



Telecom Decision CRTC 2007-43

Ottawa, 14 June 2007

The Canadian Alliance of Publicly-Owned Telecommunications Systems – Part VII application regarding subsidy rates for tax-exempt companies

Reference: 8662-C30-200616956

In this Decision, the Commission denies a Part VII application by the Canadian Alliance of Publicly-Owned Telecommunications Systems in which it requested that the Commission review and vary certain subsidy rates for tax-exempt small incumbent local exchange carriers.

Introduction

1. The Commission received an application by the Canadian Alliance of Publicly-Owned Telecommunications Systems (CAPTS), dated 21 December 2006 and amended on 16 February 2007, pursuant to Part VII of the *CRTC Telecommunications Rules of Procedure*.
2. CAPTS requested that the Commission review and vary certain parts of *Regulatory framework for the small incumbent telephone companies*, Decision CRTC 2001-756, 14 December 2001 (Decision 2001-756) and *Revised regulatory framework for the small incumbent local exchange carriers*, Telecom Decision CRTC 2006-14, 29 March 2006 (Decision 2006-14) related to the subsidy rates per network access service (NAS) for tax-exempt small incumbent local exchange carriers (SILECs).
3. CAPTS submitted that the subsidy rates for tax-exempt SILECs should reflect a more equitable calculation of the effect of income tax costs on the subsidy calculation. It also submitted that there was substantial doubt regarding the correctness of Decision 2001-756, as confirmed by Decision 2006-14, with respect to the calculation of the subsidy rates applicable to tax-exempt SILECs. CAPTS requested that its proposed modifications to the subsidy rates per NAS be made effective retroactive to 1 January 2002, concurrent with the introduction of the new subsidy regime for SILECs, as established by Decision 2001-756.
4. On 1 February 2007, the Commission addressed an interrogatory to CAPTS that identified the detailed methodology used by the Commission to determine the subsidy rates for tax-exempt SILECs pursuant to Decision 2006-14. The Commission requested that CAPTS comment on this methodology and provide any updates to its 21 December 2006 application that might be required in light of the Commission's clarification.
5. On 16 February 2007, CAPTS filed its response to the Commission's interrogatory, including an amended version of its 21 December 2006 application. In its amended application, CAPTS adjusted the proposed subsidy rates in light of the further clarification provided by the Commission.
6. The Commission received no comments regarding CAPTS's application and interrogatory response.

Guidelines for review and vary applications

7. The Commission notes that its guidelines for review and vary applications made under section 62 of the *Telecommunications Act* (the Act) are set out in *Guidelines for review and vary applications*, Telecom Public Notice CRTC 98-6, 20 March 1998 (Public Notice 98-6). In that Public Notice, the Commission indicated that in order for the Commission to exercise its discretion pursuant to section 62 of the Act, applicants must demonstrate that there is substantial doubt as to the correctness of the original decision. The Commission also specified that review and vary applications should generally be filed within six months of the Commission's original decision.
8. The Commission notes that in this case, CAPTS's review and vary application was filed five years after Decision 2001-756 was issued, and eight and a half months after Decision 2006-14 was issued.
9. The Commission considers that although the review and vary application regarding Decision 2006-14 was slightly outside of the six-month period provided for in Public Notice 98-6, it is appropriate under the circumstances of this case for the Commission to consider it as such. In the Commission's view, CAPTS's delay in filing its application was reasonable in this instance since it arose due to efforts by the organization to obtain clarification from the Commission regarding the portion of Decision 2006-14 that CAPTS subsequently requested be reviewed and varied.
10. With respect to Decision 2001-756, the Commission considers that it is sufficiently interrelated with Decision 2006-14 to allow the application to review and vary both decisions to proceed.

Commission's analysis and determinations

11. The Commission considers that CAPTS's application raises the issue of whether there is substantial doubt regarding the correctness of Decisions 2001-756 and 2006-14 with respect to the calculation of the subsidy rates as they apply to tax-exempt SILECs.
12. CAPTS submitted that the Commission's methodology did not result in a fair and equitable calculation of the subsidy for tax-exempt SILECs relative to tax-paying SILECs. It contended that the subsidy calculation for tax-exempt SILECs resulted in a lower contribution to the recovery of the tax-exempt company's fixed common costs, even though it considered that these expenses would likely be the same as those of the tax-paying SILECs.
13. In support of its argument, CAPTS contended that the Commission had incorrectly calculated the effect of income tax costs on the tax-exempt subsidy calculation by failing to consider the fact that, in CAPTS's view, the absolute value of the 15 percent mark-up used to calculate the subsidy for tax-paying SILECs should also be used to calculate the subsidy for the tax-exempt SILECs.
14. In Decision 2001-756, the Commission considered that a Phase II estimate of residential primary exchange service (PES) costs for SILECs was required to determine their subsidy requirement. However, the Commission notes that in Decision 2001-756, it gave the SILECs

the option to file Phase II cost studies or to use Phase II proxy costs established in that Decision to determine their subsidy requirements. This second option eliminated the need for SILECs to perform detailed Phase II cost studies.

15. Following a review of the regulatory framework for the SILECs, the Commission issued Decision 2006-14, in which it reiterated that to determine an estimate of the Phase II residential PES costs for tax-exempt SILECs, it was necessary to remove the Phase II-based income tax impacts from the Phase II proxy costs it had established for the tax-paying SILECs. Accordingly, in Decision 2006-14 the Commission denied a request by CAPTS for an upward adjustment to the tax-exempt proxy costs set out in Decision 2001-756, on the basis that CAPTS's proposed accounting-based income tax cost adjustment would not provide an appropriate estimate of income tax costs that was consistent with the Phase II tax cost calculation.
16. The Commission notes CAPTS's argument that, in the calculation of the subsidy rates for the SILECs, the Commission had erred in assuming that the fixed common costs of tax-paying SILECs were higher than those of the tax-exempt SILECs.
17. In this respect, the fixed common costs for both tax-paying and tax-exempt SILECs include both capital and expense-related costs. The Commission notes that for the tax-paying SILECs, there is an income tax impact on fixed common capital costs that increases these costs, while there is no such income tax impact for tax-exempt SILECs. In addition, the Commission considers that while the tax-paying SILECs will incur additional expenses related to income tax activities, such as report preparation, filing, and auditing, the tax-exempt SILECs will not. Based on the foregoing analysis, the Commission considers that the fixed common costs for tax-paying SILECs are higher than those of tax-exempt SILECs, all other things being equal.
18. Further, the Commission notes that in the subsidy calculations, the level of contribution towards recovery of the fixed common costs of all ILECs, including the tax-exempt and tax-paying SILECs, is identical – that is, 15 percent of the associated Phase II residential PES costs.

Conclusion

19. In light of the foregoing, the Commission concludes that in the absence of Phase II cost studies filed by the SILECs, the Commission's calculation of the subsidy rates per NAS continues to be appropriate for each of the tax-exempt and tax-paying SILECs.
20. The Commission also concludes that CAPTS has not demonstrated that there is substantial doubt as to the correctness of Decisions 2001-756 and 2006-14. Accordingly, the Commission finds that CAPTS has not met the criteria set out in Public Notice 98-6 for review and variance of a Commission decision.
21. The Commission considers that the Governor in Council's Policy Direction¹ is not germane to this application. The Commission established the contribution regime to maintain affordable local telephone service in high-cost serving areas, because it considered that market forces

¹ *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, effective 14 December 2006.

were unlikely to provide such service due to the high costs associated with operating and maintaining telecommunications facilities in these areas. In this case, the applicant is not challenging the existence of the contribution regime, nor is the applicant proposing a change that would have the effect of increasing or decreasing the regulatory burden for any party.

22. The Commission therefore **denies** CAPTS's request to modify the subsidy rates per NAS for tax-exempt SILECs.

Secretary General

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