



Telecom Decision CRTC 2015-79

PDF version

Ottawa, 4 March 2015

File number: 8663-N1-201401406

Northwestel Inc. – Basket structure and pricing constraints for terrestrial retail Internet services

The Commission assigns Northwestel's terrestrial retail Internet services to a separate capped Internet Services basket, with sub-baskets for each of residential and business services. Further, the Commission caps Northwestel's residential Internet service rates, while applying a rate element constraint of 5% to business retail Internet service rates.

Introduction

1. In Telecom Regulatory Policy 2013-711, in which it reviewed the regulatory framework and network modernization plan for Northwestel Inc. (Northwestel), the Commission determined, among other things, that the characteristics of the terrestrial retail Internet market in the Far North had changed since the Commission forbore from regulating Northwestel's Internet services in 1999 and that Northwestel now has significant market power.
2. The Commission determined, therefore, that it was no longer appropriate to refrain from regulating Northwestel's terrestrial retail Internet services (Internet services), and directed the company to file tariffs and associated cost studies for these services.¹ The Commission also directed Northwestel to file an application with a proposal for the basket structure and pricing constraints for Internet services under the company's price cap regime.² In the interim, the Commission found it appropriate to place these services into an Internet Services basket and to cap the rates for these services at their current rates pending completion of this proceeding.

Application

3. The Commission received an application from Northwestel, dated 4 February 2014, in which the company proposed that the best fit for its Internet services is in the Other

¹ On 4 February 2014, Northwestel filed Tariff Notice 904, as amended by Tariff Notices 904A, 904B, and 904C, filed on 2 April 2014, 17 October 2014, and 23 January 2015, respectively (Tariff Notice 904).

² Price cap regulation generally places upward constraints on retail and wholesale prices that a company can charge its customers. Under price cap regulation, regulated services are assigned to baskets with individualized basket constraints on rates and, in some instances, specific rate element constraints.

Capped Services basket.³ This basket has an overall basket constraint of the rate of inflation⁴ and a rate element constraint of 10% annually.

4. The Commission received interventions from the Government of the Northwest Territories (GNWT), the Public Interest Advocacy Centre (PIAC), and the Yukon Government (YG). The public record of this proceeding, which closed on 15 August 2014, is available on the Commission's website at www.crtc.gc.ca or by using the file number provided above.

To which basket should Northwestel's Internet services be assigned?

5. Northwestel submitted that classifying its Internet services in the Other Capped Services basket is the most appropriate price cap treatment for the following reasons:
 - these services are not basic residential or business voice services;
 - these services logically fit within the definition of Other Capped Services;
 - prices for these services require adjustments over time, which gives companies the flexibility to manage "out-of-lifecycle" services and packages efficiently, while still providing significant price protection for customers; and
 - a separate price cap basket would increase regulatory complexity.
6. Northwestel further submitted that the inclusion of its Internet services in a basket with other services provides price protection for customers because prices in the basket will only go up, in aggregate, by the rate of inflation, and no rate element could increase by more than 10%.
7. GNWT, PIAC, and YG opposed classifying Northwestel's Internet services as Other Capped Services. GNWT and YG supported assigning these services to a separate basket. GNWT submitted that the creation of a separate basket allows for a better focus on this important group of services, which are increasingly recognized as being a part of basic service, and would avoid creating an inappropriate interdependency between rate levels for these services and the services included in the Other Capped Services basket. GNWT submitted that a separate basket does not increase regulatory complexity because the specific formulas used in the calculations would differ, but that in itself does not imply any increased complexity.

Commission's analysis and determinations

8. As noted in Telecom Regulatory Policy 2013-711, Northwestel possesses significant market power for Internet services in its operating territory. The Commission

³ Services assigned to this basket include such services as voice messaging and enhanced calling features for both residential and business customers, as well as other business services (e.g. digital exchange access and digital private lines).

⁴ The rate of inflation is the annual chain-weighted gross domestic product price index, which is a measure of the national output price change published by Statistics Canada.

considers that, under these circumstances, placing Northwestel's Internet services into the Other Capped Services basket would provide Northwestel with undue flexibility to modify the rates for its Internet services.

9. The Commission also considers that placing Northwestel's Internet services into a separate price cap basket would permit the establishment of specific pricing constraints that would be consistent with current market conditions and those expected for the next few years.
10. The Commission therefore concludes that Northwestel's Internet services are to be assigned to a separate Internet Services basket.

What are the most appropriate basket and rate element constraints?

11. Northwestel submitted that an overall basket constraint of the rate of inflation with a rate element constraint of 10% annually would provide the company with some flexibility to manage its Internet services while still ensuring that prices remain just and reasonable for all customers.
12. Northwestel also submitted that, while prices on a per-megabit basis have generally decreased over time, the amount of data usage included in Internet packages has increased. As a result, prices for Internet packages should not be expected to decrease over time.
13. GNWT proposed that overall rates be capped at existing levels, and that a maximum 10% annual increase be allowed for individual rate elements. Although YG agreed with GNWT's proposal, it was not opposed to a basket constraint of the rate of inflation in lieu of capping the basket, while retaining the 10% rate element constraint.
14. PIAC questioned the appropriateness of granting the company the ability to increase the revenues overall for Internet services at the rate of inflation and the rates for individual service elements by 10% per year. PIAC also argued that the Commission should consider a productivity factor or other offset so that the company's customers, and not just shareholders, can benefit from productivity improvements.
15. Northwestel responded that a productivity offset should not be considered, since the Commission determined that the inclusion of such factors in Northwestel's price cap regime would not be appropriate given the network changes involved in the implementation of the company's Modernization Plan during the next price cap period. Northwestel argued that capping an Internet services basket sets a target productivity factor of the rate of inflation and ignores the incentive to invest. It submitted that the business case to provide Internet service in many communities is uneconomic and that there is no way to achieve any productivity improvements.

16. Northwestel further submitted that not allowing for inflationary increases would ignore the significant investment that has to take place to expand the company's broadband footprint so that it can serve more customers under its Modernization Plan. Further, substantial investments must continue in order to augment its network to handle increasing levels of traffic as more consumers use greater amounts of bandwidth for services such as streaming, video-conferencing, or other real-time applications.

Commission's analysis and determinations

17. Basket constraints are used to provide companies with (i) incentives to increase efficiencies, and (ii) sufficient pricing flexibility to restructure rates, while providing a level of protection to customers. Rate element constraints on services within a particular basket are imposed to further limit the magnitude of a company's pricing actions with respect to a particular service in order to further protect customers.

18. In Telecom Decision 2015-78, issued today, the Commission approved, with changes, Northwestel's tariffs for Internet services. While it approved most of the proposed residential, business, and enterprise rates, the Commission has determined that it is appropriate to lower certain residential Internet service rates in order to reduce the disparity among the service rates for Northwestel's customers. The Commission notes that there is a limited level of competition for Internet services in Northwestel's operating territory and that the company's rates for these services are higher than those for comparable services offered in southern Canada even after the Commission's adjustments.

19. In order to provide Northwestel's customers with a certain level of price protection, the Commission finds it appropriate to place a cap on the Internet Services basket such that the weighted average price of all the services in this basket will not be allowed to increase annually over the price cap period. The Commission considers that placing an overall cap on the Internet Services basket should provide Northwestel with incentives to increase efficiencies and would not prevent the company from developing new Internet service offerings to increase demand and revenues.

20. In addition, given its concerns regarding the rates for Northwestel's residential Internet services, the Commission considers it appropriate to provide additional pricing protection to consumers. Accordingly, the Commission creates a Residential Internet Services sub-basket for residential Internet services, including residential overage charges, and a separate Business Internet Services sub-basket for business and enterprise Internet services, including applicable overage charges. The Commission finds it appropriate to cap the rates for the services assigned to the Residential Internet Services sub-basket at the rates approved by the Commission in Telecom Decision 2015-78.

21. The Commission considers that providing some flexibility in the rates for services in the Business Internet Services sub-basket would enable Northwestel to restructure rates in order to manage "out-of-lifecycle" services and packages in this sub-basket. Accordingly, the Commission finds that the Business Internet Services sub-basket

will be subject to an overall cap such that the weighted average price of all the services in this sub-basket will not be allowed to increase annually over the price cap period. Further, individual rates in this sub-basket will be subject to an annual rate element constraint of 5%.

22. In addition, any rate increases to services in either sub-basket, including exogenous adjustments, will be limited to 5% per year per rate element.

Conclusion

23. In light of the above, the Commission

- assigns Northwestel's Internet services to a separate basket and places an overall cap on this basket;
- creates a Residential Internet Services sub-basket for residential Internet services and a Business Internet Services sub-basket for business and Enterprise Internet services;
- caps residential Internet service rates at the rates approved in Telecom Decision 2015-78;
- places an overall cap on the Business Internet Services sub-basket with an annual rate element constraint of 5%; and
- limits any increases, including exogenous adjustments, to 5% per year per rate element.

Policy Direction

24. The Commission considers that the determinations made in this decision are consistent with the Policy Direction⁵ for the reasons set out below.

25. The Policy Direction states that the Commission, in exercising its powers and performing its duties under the Act, shall implement the policy objectives set out in section 7 of the Act, in accordance with paragraphs 1(a), (b), and (c) of the Policy Direction.

26. The regulatory measures under consideration in this decision relate to the regulated rates for Northwestel's terrestrial retail Internet services. Therefore, subparagraph 1(a)(ii)⁶ and subparagraphs 1(b)(i) and (ii)⁷ of the Policy Direction apply to the Commission's determinations in this decision.

⁵ *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

⁶ Paragraph 1(a)(ii) states that the Commission should, when relying on regulation, use measures that are efficient and proportionate to their purpose and that interfere with the operation of competitive market forces to the minimum extent necessary to meet the policy objectives.

⁷ Paragraph 1(b) states that the Commission, when relying on regulation, should use measures that satisfy the following criteria, among others: (i) specify the telecommunications policy objective that is advanced

27. Consistent with subparagraphs 1(a)(ii) and 1(b)(ii) of the Policy Direction, the Commission considers that the regulatory measures approved in this decision are 1) efficient and proportionate to their purpose, and minimally interfere with market forces, and 2) neither deter economically efficient competitive entry into the market nor promote economically inefficient entry. Specifically, the Commission considers that the pricing constraints applied in this decision are narrow in their application to a subset of Northwestel's service offerings, and proportionate to the need for affordability in terrestrial Internet services for Northern Canadians.
28. In compliance with subparagraph 1(b)(i) of the Policy Direction, the Commission considers that the policy objectives set out in paragraphs 7(b) and (h) of the Act⁸ are advanced by the regulatory measures established in this decision.

Secretary General

Related documents

- *Northwestel Inc. – Tariffs for terrestrial retail Internet services*, Telecom Decision CRTC 2015-78, 4 March 2015
- *Northwestel Inc. – Regulatory Framework, Modernization Plan, and related matters*, Telecom Regulatory Policy CRTC 2013-711, 18 December 2013

by those measures and demonstrate their compliance with this Order, and (ii) if they are of an economic nature, neither deter economically efficient competitive entry into the market nor promote economically inefficient entry.

⁸ The cited policy objectives of the Act are 7(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; and (h) to respond to the economic and social requirements of users of telecommunications services.