



## Telecom Regulatory Policy CRTC 2018-213

PDF version

References: 2017-92 and 2017-92-1

Ottawa, 26 June 2018

*Public record: 1011-NOC2017-0092*

### Phase-out of the local service subsidy regime

*Consistent with the Commission's shift of its regulatory frameworks away from wireline voice services, the Commission determines in this decision that the phase-out of the local service subsidy will occur over three years, from 1 January 2019 to 31 December 2021, through semi-annual reductions. The total subsidy amounts for 2018 for each incumbent local exchange carrier (ILEC) are to be used to calculate the amounts of subsidy to be paid during the transition period from 2019 to 2021. However, funding for Northwestel's service improvement plan will continue as planned and then cease on 31 December 2020. This decision also sets out the Commission's determinations regarding certain policies for the small ILECs' subsidies.*

*The Commission also determines that several regulated residential high-cost serving area exchanges are eligible for forbearance and are therefore no longer eligible for the local service subsidy, subject to other applicable forbearance criteria being met. The Commission **directs** each of the ILECs listed in the Appendix to this decision to file a streamlined forbearance application with respect to these exchanges no later than **30 days** after the date of this decision.*

### Background

1. The local service subsidy regime<sup>1</sup> was established to subsidize the provision of residential local voice telephone services in high-cost serving areas (HCSAs).<sup>2</sup> Telecommunications service providers (TSPs), or groups of related TSPs, that have \$10 million or more in annual Canadian telecommunications revenues are required to contribute to the National Contribution Fund (NCF).
2. Contribution (money) is collected by means of a revenue-percent charge that is applied to the contribution-eligible revenues of a TSP. Certain revenues (e.g. from retail Internet and texting services, and terminal equipment) and other amounts (e.g. inter-carrier payments) are excluded from the calculation of a TSP's

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<sup>1</sup> The current local service subsidy regime was established in Decision 2000-745. A summary of this regime can be found in Telecom Circular 2007-15.

<sup>2</sup> An HCSA is a defined geographical area where an incumbent local exchange carrier's monthly costs to provide residential local exchange service are estimated to be greater than the associated revenues generated by service rates.

contribution-eligible revenues. The money collected in the NCF is distributed to incumbent local exchange carriers (ILECs)<sup>3</sup> serving regulated HCSAs – that is, HCSAs where the Commission has not forborne from rate regulation. Each year, the Commission issues a decision that sets out the contribution collection revenue-percent charge for TSPs and the subsidy amounts for the ILECs (the revenue-percent charge decision).

3. ILECs receive monthly subsidy amounts based on the number of residential network access services (NAS)<sup>4</sup> they serve. The amount of subsidy is generally based on the following formula: (i) the ILEC's estimated costs of providing local voice service, plus a 15% markup for fixed/common costs, (ii) minus the maximum allowable local residential rate, and (iii) minus \$5 imputed for optional local services.
4. In Decision 2001-238, the Commission established the HCSA band structure for the large ILECs and approved the corresponding per-NAS residential local service costs to be used in the local service subsidy calculation. In Decision 2001-756, the Commission determined that the small ILECs would have a slightly different subsidy regime (including band structure and costing rules) than the large ILECs, which results in some small ILECs receiving more subsidy on a per-NAS basis. In Telecom Decision 2007-5, the Commission determined that Northwestel would also have a slightly different subsidy regime than the large ILECs, such as only one high-cost band for all its wire centres outside Whitehorse, Yukon, and Yellowknife, Northwest Territories.

### **Telecom Regulatory Policy 2016-496**

5. In Telecom Regulatory Policy 2016-496, the Commission stated that it would begin to shift the focus of its regulatory frameworks from wireline voice services to broadband Internet access services. The Commission established the following universal service objective:

Canadians, in urban areas as well as in rural and remote areas, have access to voice services and broadband Internet access services, on both fixed and mobile wireless networks.

6. The Commission also indicated that to support continued access to broadband Internet access services in underserved areas, it would phase out the local service subsidy regime and establish a new funding mechanism for projects to build or upgrade broadband Internet access service infrastructure. The Commission stated that (i) contribution towards the broadband funding mechanism would be collected

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<sup>3</sup> The term "ILECs" includes the large and small ILECs, and Northwestel Inc. The large ILECs are Bell Canada (including the former Bell Aliant Regional Communications, Limited Partnership; Bell MTS; and Télébec, Limited Partnership); Saskatchewan Telecommunications; and TELUS Communications Inc. There is one small ILEC operating in British Columbia and the rest operate in Ontario and Quebec.

<sup>4</sup> A NAS is a connection or line that provides customers with access to the public switched telephone network.

by means of a revenue-percent charge that would be applied to the contribution-eligible revenues of a TSP, and (ii) these revenues would be expanded to include both retail Internet and texting service revenues.

7. The Commission further stated that local voice service subsidy would be eliminated in regulated HCSAs if they qualify for forbearance, as set out in the forbearance decisions.<sup>5</sup> However, in all other regulated HCSAs, the Commission did not intend to remove the local service subsidy for a NAS unless reliable broadband Internet access service is available.
8. Also in Telecom Regulatory Policy 2016-496, the Commission retained the obligation to serve, as it currently applies to voice telephone service, for the ILECs. The obligation to serve requires the ILECs to provide, subject to certain conditions, telephone service to (i) existing customers, (ii) new customers requesting service where the ILECs have facilities, and (iii) new customers requesting service beyond the limits of the ILECs' facilities.

### **Telecom Notice of Consultation 2017-92**

9. Through Telecom Notice of Consultation 2017-92, the Commission initiated a proceeding to examine how the local service subsidy regime should be phased out, as well as associated policies that could have an impact on the subsidy amounts. The Commission also invited comments on whether, and if so when, the remaining subsidies should be phased out.
10. The Commission also stated that it would examine the competitive market for residential local telephone service in regulated HCSA exchanges (i) that currently receive subsidy, and (ii) where competition has been established, to determine which of these exchanges qualify for forbearance and therefore no longer qualify for local service subsidy.
11. The Commission received almost 170 interventions, most of which were from individual Canadians. The Commission also received interventions from the following parties: Bell Canada, on behalf of itself and DMTS, KMTS, NorthernTel, Limited Partnership, Ontera, and Télébec, Limited Partnership (collectively, Bell Canada et al.); Bragg Communications Incorporated, carrying on business as Eastlink, on behalf of itself and Amtelecom Telco GP Inc. and People's Tel Limited Partnership (collectively, Eastlink et al.); the Canadian Network Operators Consortium Inc. (CNO); Cogeco Communications Inc. (Cogeco); the Independent Telecommunications Providers Association (ITPA); Northwestel Inc. (Northwestel); Quebecor Media Inc., on behalf of Videotron Ltd. (Videotron);<sup>6</sup>

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<sup>5</sup> The forbearance framework for local exchange services was established in Telecom Decision 2006-15 for the large ILECs and in Telecom Regulatory Policy 2009-379 for the small ILECs.

<sup>6</sup> In the proceeding, submissions were received from Videotron G.P. However, effective 29 December 2017, all of Videotron G.P.'s assets and operations were transferred to Videotron Ltd., and Videotron G.P. was subsequently dissolved. For ease of reference, "Videotron Ltd." is used in this decision.

Rogers Communications Canada Inc. (RCCI); Saskatchewan Telecommunications (SaskTel); Shaw Cablesystems G.P. (Shaw); SSI Micro Ltd. (SSI); TELUS Communications Inc. (TCI);<sup>7</sup> as well as the British Columbia Broadband Association (BCBA); the Consumer Association of Saskatchewan; the First Mile Connectivity Consortium (FMCC); the National Pensioners Federation jointly with the Public Interest Advocacy Centre (NPF-PIAC); the Northwest Territories Association of Communities; l'Union des consommateurs (l'Union); the Cree Nation / Eeyou Communications Network; the Saskatchewan Association of Rural Municipalities; and the governments of each of British Columbia, the Northwest Territories, Nunavut, and Yukon.

## **Issues**

12. The Commission has identified the following issues to be addressed in this decision:

- Eligibility for forbearance in HCSA exchanges
- Plan to phase out the local service subsidy
- Other subsidy-related policies
  - Northwestel's service improvement plan (SIP)
  - Subsidy policies for small ILECs
  - Regulatory framework to be applied when large ILECs purchase small ILECs
- Potential compensation for the elimination of the local service subsidy

## **Eligibility for forbearance in HCSA exchanges**

### **Positions of parties**

13. The majority of parties, including Bell Canada et al., CNOC, Cogeco, Eastlink et al., RCCI, Shaw, SSI, and Videotron, supported the Commission's proposal to eliminate the local service subsidy in HCSA exchanges that would be eligible for forbearance pursuant to the forbearance decisions based on the information gathered in this proceeding.
14. Bell Canada et al. submitted that the local service subsidy in exchanges eligible for forbearance could be removed as of 1 January 2018, but that this removal should be concurrent with the granting of local forbearance in these exchanges. Most parties, including most ILECs, agreed with Bell Canada et al.'s view regarding the timing to remove subsidy.

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<sup>7</sup> In the proceeding, submissions were received from TELUS Communications Company (TCC). However, effective 1 October 2017, TCC's assets were legally transferred to TCI and TCC ceased to exist. For ease of reference, "TCI" is used in this decision.

15. While RCCI and Shaw did not object to Bell Canada et al.'s proposal, they submitted that the Commission should not delay the removal of the local service subsidy in HCSA exchanges where facilities-based competition is present.

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

16. The Commission forbears from regulating residential local exchange services when it is satisfied that an ILEC's forbearance application meets all the applicable criteria set out in the forbearance decisions, including meeting the competitor presence test and the competitor quality of service test.
17. The Commission has assessed which regulated residential HCSA exchanges would be eligible for forbearance based on information provided by TSPs on the record of this proceeding. This information demonstrates that, in the 42 exchanges listed in the Appendix to this decision, at least two facilities-based competitors (one of which is fixed line) are present, and each of these service providers is capable of serving at least 75% of the number of residential local exchange service lines that the ILEC is capable of serving (i.e. these exchanges meet the competitor presence test).
18. Based on the information provided on the record of this proceeding, the Commission determines that the 42 HCSA exchanges listed in the Appendix to this decision are eligible for forbearance, subject to the other forbearance criteria being met. The Commission considers that the removal of local service subsidy in the eligible exchanges concurrent with the Commission's approval of an ILEC's application for forbearance would be consistent with the Commission's current forbearance framework.
19. Consequently, the Commission is establishing a streamlined process applicable to the affected ILECs' exchanges, given that the competitor presence test has already been met as a result of this proceeding.
20. The Commission **directs** the ILECs identified in the Appendix to file an application for forbearance from the regulation of local exchange services in their respective residential HCSA exchanges that are eligible for forbearance, no later than **30 days** after the date of this decision.
21. The forbearance applications are to contain the following information:
  - the geographic component of the relevant market;
    - indicate the name of the eligible exchange(s),
  - evidence that the ILEC has satisfied all the local forbearance criteria;
    - indicate that the Commission has already assessed the competitor presence test in the context of this proceeding, and

- file the quality of service information prescribed in the forbearance decisions, as of 31 March 2018,<sup>8</sup>
  - the tariff items and associated tariff numbers of the services for which the ILEC is requesting local forbearance; and
  - a draft communications plan.
22. The Commission will remove the local service subsidy in the eligible HCSA exchanges concurrent with its approval of the forbearance applications.

## **Plan to phase out the local service subsidy**

### **Background**

23. In Telecom Notice of Consultation 2017-92, the Commission set out a preliminary view that NAS with access to the digital wireline technologies<sup>9</sup> have access to reliable broadband Internet access service and that it would be appropriate to remove the local service subsidy for these NAS.
24. In support of this proposed approach, the Commission noted that it is possible for ILECs to offer many services, such as broadband Internet access service, voice over Internet Protocol (VoIP) service, or Internet Protocol television (IPTV) service, on the same access line that they use to provide local telephone service. Thus, ILECs' revenues from the provision of these other services can contribute to recovering the costs associated with providing residential local telephone service. As a result, the Commission considered that it would be appropriate to remove the local service subsidy for the above-mentioned NAS.
25. The Commission requested comments on the appropriateness of this proposed approach, and whether reliable broadband Internet access service should be defined as broadband Internet access service at a minimum of 1.5 megabits per second (Mbps) download provided through the digital wireline technologies, or based on a different approach.
26. During the proceeding, parties were asked to provide their views on various other approaches regarding the phase-out of the local service subsidy, such as

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<sup>8</sup> In Telecom Regulatory Policy 2018-123, the Commission determined that the large ILECs' wholesale services and processes that were subject to the competitor quality of service regime were no longer subject to that regime. However, the Commission also determined that when large ILECs file local forbearance applications, they must continue to demonstrate that they meet the competitor quality of service criterion, pursuant to Telecom Decision 2006-15. The Commission retained the current complaints-based approach for the small ILECs.

<sup>9</sup> These include technologies such as digital subscriber line (DSL), a combination of fibre to the node and DSL, fibre to the home, and cable technologies.

- eliminating the subsidy immediately where reliable broadband Internet access service is available and establishing a schedule to remove the remaining subsidy,
- allowing the subsidy to be eliminated “organically” over time as technology and coverage improve, and
- eliminating the subsidy over the first five years of the broadband fund.

## **Positions of parties**

### **Appropriateness of using the Commission’s preliminary view**

27. Bell Canada et al., the BCBA, CNOC, Cogeco, the Government of Yukon, RCCI, Shaw, and Videotron supported the Commission’s proposal that access to reliable broadband Internet access service be a prerequisite to determine which NAS should not receive subsidy.
28. CNOC added that this approach would (i) promote maximum reliance on market forces, (ii) support a level playing field for competition, (iii) incent the ILECs to transition their end-users to Internet Protocol (IP)-based telecommunications services as quickly as possible, and (iv) mitigate the risk of any undue financial impact from TSPs being required to contribute to both the local service subsidy regime and the upcoming broadband fund.
29. Northwestel opposed the use of reliable broadband Internet access service as a criterion to eliminate local service subsidy based on the premise that ILECs can cross-subsidize the cost of providing local service. Northwestel indicated that its residential Internet access service rates in HCSA exchanges are set below cost, so it is impossible for the company to obtain any cross-subsidy from its residential Internet access service to mitigate the loss of its local service subsidy.
30. Most local service subsidy recipients, such as the ITPA, SaskTel, and TCI, argued that this subsidy should not be phased out regardless of the criteria used, except in exchanges that are eligible for forbearance. The ITPA stated that if the local service subsidy were eliminated, some small ILECs would sustain irreparable harm. SaskTel submitted that removal of its local service subsidy would severely impact its bottom line and investment plans.

### **Definition of reliable broadband Internet access service**

31. Many parties, such as CNOC, Cogeco, RCCI, and Videotron, agreed that the Commission should use the 1.5 Mbps download speed to define reliable broadband Internet access service. However, other parties, including most ILECs, NPF-PIAC, and l’Union, submitted that 1.5 Mbps was too low. Some parties, such as Bell Canada et al., proposed that the Commission use speeds of 5 Mbps download and 1 Mbps upload. Other parties, such as the FMCC, proposed that the Commission use the speeds set out in the universal service objective (i.e. 50 Mbps download and 10 Mbps upload).

32. Concerning the technologies used to deliver broadband Internet access service, some parties, such as RCCI, Shaw, and Videotron, expressed the view that Canadians are increasingly adopting wireless technologies, which can be as reliable as digital wireline technologies. Bell Canada et al. agreed that wireless technologies could be added to the definition of reliable broadband Internet access service, but wanted to exclude services offered through satellite technology. NPF-PIAC stated that current geo-synchronous orbit satellite services should be excluded. SaskTel agreed with the Commission's statement in Telecom Notice of Consultation 2017-92 that the reliability of broadband Internet access service offered via wireless technologies was more variable than that of the digital wireline technologies. Many individual interveners argued that wireless services are unreliable since they could be affected by factors such as bad weather.
33. Finally, some parties, such as SaskTel and Shaw, stated that many other factors (e.g. latency and loop length) have a role to play in the reliability of broadband Internet access service. Some of those parties suggested other criteria, such as upload speeds, availability, and latency, to be included in the Commission's proposed definition.

**Other approaches to phase out the local service subsidy**

34. Bell Canada et al. and Eastlink et al. favoured phasing out the local service subsidy over the first five years of the broadband fund, and immediately where download/upload speeds of 50/10 Mbps are currently offered by the ILECs, so long as the phase-out is accompanied by rate increases for local residential voice services. The ITPA and Northwestel were opposed to eliminating local service subsidy where these speeds are offered since factors other than speed should be used to define reliable broadband Internet access service.
35. CNOC, the ITPA, Northwestel, NPF-PIAC, SaskTel, Shaw, and TCI opposed phasing out the local service subsidy over the first five years of the broadband fund. SaskTel argued that it remains unclear when contributions to the broadband fund will start and how the proposed five-year phase-out would occur. CNOC stated that much of the local service subsidy can be eliminated immediately without waiting for the broadband fund to take effect. Shaw indicated that layering one subsidy on top of another would increase overall costs to the NCF's contributors.
36. The ITPA, NPF-PIAC, SaskTel, and TCI opposed the implementation of a plan to phase out the local service subsidy, arguing that since local voice service subscriptions have steadily declined in the last few years, the subsidy should be allowed to be eliminated organically as customers move to other voice services.
37. Other parties, including CNOC, Cogeco, RCCI, Shaw, SSI, and Videotron, submitted that the local service subsidy regime is no longer necessary and that the Commission should develop a specific phase-out plan with a cut-off date. Cogeco argued that establishing such a date would incent ILECs to deploy and extend the availability of their broadband Internet access services in exchanges that are currently subsidized.

38. NPF-PIAC opposed the implementation of a cut-off date for the remaining local service subsidy, citing the importance of wireline telephone services for customers in HCSAs who fear that once the subsidy is removed, these services will no longer be available at just and reasonable rates.
39. RCCI and Shaw proposed a phase-out plan of three years at an equal reduction of 33% of subsidy per NAS per year. Bell Canada et al. proposed that the local service subsidy be eliminated simultaneously with the implementation of the Commission's determinations from the upcoming proceeding to examine the price cap and local forbearance regimes.<sup>10</sup>

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

40. The Commission made several determinations in Telecom Regulatory Policy 2016-496 that collectively contribute to the fulfillment of the policy objectives in the *Telecommunications Act* (the Act). Specifically, the Commission decided, among other things, to shift its focus from voice services to broadband Internet access services in order to use the funds collected pursuant to subsection 46.5(1) of the Act to support continuing access by Canadians to basic telecommunications services. Modern telecommunications services, such as mobile wireless and fixed broadband Internet access services, are now also considered basic telecommunications services within the meaning of subsection 46.5(1) of the Act.
41. The Commission has provided subsidy to ILECs in support of local residential voice services for decades. There is currently near-ubiquitous access in Canada to local services. As stated in Telecom Regulatory Policy 2016-496, the Commission is shifting its focus to support modern telecommunications services to help ensure that all Canadians have the opportunity to participate in the digital economy. Consequently, the Commission determined that it would phase out the local service subsidy regime.
42. Some parties argued in this proceeding that the local service subsidy should not be eliminated without them receiving some form of compensation. This issue is addressed later in this decision.
43. There was no consensus from parties on either the Commission's preliminary view set out in Telecom Notice of Consultation 2017-92 regarding the manner in which the local service subsidy regime should be phased out or the definition of reliable broadband Internet access service. The Commission's analysis of the evidence in this proceeding demonstrates that implementation of the Commission's preliminary view would be very difficult and complex.

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<sup>10</sup> In Telecom Regulatory Policy 2016-496, the Commission stated its intention to launch a proceeding to examine the price cap and local forbearance regimes following its review of the local service subsidy regime. That proceeding was initiated by Telecom Notice of Consultation 2018-214, issued today.

44. For example, ILECs used different methods and assumptions to calculate the number of NAS that have access to what they considered to be reliable broadband Internet access service. As well, since ILECs are upgrading their networks, and consequently the broadband Internet access services they offer, an approach to remove the local service subsidy based on the Commission's preliminary view would require the implementation of a system to monitor and report on whether any additional NAS no longer qualify for the local service subsidy.
45. The Commission considers that such a system would constitute a considerable burden, especially for smaller ILECs, and would be contrary to subparagraph 1(a)(ii) of the Policy Direction,<sup>11</sup> which requires the Commission to use regulatory measures that are efficient and proportionate to their purpose. The Commission also considers that while its proposed approach would likely reduce the amount of subsidy provided to ILECs, it would likely not eliminate the subsidy in a timely manner.
46. In light of the above, the Commission finds that the use of the preliminary view set out in Telecom Notice of Consultation 2017-92 is not appropriate for the elimination of the local service subsidy.
47. Regarding the proposal to allow subsidy to phase out organically, the Commission estimates that it would take at least 10 years, if not longer, for the local service subsidy to be completely eliminated organically for some ILECs. The elimination of the local service subsidy over the first five years of the broadband fund would also result in a long phase-out period. Since contributions to the NCF will be used to distribute Commission funds, including the broadband fund, a long phase-out period for the local service subsidy would have a significant financial impact on contributors to the NCF. Accordingly, the Commission considers that a shorter time frame for the phase-out of the local service subsidy regime would be appropriate.
48. To ensure that the phase-out of the local service subsidy is done fairly and efficiently, a clear and straightforward implementation plan is required. In establishing such an implementation plan, the Commission considered many factors. For example, the phase-out of the local service subsidy should start on a date that would give sufficient notice to the ILECs and enable them to adjust their financial plans if required. The local service subsidy should then be gradually reduced over a reasonable period of time and end by a defined date (i.e. a transition period) to provide certainty to both NCF contributors and subsidy recipients. In addition, the implementation plan should minimize the administrative burden during the transition period to the greatest extent possible for all stakeholders, including the Central Fund Administrator (CFA).

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<sup>11</sup> *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

49. Accordingly, based on the record of this proceeding, the Commission considers that a three-year transition period, starting on 1 January 2019, would satisfy all the above factors and be a reasonable amount of time to phase out the local service subsidy.
50. In light of the above, the Commission determines that the phase-out of the local service subsidy will occur over three years, from 1 January 2019 to 31 December 2021.
51. Regarding how the subsidy should be phased out, the Commission considers that starting with the total amount of subsidy paid during 2018 and reducing this amount as of 1 January 2019 at regular intervals during the transition period would simplify the phase-out process. The Commission also considers that semi-annual reductions during the transition period would provide the best balance between reducing subsidy gradually and minimizing the administrative burden for all stakeholders. Through this method, the ILECs would (i) no longer have to file monthly NAS reports or an annual NAS audit or affidavit with the CFA, which would reduce their administrative burden, and (ii) be provided with certainty regarding the amount of subsidy they would receive each month during the three-year transition period.
52. Accordingly, the Commission determines that the final subsidy amounts for 2018 paid to each ILEC will be used to calculate the amounts of subsidy to be paid monthly during the transition period from 2019 to 2021, and that subsidy will be reduced by equal amounts semi-annually over the transition period. The Commission will instruct the CFA on how to implement these determinations in its 2018 revenue-percent charge decision.

## **Other subsidy-related policies**

### **Northwestel's service improvement plan (SIP)**

#### **Background**

53. In Decision 2000-746, the Commission approved a SIP for Northwestel to extend and improve the telecommunications network in the North. The Commission also approved supplemental funding from the NCF for Northwestel for 2001, and determined that it would conduct annual financial reviews to establish an appropriate level of funding for the company.
54. In Telecom Decision 2007-5, the Commission changed its methodology for calculating subsidy from the NCF for Northwestel. The Commission defined HCSAs in Northwestel's territory and began to provide subsidy from the NCF on a per-residential-NAS basis (similar to the large ILECs). The Commission also determined that Northwestel should continue to receive subsidy from the NCF for a portion of its SIP.<sup>12</sup>

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<sup>12</sup> To determine the amount of subsidy, the Commission used an 18-year study period, based on the useful life of the assets to be subsidized.

### **Positions of parties**

55. Northwestel stated that the SIP was designed to compensate the company for investments made between 2001 and 2005, and that the Commission had approved the cost recovery model over an 18-year period ending on 31 December 2020. As such, Northwestel proposed that it continue to receive subsidy from the NCF until the end of 2020 in order to be fully compensated for its SIP-related investments.
56. Most parties agreed that funding should continue to be provided under Northwestel's SIP until it expires. However, SSI submitted that the Commission should phase out the subsidy from Northwestel's SIP as quickly as possible.

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

57. The Commission considers that Northwestel's proposal is reasonable and that it would allow for the phase-out of this subsidy to take place during the transition period for phasing out the local service subsidy. Accordingly, the Commission determines that funding from the NCF to Northwestel for its SIP will continue and will cease on 31 December 2020.

### **Subsidy policies for small ILECs**

#### **Background**

58. In Telecom Regulatory Policy 2011-291, the Commission made two determinations to mitigate the potential financial impact of wireless number portability (WNP) and local competition on the small ILECs:
  - During the first three years following the implementation of local competition or WNP, whichever comes first, the small ILECs are to receive full subsidies for all the NAS they serve in their regulated HCSAs, plus 50% of the subsidy for each of the residential NAS they no longer serve (known as lost NAS subsidy). These subsidies are to be calculated monthly, and after the three-year period, subsidies are to continue to be paid only for the number of residential NAS the small ILECs serve.
  - Following the implementation of local competition or WNP in an exchange, the small ILECs are entitled to recover up to \$2 per NAS per month from the NCF for the ongoing costs of local competition or WNP.

### **Positions of parties**

59. The ITPA submitted that these subsidies are important transition tools that should remain available to the small ILECs.
60. TCI submitted that the lost NAS subsidy should be applied to the large ILECs because they are also losing customers in HCSAs. If not, the subsidy should be eliminated.

61. Eastlink et al. and NPF-PIAC submitted that special circumstances apply to the small ILECs and that the Commission should retain the policies that were implemented because of those circumstances. Eastlink et al. submitted that the lost NAS subsidy should continue because the reasons for the policy being implemented still exist. NPF-PIAC supported retaining the lost NAS subsidy or, alternatively, phasing it out over three to five years.

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

##### ***Lost NAS subsidy***

62. The small ILECs were moved from a subsidy based on fixed annual amounts to one based on the number of actual NAS served each month effective January 2012. The Commission implemented the lost NAS subsidy to give the small ILECs time to adjust to this change.
63. The Commission considers that the small ILECs have had sufficient time to adjust to receiving monthly subsidy based on the number of actual NAS served. Accordingly, the Commission determines that effective the date of this decision, it will no longer accept new applications for lost NAS subsidy.

##### ***Ongoing costs of local competition or WNP***

64. The Commission considers that the small ILECs have had a number of years to prepare for the possible introduction of local competition and WNP. In addition, the Commission considers that the removal of subsidy for the ongoing costs of local competition or WNP would likely not have a large impact on the small ILECs' revenues. Therefore, the Commission determines that effective the date of this decision, it will no longer accept new applications for the recovery of ongoing costs from the local service subsidy regime associated with local competition or WNP.

#### **Regulatory framework to be applied when large ILECs purchase small ILECs**

##### **Background**

65. As stated earlier, some small ILECs receive more subsidy on a per-NAS basis than the large ILECs. Recently, DMTS and KMTS, both formerly small ILECs, became divisions of Bell Canada and are no longer separate legal entities.
66. There is currently no Commission decision regarding how a former small ILEC that becomes a division of a large ILEC should be treated for subsidy purposes.

##### **Positions of parties**

67. CNOC, NPF-PIAC, RCCI, Shaw, SSi, TCI, and l'Union all submitted that the large ILEC regime should apply to a small ILEC that is purchased by a large ILEC.

68. Bell Canada et al., on the other hand, submitted that they were unaware of any regulation requiring a small ILEC to be a separate legal entity to receive subsidy. They argued that the small ILEC subsidy should continue after a small ILEC is purchased by a large ILEC for reasons such as the following: (i) legal structure does not affect costs and efficiencies, but rather geographic territory, which does not change with the purchase; (ii) different operating territories have different costs (e.g. provincial/band costs vary); and (iii) the costs of serving customers in the small ILECs' operating territories remain high, and subsidy would be considered in a large ILEC's decision to acquire a small ILEC.

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

69. The Commission applies its regulations to companies and not divisions of companies. As such, the Commission considers that the special considerations given in various decisions to small ILECs as stand-alone companies should not apply to small ILECs that are purchased by and integrated into a large ILEC. The Commission therefore determines that when a small ILEC is purchased by and integrated into a large ILEC, the corresponding NAS in the former small ILEC's territory should be subject to subsidy using the large ILEC subsidy regime, including band structure and costing rules.
70. Since DMTS and KMTS were originally purchased by Bell Aliant Regional Communications, Limited Partnership (Bell Aliant), which was subsequently purchased by Bell Canada, the DMTS and KMTS residential NAS in HCSAs should be considered part of Bell Canada – Ontario and Quebec (formerly Bell Aliant) for subsidy calculation and reporting purposes. Since the subsidy rates are currently interim, these subsidy reporting changes should take effect retroactively as of 1 January 2018.
71. Accordingly, the Commission **directs** Bell Canada to file 2018 subsidy reporting changes with the CFA, retroactive to 1 January 2018, within **60 days** of the date of this decision to reflect DMTS and KMTS as part of Bell Canada.

#### **Potential compensation for the elimination of the local service subsidy**

##### **Positions of parties**

72. Eastlink et al., the ITPA, SaskTel, and TCI argued that the Commission does not have the jurisdiction to eliminate the local service subsidy without providing compensation for the resulting revenue loss, based primarily on the concept of the "regulatory compact."
73. These parties argued that in HCSAs where the Commission requires the ILECs to provide service through the obligation to serve, while also imposing a price cap on the amount that can be charged to customers, the elimination of subsidy without compensation would contravene the regulatory compact because it would result in rates for local services that are not just and reasonable. Certain ILECs, such as the

ITPA and SaskTel, argued that removing the local service subsidy without compensation would have a significant impact on some ILECs' financial and investment plans.

74. As such, Eastlink et al., the ITPA, SaskTel, and TCI argued that some form of compensation to offset the loss of subsidy would be required. Such compensation could include the ability to raise rates, the option to provide service using less expensive technology, or the elimination of the obligation to serve.
75. CNOC, NPF-PIAC, and RCCI supported the elimination of the local service subsidy and argued that no additional compensation would be required. RCCI and Videotron argued that multiple services delivered over the same infrastructure provide opportunities for cost savings that were not reflected in cost studies conducted over 15 years ago. RCCI added that ILECs have enjoyed an operational subsidy long enough, and given that capital investments are no longer required to bring local service to HCSAs, there are few costs associated with providing local service. RCCI stated that the era of regulatory frameworks with guaranteed rates of return for the ILECs ended 20 years ago with their monopoly of local service.
76. Bell Canada et al. submitted that the costing method used to establish the subsidy amounts for large ILECs is outdated since it was developed over 15 years ago and is no longer consistent with Commission decisions issued in recent years. Consequently, the costs upon which the current subsidies are based for the large ILECs are inaccurate and overstated, resulting in subsidy amounts that are also overstated.
77. Given the above, Bell Canada et al. submitted that ILECs should not be given the flexibility to implement rate increases that entirely make up for the subsidy loss. Instead, they argued that ILECs should be permitted to mitigate the impact of the lost subsidy with small but reasonable rate increases to residential primary exchange service. In addition, Bell Canada et al. submitted that the Commission should forbear from regulation in exchanges where subsidy is removed due to the availability of reliable broadband Internet access service.
78. With respect to the proposal to eliminate the obligation to serve as a form of compensation, NPF-PIAC noted that this would be outside the Commission's jurisdiction since the obligation rests not only in Commission legislation, but also in common law and, in the case of Bell Canada, the *Bell Canada Act*. CNOC and NPF-PIAC submitted that ILECs have the power to ensure that the operation of the wireline network is profitable overall, even with the obligation to serve and price regulation.

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

79. The regulatory compact is a fundamental principle governing the relationship of public utility service providers and regulators in Canada. It provides that in exchange for serving all customers at reasonable rates and without undue discrimination, a

public utility service provider is entitled to a fair rate of return on its investment. This concept was given statutory force through subsections 27(1) and (2) of the Act, and forms the basis of the Commission's rate-setting authority.

80. Under the Act's predecessor legislation, the *Railway Act*, the Commission's rate-setting decisions were limited to balancing the carriers' interests in a fair rate of return with the customers' interests in fair prices. However, the enactment of the Act, specifically sections 7 and 47, and subsection 27(5), extend the scope of the considerations relevant to the Commission's rate-setting analysis beyond its rate base rate of return analysis conducted under the powers of the *Railway Act*.
81. Section 7 of the Act sets out the telecommunications policy objectives. Section 47 directs the Commission to exercise its statutory powers and perform its duties, including its rate-setting authority, with a view to implementing those objectives. Subsection 27(5) permits the Commission to determine just and reasonable rates using any method or technique that it considers appropriate. Combined, these provisions require the Commission to balance a broad range of interests and objectives when determining just and reasonable rates. In addition to balancing the carriers' interests in a fair rate of return and the customers' interests in fair prices, the Commission must consider the policy objectives set out in the Act, the interests of competitors, the public interest, and the needs of the telecommunications system as a whole.
82. Subsection 46.5(1) of the Act provides that the Commission may create a fund to support continuing access by Canadians to basic telecommunications services, but the Commission is not required to do so. In making the determination to eliminate the local service subsidy, as set out in Telecom Regulatory Policy 2016-496, the Commission is acting directly within this jurisdiction. It is not exercising its rate-setting powers, nor is it making determinations on just and reasonable rates. Since the decision to provide subsidy for local voice services is discretionary, the elimination of that subsidy does not result in any direct right to compensation.
83. However, the question that flows from the elimination of the local service subsidy is whether other adjustments are required to the Commission's regulatory frameworks to ensure that all the requirements of the Act, including the requirement for just and reasonable rates, continue to be met.
84. The Commission considers that the record of this proceeding has not established that the elimination of subsidy will result in rates that are not just and reasonable, such that some form of compensation is required at this time. While some ILECs argued that the removal of subsidy would have significant financial consequences, they did not provide sufficient financial data to support the need for compensation for the loss of the local service subsidy in HCSAs to maintain just and reasonable rates.
85. Furthermore, several parties made persuasive submissions that the method used to determine the subsidy amounts and the associated costs is likely out of date, as are the costs estimated for the local loop used to provide local voice services in HCSAs.

The record of this proceeding shows that ILECs are now earning, or have the potential to earn, additional revenues from other services (e.g. broadband Internet access services) that use the same local loop for which ILECs are receiving local voice subsidy on a per-line basis. These services were not available at the inception of the local service subsidy and, all things being equal, due to the revenues they generate, subsidy amounts are likely overstated.

86. While the record of this proceeding does not support the position that compensation to offset the elimination of subsidy is required at this time, ILECs will have the opportunity, in the context of Telecom Notice of Consultation 2018-214, issued today, to present evidence to demonstrate the need for some form of compensation.

### **Policy Direction**

87. 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) and (b) of the Policy Direction. The determinations made in this decision are consistent with the Policy Direction.
88. In accordance with subparagraphs 1(a)(i) and (ii) of the Policy Direction, the Commission considers that the determinations made in this decision (i) foster reliance on market forces to the maximum extent feasible, and (ii) are efficient and proportionate to their purpose and interfere with the operation of competitive market forces to the minimum extent necessary. For instance, the direction to the ILECs to apply for forbearance from regulation with respect to the 42 HCSA exchanges listed in the Appendix supports reliance on market forces.
89. In compliance with subparagraph 1(b)(i) of the Policy Direction, the policy objectives listed in paragraphs 7(a), (b), (c), (f), and (h) of the Act are advanced by the determinations in this decision.

Secretary General

### **Related documents**

- *Review of the competitor quality of service regime*, Telecom Regulatory Policy CRTC 2018-123, 13 April 2018
- *Phase-out of the local service subsidy regime*, Telecom Notice of Consultation CRTC 2017-92, 6 April 2017; as amended by Telecom Notice of Consultation CRTC 2017-92-1, 16 May 2017
- *Modern telecommunications services – The path forward for Canada’s digital economy*, Telecom Regulatory Policy CRTC 2016-496, 21 December 2016

- *Obligation to serve and other matters*, Telecom Regulatory Policy CRTC 2011-291, 3 May 2011; as amended by Telecom Regulatory Policy CRTC 2011-291-1, 12 May 2011
- *Framework for forbearance from regulation of retail local exchange services in the serving territories of the small incumbent local exchange carriers*, Telecom Regulatory Policy CRTC 2009-379, 23 June 2009
- *The Canadian revenue-based contribution regime*, Telecom Circular CRTC 2007-15, 8 June 2007
- *Price cap regulation for Northwestel Inc.*, Telecom Decision CRTC 2007-5, 2 February 2007
- *Forbearance from the regulation of retail local exchange services*, Telecom Decision CRTC 2006-15, 6 April 2006; as amended by Order in Council P.C. 2007-532, 4 April 2007
- *Regulatory framework for the small incumbent telephone companies*, Decision CRTC 2001-756, 14 December 2001
- *Restructured bands, revised loop rates and related issues*, Decision CRTC 2001-238, 27 April 2001; as amended by Decisions CRTC 2001-238-1, 28 May 2001; and 2001-238-2, 7 August 2001
- *Long-distance competition and improved service for Northwestel customers*, Decision CRTC 2000-746, 30 November 2000
- *Changes to the contribution regime*, Decision CRTC 2000-745, 30 November 2000

## Appendix to Telecom Regulatory Policy CRTC 2018-213

### Exchanges eligible for forbearance for HCSA residential local exchange services

ILEC	Province	Band	Eligible exchanges
Bell Canada	NL	E	Arnold's Cove Baie Verte Bellevue Birchy Bay Boyd's Cove Catalina Centreville Chance Cove Chapel Arm Charlottetown (Bonavista Bay) Clarke's Head Come By Chance Comfort Cove – Newstead Eastport Gambo Glenwood Glovertown Hare Bay Hickman's Harbour Hillgrade Horwood King's Cove Ladle Cove Moreton's Harbour Musgravetown Newman's Cove Plate Cove Pouch Cove Robert's Arm South Brook Summerford Triton Upper Island Cove
		F	Harbour Main
Télébec, Limited Partnership	QC	E	Ste-Angèle-de-Laval
		G	Cap-aux-Meules Grande-Entrée Havre-Aubert Havre-aux-Maisons
NorthernTel, Limited Partnership	ON	E	Opasatika
		F3	Kirkland Lake
Sogetel inc.	QC	E	Warwick