



Telecom Decision CRTC 2011-562

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Ottawa, 1 September 2011

MTS Allstream Inc. – Impact of the Harmonized Sales Tax on wholesale service rates in British Columbia and Ontario

File number: 8661-M59-201015868

In this decision, the Commission denies MTS Allstream's application to revise all wholesale service rates in British Columbia and Ontario to reflect the reduction in the costs of providing these services due to the implementation of the Harmonized Sales Tax in those provinces.

Introduction

1. The Commission received an application by MTS Allstream Inc. (MTS Allstream), dated 22 October 2010, in which the company requested that the rates for all wholesale services offered by the incumbent local exchange carriers (ILECs) in British Columbia and Ontario¹ be reduced to account for the implementation of the Harmonized Sales Tax (HST) in those provinces. MTS Allstream proposed a process for such a rate adjustment and further requested that current rates for all wholesale services be made interim so that any rate adjustment approved by the Commission could be made effective on the date of interim approval.
2. MTS Allstream submitted that the implementation of the HST in British Columbia and Ontario, which took effect on 1 July 2010 in both provinces, resulted in a material reduction in the ILECs' costs of providing wholesale services in those provinces. MTS Allstream also submitted that the HST is a refundable business expense, whereas the Provincial Sales Tax (PST) was not, and that the ILECs are therefore now saving the PST that was previously payable on the equipment, material, and supplies required to provide wholesale services in those provinces. MTS Allstream estimated that the implementation of the HST has reduced the costs of providing wholesale services by 3.5 to 5.75 percent in British Columbia and by 4 to 6 percent in Ontario.
3. The Commission received comments from Bell Aliant Regional Communications, Limited Partnership and Bell Canada (collectively, the Bell companies) and from TELUS Communications Company (TCC). The public record of this proceeding,

¹ MTS Allstream identified Bell Aliant Regional Communications, Limited Partnership; Bell Canada; CityWest Telephone Corporation; the members of the Ontario Telecommunications Association; TBayTel; and TELUS Communications Company as respondents to its application.

which closed on 5 May 2011, is available on the Commission's website at www.crtc.gc.ca under "Public Proceedings" or by using the file number provided above.

4. The Commission has identified the following issues to be addressed in this decision:
 - I. Should the implementation of the HST in British Columbia and Ontario be considered a price cap exogenous factor?
 - II. Will the annual price cap rate adjustment process address the possible effects of the HST?
 - III. Should the Commission adjust wholesale service rates using MTS Allstream's proposed process?

I. Should the implementation of the HST in British Columbia and Ontario be considered a price cap exogenous factor?

5. MTS Allstream submitted that the implementation of the HST can be viewed as a price cap exogenous factor because (i) it is beyond the control of the affected ILECs, (ii) it has a material impact that is not otherwise accounted for under the existing price cap framework, and (iii) it has a unique impact on wholesale services since rates for these services are determined by the Phase II costs plus an approved markup. Under the price cap framework, ILECs are required to reflect the effect of an exogenous factor in the rates for services subject to price caps.
6. The Bell companies and TCC submitted that, since the implementation of the HST is not specific to the telecommunications industry, it cannot be characterized as a price cap exogenous factor.

Commission's analysis and determinations

7. The Commission notes that, as set out in *Price cap framework for large incumbent local exchange carriers*, Telecom Decision CRTC 2007-27, 30 April 2007 (Telecom Decision 2007-27), the criteria that an event must meet in order to qualify as a price cap exogenous factor are as follows:
 - it is a legislative, judicial, or administrative action which is beyond the control of the company;
 - it is addressed specifically to the telecommunications industry; and
 - it has a material impact on the company.
8. Based on these criteria, the Commission considers that the implementation of the HST in British Columbia and Ontario is not a price cap exogenous factor because this event is not addressed specifically to the telecommunications industry.

II. Will the annual price cap rate adjustment process address the possible effects of the HST?

9. MTS Allstream submitted that the annual price cap rate adjustment process will not ensure that the cost changes attributable to the HST are reflected in the rates for wholesale services. The company argued that only some wholesale services are subject to this adjustment, and that since the overall effect of the adjustment depends on the relative size of the productivity and inflation factors used, the rates for those services would not necessarily decrease.
10. TCC submitted that the annual price cap rate adjustment process provides a substantial benefit to wholesale service users. The Bell companies submitted that this process will capture the cost changes caused by the implementation of the HST and that no further adjustment to wholesale service rates is required.

Commission's analysis and determinations

11. The Commission notes that through the price cap rate adjustment process, which is applied annually to wholesale services, the rates for the affected services change in accordance with both a productivity factor, as determined in Telecom Decision 2007-27, and an inflation factor that is calculated based on economy-wide price changes that were actually realized in the previous year. The productivity factor tends to reduce rates, but the size of the factor is not dependent on tax changes such as the implementation of the HST. The inflation factor is based on changes to all prices in the Canadian economy, and it works to decrease or increase rates in any year depending on what has occurred in the previous year. The Commission considers that, because the implementation of the HST is specific to two provinces and reduces costs only for the business sector, it will have little or no effect on the price index used in the price cap rate adjustment process.
12. Accordingly, the Commission considers that the annual price cap rate adjustment process will not incorporate the impact of the implementation of the HST on ILECs' costs.

III. Should the Commission adjust wholesale service rates using MTS Allstream's proposed process?

13. MTS Allstream proposed that, for wholesale services for which a cost study has been filed, the Commission estimate the amount by which costs have been reduced due to the implementation of the HST and direct each ILEC to revise the associated rates accordingly. MTS Allstream also proposed that, for wholesale services for which no cost study has been filed, the Commission direct each ILEC to revise the associated rates based on the average changes applied to the rates for wholesale services with an available cost study.

14. According to MTS Allstream, because wholesale services are not subject to market forces, its proposal is consistent with the Policy Direction.²
15. The Bell companies and TCC submitted that MTS Allstream's proposed process is fundamentally flawed, for many reasons. These parties argued that the cost savings due to the implementation of the HST would vary significantly between wholesale services because the proportion of cost inputs previously subject to the PST varied between these services. They further argued that the impact of the HST on wholesale service costs could only be determined by soliciting information from the ILECs that had performed the supporting cost studies, since the cost studies that were filed did not provide the information necessary to calculate that impact.
16. The Bell companies and TCC further submitted that adjusting wholesale service rates based solely on the implementation of the HST would not be appropriate because, for most wholesale services, other cost elements have also changed since the rates were last reviewed. These companies stated that MTS Allstream's proposed rate adjustment process ignores complex costing issues that must be taken into account and that these issues can only be properly addressed through a full cost review for every affected service.³

Commission's analysis and determinations

17. The Commission considers that, for each wholesale service, the cost savings resulting from the implementation of the HST depend on the extent to which the service's cost inputs were previously subject to the PST, and that the cost savings will therefore be different for each service.⁴ The Commission also considers that the amount by which a wholesale service's costs may change as a result of the implementation of the HST should not be considered in isolation from possible changes to other cost elements that are material to the provision of wholesale services.
18. The Commission is therefore of the view that MTS Allstream's proposed rate adjustment process would not ensure that the resulting rates are just and reasonable.⁵ The Commission notes that it typically reviews wholesale service rates in cases where the ILECs or competitors provide evidence that the current rates may not be just and reasonable. The Commission considers that this review process provides it with the opportunity to take into account all relevant factors to ensure that wholesale service rates are just and reasonable. The Commission further considers that this review process is the most efficient and effective means of considering the current circumstances under which wholesale services are provided.

² *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

³ The Bell companies and TCC noted that the cost studies they have filed for wholesale services since the implementation of the HST already reflect the impact of the tax change on wholesale service costs and that, therefore, the issues raised by MTS Allstream do not apply in these cases.

⁴ Based on the record of this proceeding, the Commission estimates that, in those cases in which there would be a cost reduction, the average reduction may range between two and five percent per year.

⁵ The Commission notes that the HST has been taken into account for changes to wholesale service rates approved since its implementation.

19. Accordingly, the Commission finds that MTS Allstream's proposed rate adjustment process is not appropriate. Given this conclusion, the Commission also finds that it is unnecessary to address MTS Allstream's request to make wholesale service rates interim.
20. In addition, the Commission finds that its approach to reviewing wholesale service rates is consistent with the Policy Direction's requirement that the Commission use regulatory measures that are efficient and proportionate to their purpose.

Conclusion

21. In light of all the above, the Commission **denies** MTS Allstream's application.

Secretary General