as it transitioned from rate of return on equity to price cap regulation. The Commission notes that Télébec's going-in revenue requirement shortfall was quantified in Telecom Decision 2005-4 following a reappraisal of Télébec's total subsidy requirement. The Commission notes that since these draw-downs were meant to compensate Télébec for the revenue requirement not captured by the company's total subsidy requirement, the beneficiaries of these draw-downs are the subscribers to services in all service baskets, with the exception of the Residential Services in HCSAs basket.

30. With respect to the deferral account draw-down of $276,285 for the first year of Télébec's price cap period initiated by Telecom Decision 2002-43 and $365,000 in subsequent years, the Commission considers that the primary beneficiaries are the company's subscribers to basic residential services in non-HCSAs. The Commission considers that adoption of its customary approach to allocating exogenous amounts would appropriately recognize this fact.

31. In light of the above, the Commission is not persuaded that it would be appropriate to depart from its customary approach to allocating amounts between service baskets on the basis of cost-causality. Accordingly, the Commission considers that it would not be appropriate to limit the allocation of the exogenous amount under consideration to the Residential Services in non-HCSAs basket as suggested by Télébec.

32. The Commission accordingly determines that it is appropriate to allow Télébec to recover both the cumulative and recurring shortfall in its deferral account through exogenous factor adjustments within the price cap framework established in Telecom Decision 2007-27, which framework was extended to Télébec in Telecom Decision 2007-60, subject to the considerations that follow.

33. In Telecom Decision 2007-27, the Commission assigned local services to the following service baskets:

- Residential Services in Non-HCSAs basket;
- Residential Services in HCSAs basket;

- Services with Frozen Rate Treatment basket;
- Pay Telephones basket;
- Other Capped Services basket;
- Competitor Services basket; and
- Uncapped Services basket.

34. The Commission notes that in Telecom Decision 2007-27, it determined that exogenous factors should not be assigned to either the Services with Frozen Rate Treatment basket or the Competitor Services basket. In that Decision, the Commission also determined that all affected ILECs would be allowed to increase rates for local payphone calls to predetermined upper limits. Accordingly, the Commission considers that it is not appropriate to assign exogenous factors to either of the Services with Frozen Rate Treatment basket or the Competitor Services basket. The Commission further considers that it is not appropriate to assign exogenous factors that would result in additional pricing flexibility on rates in the Pay Telephones basket.

35. In light of the above, the Commission directs Télébec to allocate the entire exogenous amount across all remaining regulated services, weighted by revenues, including Uncapped Services.

36. The Commission further determines that the $2.709 million corresponding to Télébec's cumulative deferral account deficit should be amortized in equal amounts over four years. The Commission considers that amortizing this amount over a four-year period will result in permitted rate increases that will properly balance the needs of the company and the interests of its customers.

37. The Commission directs Télébec to file updated service basket limits reflecting the exogenous factor allocation set out above by 28 September 2007.

IV. The appropriateness of Télébec's proposed rate increases

38. Télébec proposed that $863,000 of its recurring shortfall in its deferral account, which corresponds to the part of the recurring shortfall not captured by its proposal to increase its total subsidy requirement, be recovered through various rate increases, set out below. Télébec submitted that these proposed rate increases represented a maximum and that any increases in excess of those proposed would expose the company to significant competitive harm:

- a monthly rate increase of $0.75 to the basic residential local rates in certain exchanges identified by the company;
- a five percent rate increase to individual and multi-party access lines for business customers;
- a five percent rate increase to certain services in the Other Capped Services basket, including intra-exchange distance charges and additional directory listings; and

- with respect to pay telephone rates, an increase to $0.50 for local coin telephone calls and to $1.00 for local calls otherwise initiated.

Commission's analysis and determinations

39. In Telecom Order 2007-290, the Commission (i) approved, on an interim basis, Télébec's proposed increases to the company's pay telephone rates and (ii) deferred its determination on the remaining proposed rate increases and indicated that it would address the proposed rate increases in this Decision.

40. In this Decision, the Commission **approves**, on a final basis, the proposed rate increases to Pay telephone service set out in Tariff Notice 350. The Commission considers, however, that it is not appropriate to approve the remaining proposed rate increases set out in Tariff Notice 350 as it has not accepted Télébec's proposals to recover part of the shortfall in its deferral account from the NCF and has, instead, established the exogenous factor allocation as set out above. Accordingly, the Commission **denies** the remainder of the proposed rate increases set out in Tariff Notice 350.

41. The Commission notes that it is open to Télébec to propose rate increases consistent with the pricing flexibility resulting from the Commission's determinations in this Decision. In this regard, the Commission notes that Télébec's tariffed rates were made interim, effective 1 August 2007, in Telecom Decision 2007-60.

Conclusions

42. In light of the above, the Commission

- **denies** Télébec's proposal to recover its cumulative price cap deferral account shortfall by means of a subsidy from the NCF;

- **denies** Télébec's proposed adjustments to its subsidy calculation;

- **approves**, on a final basis, Télébec's pay telephone rates;

- **denies** the remainder of Télébec's proposed rate increases set out in Tariff Notice 350;

- approves an exogenous factor of $803,435 per year for the recovery of the company's cumulative deferral account shortfall over four years, starting 1 August 2007;

- approves an exogenous factor of $3.046 million for the recovery of the company's recurring deferral account shortfall each year, starting 1 August 2007.

- directs Télébec to allocate its exogenous amounts, by revenue weight, to all service baskets except the Services with Frozen Rate Treatment basket, the Pay Telephones basket, and the Competitor Services basket; and

- directs Télébec to file updated service basket limits reflecting the exogenous factor allocation set out in this Decision by 28 September 2007.

Secretary General

Related documents

- *Télébec, Limited Partnership – Miscellaneous services*, Telecom Order CRTC 2007-290, 10 August 2007
- *Follow-up to Decision 2007-27 – Show cause submission related to the application of the price cap regime to Télébec, Limited Partnership*, Telecom Decision CRTC 2007-60, 30 July 2007, as amended by Telecom Decision CRTC 2007-60-1, 10 August 2007
- *Price cap framework for large incumbent local exchange carriers*, Telecom Decision CRTC 2007-27, 30 April 2007
- *Disposition of funds in the deferral accounts*, Telecom Decision CRTC 2006-9, 16 February 2006
- *Follow-up to Decision 2002-43 – Société en commandite Télébec's request to recover the start-up costs for local competition and local number portability*, Telecom Decision CRTC 2005-76, 22 December 2005
- *Follow-up to* Access to pay telephone service, *Telecom Decision CRTC 2004-47 – Société en commandite Télébec request to recover costs associated with upgrading pay telephones with teletypewriter units*, Telecom Decision CRTC 2005-75, 22 November 2005
- *Implementation of competition in the local exchange and local payphone markets in the territories of Société en commandite Télébec and the former TELUS Communications (Québec) Inc.*, Telecom Decision CRTC 2005-4, 31 January 2005
- *Société en commmandite Télébec – Follow-up to Decision 2002-43 – Service improvement plan*, Telecom Decision CRTC 2004-77, 18 November 2004
- *Implementation of price regulation for Télébec and TELUS Québec*, Telecom Decision CRTC 2002-43, 31 July 2002
- *Changes to the contribution regime*, Decision CRTC 2000-745, 30 November 2000