



## Telecom Decision CRTC 2011-733

PDF version

Ottawa, 28 November 2011

### **ACTQ/OTA/CityWest – Application to review and vary Telecom Regulatory Policy 2011-291 regarding determinations affecting small incumbent local exchange carriers**

File number: 8662-A5-201110270

*In this decision, the Commission denies a request by the ACTQ, the OTA, and CityWest to review and vary Telecom Regulatory Policy 2011-291 to modify aspects of the obligation to serve, the local service subsidy regime, and the local competition and wireless number portability frameworks established for the small incumbent local exchange carriers. The dissenting opinion of Commissioner Suzanne Lamarre is attached.*

#### **Introduction**

1. The Commission received an application by l'Association des Compagnies de Téléphone du Québec inc., the Ontario Telecommunications Association, and CityWest Telephone Corporation (collectively, ACTQ/OTA/CityWest), dated 14 July 2011, on behalf of 30 small incumbent local exchange carriers (small ILECs),<sup>1</sup> requesting that the Commission review and vary certain determinations in Telecom Regulatory Policy 2011-291.
2. In Telecom Regulatory Policy 2011-291, the Commission, among other things, rendered determinations with respect to the small ILECs' obligation to serve and the local service subsidy regime.<sup>2</sup> The Commission also rendered its determinations regarding the frameworks for local competition and wireless number portability (collectively, local competition) that apply in the small ILECs' territories. A key component of the Commission's determinations was its reaffirmation that local competition should be introduced in the territories of the small ILECs. The Commission, however, adopted special considerations for the small ILECs to mitigate any potential financial impacts of implementing local competition.

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<sup>1</sup> See the Appendix for the list of small ILECs represented by ACTQ/OTA/CityWest.

<sup>2</sup> The obligation to serve requires incumbent carriers to provide telephone service to existing customers, new customers requesting service where the incumbent carrier has facilities, and new customers requesting service beyond the limits of the incumbent carrier's facilities (the terms and conditions associated with such service extensions are set out in the incumbent carriers' respective General Tariffs). The local service subsidy regime is a regulatory mechanism designed to adequately compensate incumbent carriers for the provision of their residential services in high-cost areas where the Commission-approved rate charged for basic residential local service does not recover the associated costs of providing that service.

3. In their application, ACTQ/OTA/CityWest submitted that there is substantial doubt as to the correctness of Telecom Regulatory Policy 2011-291, and that the Commission erred in law and/or in fact in its determinations affecting the small ILECs. In general, ACTQ/OTA/CityWest argued that the special considerations adopted by the Commission were inappropriate, as they did not sufficiently mitigate the financial impact of introducing local competition.
4. Accordingly, ACTQ/OTA/CityWest proposed modifications to Telecom Regulatory Policy 2011-291. Specifically, they proposed that all small ILECs (a) not be subject to the imputation of higher residential primary exchange service (PES) rates for subsidy calculation purposes; (b) remain on a fixed subsidy mechanism rather than move to the per-network access service (NAS)<sup>3</sup> subsidy mechanism; (c) be reimbursed by competitors for all local competition implementation start-up costs; and (d) be able to recover all ongoing costs for local competition from the local service subsidy fund, in perpetuity.
5. The Commission received comments regarding ACTQ/OTA/City West's application from Bell Canada, Bragg Communications Inc., Cogeco Cable Inc., Rogers Communications Partnership, and TELUS Communications Company (collectively, the Interveners). The public record of this proceeding, which closed on 18 August 2011, is available on the Commission's website at [www.crtc.gc.ca](http://www.crtc.gc.ca) under "Public Proceedings" or by using the file number provided above.

## Issues

6. The Commission considers that the following issues must be addressed in this decision in order to determine whether there is substantial doubt as to the correctness of Telecom Regulatory Policy 2011-291:
  - I) Did the Commission err in law by failing to provide telecommunications carriers subject to an obligation to serve with fair and reasonable compensation?
  - II) Did the Commission err in fact by failing to take into account the small ILECs' operating cost environment when imposing the per-NAS subsidy mechanism?
  - III) Did the Commission err in fact and in law by adopting a 3,000 NAS threshold to determine whether a small ILEC should be responsible for its own local competition implementation start-up costs?
  - IV) Did the Commission err in fact and in law by adopting a mechanism for the recovery of the small ILECs' ongoing costs of local competition that may not permit full cost recovery?

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<sup>3</sup> NAS is the line that provides subscribers with access to the telephone network.

- V) Did the Commission err in fact by adopting special considerations for small ILECs that do not mitigate the adverse financial impact of implementing local competition?

**I) Did the Commission err in law by failing to provide telecommunications carriers subject to an obligation to serve with fair and reasonable compensation?**

7. In Telecom Regulatory Policy 2011-291, the Commission determined that the obligation to serve would be retained for both large and small ILECs (collectively referred to as ILECs) in all exchanges. In forborne exchanges, the obligation for ILECs to provide residential stand-alone PES,<sup>4</sup> subject to a revised price ceiling of \$30, was maintained.
8. In addition, the Commission implemented changes to the subsidy mechanism. Notably, the Commission determined that, for any ILEC that receives subsidy and that has monthly residential PES rates below \$30, those rates could be transitionally increased to the lesser of \$30 or the amount required to eliminate subsidy.<sup>5</sup> For subsidy calculation purposes, the Commission would impute the maximum allowable rate increases, regardless of whether the ILEC actually increased its rates, resulting in an overall reduction in subsidy for the ILEC.
9. ACTQ/OTA/CityWest submitted that implementing the determinations in Telecom Regulatory Policy 2011-291 would not provide their members a fair rate of return for their obligation to serve.
10. ACTQ/OTA/CityWest argued, for example, that small ILECs would not be able to raise residential PES rates to \$30 given the threat of competitive entry. As a result, small ILECs would be subject to a reduction in subsidy without being able to offset that loss through rate increases. According to ACTQ/OTA/CityWest, such losses would jeopardize their members' ability to meet their obligation to serve throughout their respective serving territories.
11. ACTQ/OTA/CityWest therefore proposed that small ILECs not be subject to the imputation of the target residential PES rate of \$30. ACTQ/OTA/CityWest proposed that small ILEC residential PES rates should remain at existing levels, and that no corresponding subsidy reduction should result.
12. The Interveners submitted that there was no regulatory principle or reason not to impute residential PES rates up to \$30 for small ILECs, as the same mechanism was imposed on all ILECs that receive subsidy.
13. The Interveners noted that small ILECs have the flexibility to increase their residential PES rates. They submitted that most small ILECs would be able to

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<sup>4</sup> Stand-alone PES refers to the situation where the customer subscribes only to PES and to no other telecommunications service.

<sup>5</sup> Increases would be phased in over a period of three years, in equal annual increments.

leverage such increases, as well as other revenue-generating sources (i.e. other services), to earn a fair rate of return. Consequently, the Interveners considered that no further special considerations should be adopted for the small ILECs.

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

14. The Commission notes that local service subsidy was established to maintain basic local residential service at an affordable rate in rural and remote areas (i.e. high-cost areas) where the cost of providing service exceeds that rate. ILECs are compensated for their obligation to serve regulated high-cost areas, in part, through this local service subsidy regime. The local service subsidy calculation includes a residential PES rate component, an associated cost component, and an implicit contribution component.<sup>6</sup>

#### ***Rate component***

15. The Commission notes that it established the \$30 target rate component for subsidy calculation purposes based on two principles: first, imputing the \$30 target rate component would not result in local residential rates going beyond just and reasonable levels; and second, the use of the \$30 target rate component would allow for a more equitable and more efficient distribution of subsidy, as one ILEC would not receive more or less subsidy than another simply because of rate differentials.
16. The Commission considers that the ACTQ/OTA/CityWest proposal to absolve small ILECs from the \$30 target rate component would be inconsistent with the second principle noted above, as it would result in an inequitable distribution of subsidy relative to large ILECs.
17. The Commission also considers that a small ILEC's ability to raise residential PES rates depends on its individual circumstances, but that it is not impractical for many small ILECs to raise rates in order to offset any reductions in subsidy resulting from the imputation of the \$30 target rate component. Accordingly, the Commission finds that its determinations affecting the rate component of the subsidy calculation remain reasonable.

#### ***Cost component***

18. The Commission notes that, since 2001, the residential PES cost components used to calculate subsidies for the small ILECs have been proxy amounts based on the costs of the large ILECs at that time. The Commission further notes that the large ILECs' costs have been adjusted over time. Notwithstanding these changes, the small ILECs have chosen to retain the 2001 proxy model.

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<sup>6</sup> The small ILECs' implicit contribution component was set at \$5 per residential NAS per month in Telecom Regulatory Policy 2011-291, the same as for the large ILECs. That determination was not included as part of this review and vary application.

19. The Commission notes that, if small ILECs consider that the costs used to calculate their subsidies are not reflective of costs associated with their obligation to serve, they have the opportunity to submit an application to revise their respective residential PES cost components, as noted in Telecom Regulatory Policy 2011-291. In this regard, the Commission also notes that, in Decision 2001-756, it indicated that the only way to capture the small ILECs' actual residential PES costs for subsidy calculation purposes was through the development of company-specific Phase II cost studies.
20. Accordingly, the Commission finds that no changes to the cost component of the subsidy calculation are warranted at this time. The small ILECs may file an application based on company-specific Phase II cost studies, or any other reasonable costing method, to demonstrate the requirement for an adjustment to the cost component of the subsidy calculation.

### ***Conclusion***

21. In light of the above, the Commission determines that telecommunications carriers subject to an obligation to serve are being fairly and reasonably compensated, and therefore that it did not err in law.

### **II) Did the Commission err in fact by failing to take into account the small ILECs' operating cost environment when imposing the per-NAS subsidy mechanism?**

22. Historically, small ILECs have received subsidy based on fixed annual subsidy amounts paid on a monthly basis. Since 2006, small ILECs have received this annual subsidy based on their respective NAS counts that existed in 2005. In Telecom Regulatory Policy 2011-291, however, the Commission considered that it would be appropriate for small ILEC subsidies to be both calculated and paid on a monthly basis based upon the number of residential NAS served. Accordingly, the Commission adopted a per-NAS subsidy mechanism for the small ILECs, similar to the mechanism used for large ILECs, effective 1 January 2012.
23. ACTQ/OTA/CityWest indicated that the Commission had inappropriately imposed the large ILEC subsidy mechanism onto the small ILECs. They argued that the small ILECs' costs are predominantly fixed, and therefore that the loss of any subsidy in relation to the loss of NAS, as would be the case pursuant to a per-NAS mechanism, is inappropriate.
24. As a result, ACTQ/OTA/CityWest proposed that the Commission maintain the fixed subsidy mechanism that existed prior to Telecom Regulatory Policy 2011-291.
25. The Interveners opposed ACTQ/OTA/City West's proposal to return to a fixed subsidy mechanism. Some of the Interveners argued that adopting a common per-NAS subsidy mechanism would create regulatory symmetry between large and small ILECs, particularly as there is no evidence to demonstrate that their respective operating cost environments differ substantially.

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

26. The Commission notes that, as far back as Decision 2001-756, it has continually indicated that the small ILECs should generally move to a subsidy mechanism that is essentially the same as that established for the large ILECs.
27. The Commission recognizes that all ILECs invest significantly in equipment and in technology and network infrastructure, which generates a significant amount of fixed costs for them. The Commission notes, however, that the small ILECs did not file any evidence to demonstrate that their cost structures are materially different from those of the large ILECs, which are subject to the per-NAS subsidy mechanism.
28. The Commission considers that an ILEC should only be subsidized for the NAS that it actually serves, as is the case with the per-NAS subsidy mechanism. In addition, the Commission considers that for all small ILECs, including those not facing local competition, it would be more appropriate to use up-to-date NAS counts rather than counts dating back six years, and that this would ensure a more effective distribution of local service subsidy.
29. Notwithstanding the above, the Commission recognized that small ILECs would likely require a transition period to adjust to the new per-NAS subsidy mechanism. Accordingly, the Commission established a three-year transition period for the implementation of the per-NAS subsidy mechanism for the small ILECs as part of Telecom Regulatory Policy 2011-291.<sup>7</sup>
30. In light of the above, the Commission determines that it did not err in fact given that it took into account the small ILECs' operating cost environment when imposing the per-NAS subsidy mechanism.

### **III) Did the Commission err in fact and in law by adopting a 3,000 NAS threshold to determine whether a small ILEC should be responsible for its own local competition implementation start-up costs?**

31. In Telecom Regulatory Policy 2011-291, the Commission considered that, since local competition implementation costs represent a disproportionate burden for very small ILECs, it would be appropriate to establish a threshold to determine whether a small ILEC should be subject to a special consideration for the recovery of local competition implementation start-up costs. Consequently, the Commission concluded that small ILECs serving 3,000 NAS or fewer would have their local competition implementation start-up costs reimbursed, over a period of three years, by the new entrant(s).

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<sup>7</sup> The Commission determined that during the first three years following the implementation of local competition in a given exchange, the small ILEC would receive full subsidy for all the residential NAS it serves in that exchange, as well as 50 percent of the subsidy for each of the residential NAS it no longer serves in the exchange (i.e. lost NAS). Once the three-year period is over, the small ILEC would only receive subsidy for the number of residential NAS it serves in the exchange.

32. ACTQ/OTA/CityWest submitted that the 3,000 NAS threshold unjustly discriminates against larger small ILECs, as they would pay local competition implementation start-up costs while smaller entities would not. ACTQ/OTA/CityWest also submitted that the 3,000 NAS threshold was established arbitrarily, and that small ILECs would not be able to recover the start-up costs from subscribers or to absorb the costs themselves. They therefore proposed that the threshold be eliminated and that the Commission require any new entrant(s) to pay the full amount of local competition implementation start-up costs, regardless of the size of the small ILEC, for a period of one year following the implementation of local competition.
33. The Interveners noted that ILECs and competitive local exchange carriers (CLECs) were previously responsible for their own local competition implementation costs. The Interveners generally submitted that the Commission had assigned a reasonable threshold to exempt the smaller, more vulnerable small ILECs from paying such costs. The Interveners therefore submitted that it would not be appropriate to adjust the 3,000 NAS threshold established by the Commission, indicating that requiring CLECs to bear additional start-up costs may delay or outright deter the introduction of local competition in small ILEC markets.

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

34. The Commission notes that it has previously established thresholds, based on operational size, to determine whether specific carriers should be subject to distinct regulatory treatment. For example, CLECs are not required to fulfill certain obligations if the number of subscribers they serve is lower than 10,000, and telecommunications service providers are only required to contribute to the local service subsidy fund if they generate \$10 million or more of Canadian telecommunications service revenue annually.<sup>8</sup>
35. The Commission notes that, during the proceeding that led to Telecom Regulatory Policy 2011-291, the concept of a NAS threshold was introduced in order to determine whether certain small ILECs should be subject to local competition.<sup>9</sup> Given its determination to continue to introduce local competition in all small ILEC territories, and in recognition of the challenges faced by the very small ILECs, the Commission adapted the threshold concept to determine who should pay local competition implementation start-up costs.
36. In determining the 3,000 NAS threshold, the Commission balanced various considerations, which were presented and collected during the course of the proceeding. These considerations included the size and scope of the small ILECs' operations, as well as the impact that start-up costs may have on subscriber rates. The Commission remains of the view that small ILECs with more than 3,000 NAS

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<sup>8</sup> Pursuant to Telecom Decision 2006-58 and Decision 2000-745, respectively

<sup>9</sup> At the time, most small ILECs argued that companies with fewer than 2,500 NAS should not be subject to local competition.

will be better able to manage local competition implementation start-up costs relative to those with fewer NAS.

37. In addition, the Commission notes that many CLECs have already incurred costs in order to compete in small ILEC exchanges. The Commission considers that requiring CLECs to also pay all local competition implementation start-up costs, as proposed by ACTQ/OTA/CityWest, would further delay, if not deter, the introduction of local competition in small ILEC territories.
38. For the above reasons, the Commission determines that it did not err in fact and in law by adopting a 3,000 NAS threshold to determine whether a small ILEC should be responsible for its own local competition implementation start-up costs.

**IV) Did the Commission err in fact and in law by adopting a mechanism for the recovery of the small ILECs' ongoing costs of local competition that may not permit full cost recovery?**

39. In Telecom Regulatory Policy 2011-291, the Commission considered it appropriate to assist small ILECs with respect to the recovery of the ongoing costs of local competition. Consequently, the Commission determined that small ILECs that incur such costs will be permitted to lower the residential PES rate component used in calculating their subsidy by up to \$2 per NAS per month, or by the approved amount of ongoing costs, whichever is less.
40. ACTQ/OTA/CityWest submitted that there are too many limitations associated with the Commission's ongoing cost recovery mechanism. Specifically, they took issue with the small ILECs' inability to recover ongoing costs once subsidy has been eliminated, the reduction of ongoing cost recovery due to its association with the per-NAS subsidy mechanism, and the cap on the recovery of ongoing costs of \$2 per NAS per month.
41. Consequently, ACTQ/OTA/CityWest proposed that all ongoing local competition costs be recovered from the subsidy fund, which should not be limited by any set amount, and that cost recovery continue regardless of the small ILEC's subsidy or competitive circumstances.
42. The Interveners submitted that it is inappropriate for small ILECs to fully recover the ongoing costs of local competition from the subsidy fund. In their view, the Commission reasonably accommodated small ILECs by allowing a limited recovery of ongoing local competition costs.

**Commission's analysis and determinations**

43. The Commission notes that, pursuant to Telecom Regulatory Policy 2011-291, the ongoing cost recovery mechanism for small ILECs applies even if the imputed rate increases have eliminated subsidy in their territories. The Commission also notes that a small ILEC would no longer have access to the ongoing cost recovery mechanism if the Commission approves an application for forbearance within a



small ILEC's exchange and if competitors within that exchange are capable of serving at least 75 percent of the residential NAS served by the small ILEC.

44. The Commission established the mechanism to recover ongoing local competition costs to attenuate the financial impact associated with introducing local competition. The Commission considers that allowing small ILECs access to the ongoing cost recovery mechanism beyond the thresholds set out in Telecom Regulatory Policy 2011-291 would likely create market distortions by conferring small ILECs an undue advantage in competitive markets relative to other service providers.
45. Accordingly, the Commission remains of the view that it would be appropriate for the small ILECs' mechanism for ongoing cost recovery to end once forbearance has been granted and the 75 percent competitor presence test has been achieved in a given small ILEC exchange. The Commission also remains of the view that the recovery of ongoing costs through the lowered subsidy rate component should not exceed an amount equivalent to \$2 per NAS per month.
46. In view of the above, the Commission determines that it did not err in fact and in law by adopting a mechanism for the recovery of the small ILECs' ongoing costs of local competition that may not permit full cost recovery.

**V) Did the Commission err in fact by adopting special considerations for small ILECs that do not mitigate the adverse financial impact of implementing local competition?**

47. ACTQ/OTA/CityWest argued that the special considerations adopted by the Commission do not sufficiently mitigate the negative financial impact of implementing local competition within their members' territories, thereby jeopardizing access to reliable basic phone service in small ILEC markets. They indicated that implementing the various modifications to Telecom Regulatory Policy 2011-291 proposed in their application would attenuate their more pressing concerns about the introduction of local competition.
48. For their part, the Interveners submitted that the Commission had made reasonable modifications to accommodate the small ILECs in Telecom Regulatory Policy 2011-291. In their view, consumers would continue to have access to reliable basic phone service once local competition was introduced in small ILEC markets.

**Commission's analysis and determinations**

49. The Commission considers that ACTQ/OTA/CityWest have not presented any new information with respect to the determinations in Telecom Regulatory Policy 2011-291 affecting the obligation to serve, the local service subsidy regime, and the local competition framework.
50. The Commission considers that the special considerations adopted for the small ILECs in Telecom Regulatory Policy 2011-291 should attenuate potential adverse financial impacts of implementing local competition, particularly in relation to the

regulatory frameworks that existed before that decision was issued and in contrast to the regulatory regime that applies to the large ILECs. The Commission also considers that, in increasingly competitive small ILEC markets, any additional special considerations may inappropriately distort the market.

51. The Commission considers that the introduction of local competition into small ILEC markets will provide benefits to consumers while maintaining reasonable access to reliable basic phone service. The Commission intends to monitor the availability of such services from both the small ILECs and the competitive providers entering their markets, to ensure that this objective continues to be met.
52. Accordingly, the Commission determines that it did not err in fact by adopting the special considerations for small ILECs set out in Telecom Regulatory Policy 2011-291 and that these special considerations will sufficiently mitigate any adverse financial impact of implementing local competition.

### **Conclusion**

53. In light of all the above, the Commission concludes that ACTQ/OTA/CityWest have not demonstrated that there is substantial doubt as to the correctness of Telecom Regulatory Policy 2011-291. Accordingly, the Commission **denies** ACTQ/OTA/City West's application.
54. The dissenting opinion of Commissioner Suzanne Lamarre is attached.

Secretary General

### **Related documents**

- *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
- *Canadian Cable Telecommunications Association – Part VII application regarding the application of some competitive local exchange carrier (CLEC) obligations to certain CLECs*, Telecom Decision CRTC 2006-58, 18 September 2006
- *Regulatory framework for the small incumbent telephone companies*, Decision CRTC 2001-756, 14 December 2001
- *Changes to the contribution regime*, Decision CRTC 2000-745, 30 November 2000

*Small ILECs represented by ACTQ/OTA/CityWest*

**ACTQ member companies**

CoopTel  
La Cie de Téléphone de Courcelles Inc.  
La Compagnie de Téléphone de Lambton Inc.  
La Compagnie de Téléphone de St-Victor  
La Compagnie de Téléphone Upton Inc.  
Le Téléphone de St-Ephrem inc.  
Sogetel inc.  
Téléphone Guèvremont inc.  
Téléphone Milot inc.

**OTA member companies**

Brooke Telecom Co-operative Ltd.  
Bruce Telecom  
Cochrane Telecom Services  
Dryden Municipal Telephone System  
Execulink Telecom Inc.  
Gosfield North Communications Co-operative Limited  
Hay Communications Co-operative Limited  
Huron Telecommunications Co-operative Limited  
Lansdowne Rural Telephone Co. Ltd.  
Mornington Communications Co-operative Limited  
Nexicom Telecommunications Inc.  
Nexicom Telephones Inc.  
North Frontenac Telephone Corporation Ltd.  
NRTC Communications  
Ontera  
Quadro Communications Co-operative Inc.  
Roxborough Telephone Company Limited  
Tuckersmith Communications Co-operative Limited  
Wightman Telecom Ltd.  
WTC Communications

**CityWest Telephone Corporation**

## **Dissenting opinion of Commissioner Suzanne Lamarre**

1. With this decision, the Commission is confirming its 3 May 2011 decision to adopt a threshold of 3,000 NAS to be used in determining whether a small ILEC should be responsible for recovering its own local competition implementation start-up costs. In the context of Telecom Regulatory Policy 2011-291, I expressed my dissenting opinion that this decision was an error. Neither the facts nor the applicable rules of law have since changed. Given this, I believe that the Commission did not take the opportunity presented by the review and vary application to correct its original error, which resulted not only from its improper evaluation of the evidence submitted but also from its failure to correctly apply all the relevant rules of law.
2. For the same reasons I outlined in Telecom Regulatory Policy 2011-291, I believe that the Commission is once again headed in the wrong direction.