



Telecom Regulatory Policy CRTC 2011-771

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Northwestel Inc. – Review of regulatory framework

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The Commission began a public proceeding in May 2011 to review several broad policy matters regarding the provision of telecommunications services in Canada's North. Given that Northwestel is the only provider of local telephone service in this region, the Commission regulates the rates, terms, and conditions under which it may offer this service. This regulatory regime is known as the price cap framework.

The objective of the proceeding was to review Northwestel's price cap regulatory framework, which is used to set prices for certain services, consider whether facilities-based local competition should be permitted in Northwestel's territory, and assess the amount of funding that Northwestel should receive for the provision of services in remote areas.

Regulatory framework

The Commission recognizes the importance of telecommunications services in the North and the investments needed to address northern residents' desire for a telecommunications network that offers parity with the rest of the country, supports Arctic sovereignty and national security, and provides opportunities for economic development. The Commission also recognizes that northern communities require innovative solutions for the provision of telecommunications services comparable to those available in the rest of the country and for applications to access services such as health care, education, government programs, public safety, and banking.

The Commission is concerned that Northwestel's shareholders have benefited from the price cap regulatory framework to a far greater extent than its customers. Since 2007, Northwestel has received over \$20 million in annual subsidy for the provision of service in remote communities and its annual income from operations has nearly doubled to \$69.3 million in 2010. Despite this, the company has failed to make the necessary investments in its network. Northwestel's infrastructure is aging and services comparable to those provided in the rest of Canada are unavailable in many remote communities. The Commission is also concerned that this situation has likely affected the quality, reliability, and choice of services available to customers, as evidenced by a number of outages in various communities and the lack of service options.

The Commission has decided that additional regulatory oversight is required, at least in the short term. This will allow for a holistic review of Northwestel's telecommunications services, including a plan to modernize its network infrastructure. Accordingly, the Commission is extending Northwestel's price cap regulatory framework, with some minor modifications, for the next two years while this review is ongoing. Finally, the Commission has denied Northwestel's proposed \$2 increase to residential and business local service rates.

Local competition

The Commission considers that Canadians who reside in the North should be able to enjoy the full benefits of competition. Accordingly, the Commission has decided to introduce local competition in Northwestel's territory to provide a choice of service providers and different service options. As a result of this decision, it is expected that residents in many parts of the North will have a choice of service provider beginning 1 May 2012.

It is important that customers who choose to change service providers are able to retain their telephone numbers (known as number portability). However, given the cost to upgrade Northwestel's network to provide number portability, especially in remote communities, the implementation of this feature will be a priority in the larger communities. Consequently, Northwestel is directed to provide number portability in Fort Nelson, Inuvik, Iqaluit, Whitehorse and Yellowknife within six months of a competitor's request to offer local service in these locations. The Commission expects that Northwestel will implement number portability in its other communities as it upgrades its network.

Subsidy

The Commission has decided that Northwestel will receive a subsidy of \$20.5 million in 2011. This subsidy is needed to support the provision of residential telephone service in remote communities, where the costs to provide service are greater than the revenues.

The Commission has denied Northwestel's request for additional subsidy to fund two service improvement plans and reduce the rate charged to competitors who provide long distance service in its territory.

Introduction

1. Northwestel Inc. (Northwestel) provides a wide range of telecommunications services (e.g. local, long distance, Internet, wireless) in Northern Canada serving the three territories (Yukon, Northwest Territories, and Nunavut) as well as parts of British Columbia and Alberta. Northwestel is the only provider of local telephone services in its serving territory and, as such, the rates for these services are regulated by the Commission. The rates for most other telecommunications services offered by Northwestel are not regulated.

2. Prior to 2007, Northwestel was regulated under a framework in which the company's financial forecasts were reviewed annually, on a total-company basis, to determine the amount of supplemental funding required from the National Contribution Fund (NCF) to achieve an approved rate of return.¹ As part of these reviews, the Commission performed an examination of all operations of the company, which included a review of its capital plan.
3. In Telecom Decision 2007-5, the Commission, among other things, established a price cap regulatory framework for Northwestel's regulated services. Price cap regulation generally places upward constraints on prices that a company can charge its customers. As this regulatory framework focused on prices of services as opposed to a specific rate of return earned by the company, the Commission no longer required that Northwestel file its capital plans, concluding that the information provided as part of the Commission's data collection activities would be sufficient to monitor the financial performance of the company.
4. At that time, the Commission stated that a price cap regime for Northwestel would ensure customer access to services at just and reasonable rates as well as encourage Northwestel to minimize costs and be more efficient and innovative in the provision of services.
5. In Telecom Decision 2007-5, the Commission also determined that facilities-based local competition would not be permitted in Northwestel's operating territory at that time due generally to the high cost of implementation and limited likelihood of competitive entry. However, resale of local exchange services was permitted.

The proceeding

6. In Telecom Notice of Consultation 2011-302, the Commission initiated a proceeding to review, among other things, whether
 - changes should be made to Northwestel's price cap regulatory framework;
 - facilities-based local competition should be permitted in Northwestel's operating territory; and
 - changes should be made to the calculation of the subsidies Northwestel receives from the NCF.
7. Parties that participated in the proceeding were Northwestel; the Government of the Northwest Territories (GNWT); the Government of Nunavut (GN); the Public Interest Advocacy Centre and the Consumers Association of Canada (PIAC/CAC); SSi Micro Ltd. (SSi); TELUS Communications Company (TCC); the Utilities Consumers' Group (UCG); and Yukon Government (YG). These parties participated

¹ Rate of return regulation involved the setting of rates to recover the cost of providing service plus a reasonable return on investment. Financial forecasts provided by the company were reviewed and approved by the Commission.

in a public hearing, which took place in Yellowknife, Northwest Territories in October 2011. The Commission also received over 100 comments from members of the public, including individuals, businesses, and communities.

8. The public record of this proceeding, which closed on 17 October 2011, is available on the Commission's website at www.crtc.gc.ca under "Public Proceedings" or by using the file number provided above.

Issues

9. The Commission has identified the following major issues to be addressed in this decision:
 - I. whether changes should be made to Northwestel's price cap regulatory framework;
 - II. whether facilities-based local competition should be permitted in Northwestel's operating territory, and, if so, under what conditions and time frames; and
 - III. whether changes should be made to Northwestel's subsidy.

I. Whether changes should be made to Northwestel's price cap regulatory framework

10. Under the price cap regime established in Telecom Decision 2007-5, Northwestel's regulated services are generally grouped into baskets that are subject to constraints at the overall basket level, the rate element level, or both. Northwestel's current basket structure is comprised of six baskets: Residential Services, Business Services, Services with Frozen Rate Treatment, Other Capped Services, Competitor Services, and Uncapped Services (see Appendix 1 of this decision for an overview of this regulatory framework).
11. As set out below, Northwestel proposed that certain rates and basket structures be modified in order to reflect changing market conditions in the North. Specifically, Northwestel proposed rate increases to residential and business primary exchange services (PES) at the start of the next price cap period. In addition, Northwestel proposed changes to the service basket constraints for the Residential Services and the Other Capped Services baskets. No changes were proposed to the assignment of services to the various baskets.
12. Northwestel proposed an increase of \$2.00 to residential individual-line service rates, effective 1 January 2012, after which it proposed that rates be frozen until 1 June 2014. Northwestel proposed that its rates for services in the Residential Services basket be permitted to increase by the inflation factor beginning 1 June 2014. Additionally, Northwestel submitted that it would be appropriate to set a five percent constraint on individual service rate elements within the Residential Services basket.

13. Northwestel also proposed an increase of \$2.00 to business individual-line and multi-line service rates, effective 1 January 2012. Northwestel submitted that, since its rates are currently lower than those of many southern providers, it did not believe that the \$2.00 rate increase would prevent new businesses from entering the North.² Northwestel would then continue to apply the current price cap constraints to the Business Services basket (i.e. an annual basket constraint of inflation and a rate element constraint of 10 percent) during the price cap period.
14. In order to offset declining revenues for legacy services, Northwestel proposed an annual pricing constraint of inflation for the Other Capped Services basket, with a rate element constraint of 10 percent.
15. Northwestel submitted that, as a result of these changes and the fact that Northwestel's price cap regulatory framework is relatively new compared to the large incumbent local exchange carriers (ILECs), four years would be appropriate for the next price cap period.
16. All other parties, except TCC, opposed Northwestel's proposal to increase residential and business service rates. Several parties also opposed certain specific aspects of Northwestel's proposed modifications to its price cap regulatory framework. As discussed further below, several parties questioned the effectiveness of Northwestel's price cap regulatory framework.
17. TCC submitted that Northwestel's price cap regulatory framework should be brought more in line with that of the large ILECs. TCC submitted that Northwestel's proposal continues to include concepts that exist in a rate of return environment, such as cross-subsidies. TCC further submitted that Northwestel should not be able to claim immunity from earnings regulation when it suits the interests of the company, but then benefit from rate of return regulation when the company wishes to upgrade some equipment or otherwise fund expenses and capital expenditures outside of the price cap constraints.
18. The GNWT submitted that Northwestel has enjoyed extremely healthy earnings since the onset of price cap regulation. The GNWT further submitted that, while companies are certainly entitled to benefit from good performance under a price cap regime, such performance should encourage expanded investments and allow for a lowering of service prices. The GNWT, YG, and PIAC/CAC submitted that Northwestel is seeking price increases for its regulated services without adequately increasing levels of investment in its network.
19. YG submitted that, consistent with industry-wide experience with price cap regulation, both capital investment and service quality performance go down as regulatory oversight is relaxed, at least until there is sufficient competitive pressure to inspire improvement. YG further submitted that it is fundamental to the very

² Northwestel proposed to offset most of these business rate increases with reductions to its teleconferencing service rates.

concept of price cap regulation that the regulated company assumes the risk for its own financial performance once rate of return regulation is left behind.

20. SSI submitted that a holistic view must put local competition, and the price cap regime itself, in the context of the North, noting that Northwestel operates on all fronts providing local voice, wireless, cable, television, Internet, long distance, private line, and other services.
21. The GNWT agreed with several concerns raised during the proceeding regarding shortcomings in Northwestel's service quality and investment planning. These concerns included poor quality of service results with respect to out-of-service trouble reports and repair appointments met, the overall rate of investment for regulated services, inadequate redundancy and network outages, and failure to provide capabilities such as enhanced calling features.
22. Northwestel submitted that it has taken steps to address the concerns with quality of service, and that in many cases the overall quality of service was only marginally below-standard. Further, it submitted that in many cases the missed indicators³ were for reasons entirely beyond its control, such as severe weather conditions, inability to access remote locations, or lack of onsite technicians.
23. As part of a comprehensive review of the provision of telecommunications services in the North, the GNWT recommended that the Commission include a process to review Northwestel's planned capital investments, service availability, and service quality initiatives with a view to ensuring that the company puts in place a comprehensive plan to address deficiencies in those areas subject to regulation. Many parties generally supported undertaking a comprehensive review of the model used for provisioning telecommunications services in the North.

Commission's analysis and determinations

Regulatory framework

24. The Commission's mandate includes the encouragement of investment and innovation necessary to address the needs of telecommunications customers in the North in a manner consistent with the policy objectives set out in section 7 of the *Telecommunications Act* (the Act). For example, in Telecom Regulatory Policy 2011-291, the Commission retained the obligation to serve and the basic service objective for all ILECs, including Northwestel, in regulated exchanges. The Commission also established target speeds of 5 megabits per second (Mbps) downstream and 1 Mbps upstream for broadband Internet access to all Canadians.

³ Northwestel is required to file quarterly reports with the Commission which provide monthly results for four quality of service indicators (e.g. out-of-service trouble reports, installation/repair appointments met) for each of the 96 communities in its territory. Each indicator has a service standard that the company is required to meet.

25. The Commission recognizes that telecommunications is essential to the North, in terms of providing opportunities for people residing in remote areas, supporting Arctic sovereignty and national security, developing resources, and ensuring access to services similar to those available in the South. The Commission also recognizes the requirements of northern communities for innovative solutions for the provision of telecommunications services comparable to those available in the rest of the country and for applications to access services such as health care, education, government programs, public safety, and banking.
26. The Commission is concerned with the quality and reliability of Northwestel's services given the submissions made in this proceeding and as evidenced by a number of outages in various communities. The Commission is also concerned that the quality of service reports filed during the current price cap period indicated that problems occurred consistently.⁴ The Commission considers that the age of Northwestel's equipment is likely affecting the quality and reliability of its services and is limiting the choice of telecommunications services available to customers, such as the availability of certain enhanced features.
27. Further, the Commission is concerned that Northwestel's shareholders have benefited from the price cap regulatory framework to a far greater extent than its customers. Since 2007, Northwestel has received over \$20 million in annual subsidy for the provision of service in remote communities and its annual income from operations has nearly doubled to \$69.3 million in 2010. Despite this, Northwestel has failed to make the necessary investments in its network as evidenced by the company's aging infrastructure and the unavailability of services in many remote communities comparable to those provided in the rest of Canada.
28. Based on the record on this proceeding, the Commission is concerned that Northwestel's price cap regulatory framework has not fulfilled the policy objectives of the Act, in particular those set out in paragraphs 7(b), (g), (h), and (i), with respect to the provision of services to its customers.⁵ For example, not all residents have access to call privacy features, which is inconsistent with the objective of protection and privacy of persons. In addition, the number of service outages and missed quality of service indicators is not consistent with the objective of providing reliable, high-quality services.
29. The Commission recognizes that telecommunications technology has advanced significantly in recent years, and that regulated and forborne services are

⁴ Northwestel failed to meet the required monthly standards across all indicators 29 times during the period 2007-2010. The trend for missed indicators persisted during the first six months of 2011.

⁵ The cited policy objectives of the Act are
7(b) to render reliable and affordable telecommunications services of high quality accessible to Canadians in both urban and rural areas in all regions of Canada;
7(g) to stimulate research and development in Canada in the field of telecommunications and to encourage innovation in the provision of telecommunications services;
7(h) to respond to the economic and social requirements of users of telecommunications services; and
7(i) to contribute to the protection of the privacy of persons.

increasingly using or accessing the same infrastructure. In the Commission's view, the price cap regulatory framework, which focuses only on regulated services, has failed to produce the expected benefits to northern customers as well as the investments in infrastructure required to deliver these benefits (e.g. choice, reliability, innovation) and meet the needs of northern customers. The Commission considers that it will not be possible to address its concerns with Northwestel's infrastructure and services without increasing its regulatory oversight, at least in the short term.

30. The Commission determines that it will undertake a holistic review of Northwestel's regulatory framework, and all of the company's telecommunications services, to ensure that the benefits of such a regime can be properly realized by subscribers. This review will include an examination of a modernization plan for Northwestel's network infrastructure, which is addressed in the next section of this decision.

Investment in network infrastructure

31. Northwestel indicated that there are many factors that it considers in making decisions regarding capital investments in its business (e.g. technology, non-functioning equipment, prospects for growth, and demand for new services). While there will always be many competing demands on the scarce capital available to any company, Northwestel submitted that its overall rate of corporate investment (capital intensity) compares very favourably to other major telecommunications service providers in Canada.
32. As stated earlier, the GNWT recommended a process to review Northwestel's planned capital investments with a view to ensuring that the company puts in place a comprehensive plan to address concerns raised during the proceeding.
33. YG submitted that it is clear from the submissions of various parties, including Northwestel, that investment in telecommunications infrastructure in the Far North is a critical need. YG also submitted that Northwestel has not been motivated by its current regulatory framework to invest beyond what is minimally necessary to maintain service. YG recommended that the Commission consider using additional means at its disposal to address the need for northern telecommunications infrastructure investment, and that a comprehensive investment strategy be developed involving input from northern stakeholders.
34. The GN submitted that investment strategies for northern communications networks must include provisions for the increasing rate of change of technology, and the continuous introduction of new consumer services and devices.
35. The UCG acknowledged the possibility that Northwestel has invested, and plans to invest, at an acceptable capital intensity level. However, the UCG was concerned with Northwestel's capital investment choices and suggested that it has invested mainly in non-regulated markets.

36. SSI submitted that Northwestel simply relies on the regulatory regime to support its business and does not proactively invest to improve service in the communities that need it.

Commission's analysis and determinations

37. The Commission considers that despite Northwestel's strong financial performance and overall capital spending which appears to have been in line with industry standards during the five years under price cap regulation, the company has yet to modernize its aging network infrastructure and generally only replaces equipment when maintenance costs become excessive.
38. The Commission notes that, in this proceeding, Northwestel provided a 15-year switch replacement rollout plan, which included the community affected, the estimated replacement year, and the amount of investment.⁶ However, the company provided little information as to how the switch replacements would be funded or financed. The Commission also notes that Northwestel generally depreciates its switching equipment over 12 years. The Commission is concerned that the majority of Northwestel's switches, which are already more than 15 years old and well beyond their estimated useful life, will not be replaced in a timely manner to meet customers' needs. In the Commission's view, this situation has resulted in certain services not being made available to all of Northwestel's customers and has contributed to the quality and reliability of service concerns previously noted in this decision.
39. As previously determined in this decision, additional regulatory oversight is required in the short term to allow for a more holistic review of Northwestel's regulatory framework. Consistent with that determination and in order to address its concerns with Northwestel's aging infrastructure, the Commission finds it appropriate to include an examination of Northwestel's network modernization plan as part of that review.
40. Accordingly, the Commission directs Northwestel to develop and file within six months of the date of this decision a comprehensive plan to modernize its network infrastructure. The plan is to address how Northwestel intends to update its infrastructure in a timely manner to ensure that northern customers receive telecommunications services, both regulated and forborne, comparable to those available to Southern Canada in terms of choice, quality, and reliability as well as how the company intends to fund or finance the costs to modernize its network.
41. The plan should include the amount of capital to be invested (by location/community, if applicable) and the purpose of the investment. This information is to be provided for the total company, and broken down between regulated and forborne services (e.g. local, long distance, Internet, and wireless). Further, the company is also to identify any of its non-telecommunications services

⁶ Filed in response to an undertaking at the public hearing.

(e.g. cable operations) that utilize its telecommunications infrastructure, as well as any contribution expected from these non-telecommunications services.

42. Upon receiving Northwestel's modernization plan, the Commission will initiate a process to provide parties the opportunity to comment on the plan.

Changes to price cap regime

43. As stated earlier in this decision, the price cap regulatory framework is designed to encourage Northwestel to minimize costs and be more efficient. In the Commission's view, approving Northwestel's proposed \$2.00 increase to residential and business service rates would be contrary to this principle as it would allow the company to recoup these efficiencies gained during the current price cap period directly from customers. Therefore, the Commission considers that it would not be appropriate to approve Northwestel's proposed \$2.00 increase to residential and business service rates and hereby **denies** these proposals.
44. Given that changes to Northwestel's price cap regulatory framework may result from the review set out above, the Commission considers that it would not be appropriate to make significant changes to the current price cap regulatory framework at this time. Accordingly, subject to two minor modifications discussed below, the Commission finds it appropriate to extend the current price cap regulatory framework for two years while the holistic review of Northwestel's regulatory framework, including a comprehensive modernization plan, is ongoing.
45. In light of the determination later in this decision to allow facilities-based local competition in Northwestel's territory, the Commission considers that it would be appropriate to provide Northwestel with more pricing flexibility for the services in the Other Capped Services basket. The Commission also considers that Northwestel's proposed rate element constraint of 10 percent for this basket will reasonably constrain the level of allowable rate increases and protect the interests of consumers. Therefore, the Commission **approves** an overall basket constraint of inflation for Other Capped Services, with a rate element constraint of 10 percent.
46. Northwestel also proposed that the most appropriate means of eliminating the time-limited exogenous adjustment of \$50,000⁷ would be to apply an adjustment to the Other Capped Services basket, effective 1 January 2012. The Commission determines that, as the \$50,000 time-limited exogenous adjustment was originally applied to the Business Services basket, Northwestel is required to adjust the service

⁷ When Northwestel's method of regulation was changed from rate of return to price cap, its rates at the start of the price cap period, 1 January 2007, were expected to generate \$300,000 less revenue annually than the amount approved by the Commission. In order to recover this amount, the Commission permitted the company to increase certain rates effective 1 July 2007. Since these rate increases were implemented six months after the start of the price cap regime, a \$150,000 shortfall had accumulated. This shortfall was amortized over three years (\$50,000 per year) starting 1 January 2008, and offset with corresponding increases to business services. This amortization expired at the end of the price cap regime (i.e. time-limited exogenous adjustment).

basket limit of the Business Services basket, effective 1 January 2012, to remove the impact of the time-limited exogenous adjustment.

47. Accordingly, the Commission determines that the current regulatory framework is extended for two years, effective 1 January 2012, with the minor modifications to the Business Services and Other Capped Services baskets specified above.

II. Whether facilities-based local competition should be permitted in Northwestel's operating territory, and, if so, under what conditions and time frames

48. Northwestel initially opposed the introduction of facilities-based local competition in its operating territory for various reasons, including the impact of lost revenues on its ability to provide service to remote communities and the high cost of implementation. The company subsequently revised its position, stating that it was not opposed to local competition provided that certain preconditions were met.
49. Northwestel submitted that competition should be introduced first in Iqaluit, Whitehorse and Yellowknife, proposing that an assessment be undertaken as to the feasibility of extending local competition to the remaining communities only after implementation is completed in the three major centres.
50. All other parties supported implementing facilities-based local competition throughout Northwestel's operating territory, generally noting that competition protects consumer interests and provides for consumer choice. SSi submitted that it is ready to compete in the local services market in many northern communities, given that it currently has facilities throughout Nunavut and the Northwest Territories.

Commission's analysis and determinations

51. The Commission determines that, in light of the parties' submissions in this proceeding as well as the benefits that would be provided to consumers, such as a greater choice and innovative services, it would be appropriate to implement facilities-based local competition throughout Northwestel's operating territory at this time.
52. The Commission expects Northwestel to generally follow the process established for implementing local competition in the large ILECs' territories. The issues specific to implementing facilities-based local competition in Northwestel's operating territory are addressed below.

Start-up and number portability costs

53. Northwestel submitted that the capital costs of network changes required to implement competition should be shared equally between the company and the first new entrant, and should be recovered over three years. It proposed that ongoing costs be recovered through interconnection charges. Northwestel argued that, because the costs of implementing number portability in its territory are very high, the introduction of number portability should be deferred during the initial phase of competition, with its feasibility to be assessed at the end of the forthcoming price cap period.
54. SSi submitted that, in order to ensure all communities in the North are opened to competition at the earliest time, it would be willing to accept a local competition framework that includes a transition period for the implementation of number portability. SSi further submitted that the Commission could determine how and when Northwestel would have to upgrade its switching equipment and software, and implement number portability.
55. SSi submitted that Northwestel needs to make investments in its switching infrastructure regardless of whether local competition is implemented, noting that many of Northwestel's switches are approaching 30 years of age and would have a zero valuation on the books. SSi further submitted that competitors should not be required to pay the company's costs associated with upgrading equipment/software, when those upgrades are clearly required in any event.
56. The GNWT, YG, and TCC submitted that Northwestel should be directed to develop (i) an implementation plan for the gradual provisioning of number portability (for example, implement number portability in Fort Nelson, Iqaluit, Whitehorse and Yellowknife during the first phase with other communities to follow at a later date), and (ii) specific proposals for recovery of the associated costs. PIAC/CAC submitted that where number portability is desired by a competitor, it should be required where it is economically feasible to do so.
57. The GNWT and PIAC/CAC submitted that Northwestel should bear the responsibility for its start-up costs. TCC submitted that the cost recovery mechanism for local competition costs should be finalized in a follow-up proceeding.
58. The Commission considers that in order to facilitate the development of local competition, it is important for customers who choose to change service providers to be able to retain their telephone numbers via the number portability process. However, given that all of Northwestel's switches would need to be replaced or upgraded to provide number portability functionality, the Commission considers that the implementation of number portability in the larger communities should be a priority in the local competition implementation process.
59. The Commission notes that only the switches located in Fort Nelson, Inuvik, Iqaluit, Whitehorse and Yellowknife are currently common channel signalling 7 (CCS7)⁸

⁸ CCS7 is the digital signalling system used by the telephone companies to route telephone calls and to provide other services.

capable and that they serve the major population centres in the North. The Commission also notes that these switches would be able to support number portability once software upgrades are completed. Consequently, Northwestel is directed to provide number portability in Fort Nelson, Inuvik, Iqaluit, Whitehorse and Yellowknife within six months of a request by a competitive local exchange carrier (CLEC), or a proposed CLEC, to offer local service in these locations.

60. As for Northwestel's remaining switches, the Commission notes that these switches are generally in communities with less than 1,000 network access services (NAS) and that substantial costs would need to be incurred by Northwestel to upgrade and/or replace these switches for number portability to be available in these communities. The Commission therefore considers that the benefits of requiring number portability in these communities at this time are outweighed by the costs.
61. The Commission notes that, in previous decisions, it determined that each telecommunications carrier was responsible for its own costs associated with implementing local competition in the large ILECs' territories. The Commission considers that, given these previous determinations and the relative age of Northwestel's infrastructure, it would not be appropriate for competitors to be responsible for the upgrade/replacement of facilities that should form part of the regular modernization of the company's network. Accordingly, the Commission determines that Northwestel will be responsible for its own costs for implementing facilities-based local competition, including the implementation of number portability, except as provided below.
62. As set out in this decision, Northwestel will be required to file a plan to modernize its network infrastructure, which is likely to include a schedule of the upgrades and/or replacements of switches. Accordingly, should a competitor request number portability to be available in any of these remaining communities, the competitor will be required to compensate Northwestel for all financing costs associated with advancing the upgrade/replacement of the switch prior to its implementation date.

CLEC obligations

63. Northwestel proposed that the standard CLEC obligations⁹ should apply to any competitor with the exception of (a) 9-1-1 service, which is only available in one northern exchange, and (b) equal access, which is only available in three northern communities. SSi agreed with these exceptions, adding that it should not be required to meet obligations related to number portability until it is implemented by Northwestel.
64. The Commission therefore determines that any potential competitor that wishes to offer facilities-based local service in a particular exchange in Northwestel's operating territory is required to meet these obligations if they are provided or made available in that particular exchange by Northwestel.

⁹ The complete list of CLEC obligations is available at <http://www.crtc.gc.ca/eng/8180/8180m.htm>.

Portable subsidies

65. SSi submitted that circumstances may arise under which carriers other than the incumbent could undertake the obligation to serve a community. For this reason, it argued that the local competition framework for the North should allow the subsidy to high-cost serving areas (HCSAs) to be portable.¹⁰
66. In Telecom Regulatory Policy 2011-291, the Commission determined that subsidies would be available only to the ILECs which have an obligation to serve all customers in a given HCSA. As the obligation to serve remains with Northwestel, the Commission determines that it would not be appropriate for the subsidy in Northwestel's operating territory to be portable.

Implementation

67. Northwestel is required to file its tariffs for local interconnection and component unbundling no later than 90 days after the date of this decision.
68. The Commission notes that competitors are required to complete the necessary steps and substantive obligations in order to obtain approval to operate as a CLEC prior to offering local exchange service in a specific ILEC territory. The Commission encourages competitors, such as SSi, to complete these steps and obligations as soon as possible.
69. The Commission notes that the implementation of local competition in Northwestel's operating territory also requires, among other things, the negotiation of interconnection agreements, the building and testing of facilities to support interconnection, and, where applicable, the implementation of number portability.¹¹
70. Northwestel submitted that there are a number of technical issues that must be resolved in order to bring local competition to almost all of its communities. In particular, it noted that, in the absence of CCS7, call display functionality would be unavailable when calls were made between competing networks. It also noted that there could be issues with SSi's customers losing calling capability in the event that satellite connectivity to a community was lost. Northwestel proposed that these issues be addressed through the CRTC Interconnection Steering Committee (CISC).
71. SSi argued that its proposal to implement local competition should pose no technical challenge and can be readily implemented. SSi submitted that in major markets it would expect to interconnect with Northwestel in the same manner that occurs in Southern Canada, and that in other communities, such as those served by satellite, it

¹⁰ A subsidy that is portable would allow for payments from the NCF to be made to the local exchange carrier, whether ILEC or CLEC, which provides residential local service in an HCSA.

¹¹ See paragraphs 53 to 62 with respect to the implementation of number portability.

would accept line-side interconnection rather than trunk-side interconnection¹² in order to allow for local interconnection to take place sooner rather than later.

72. The Commission notes that SSi is willing to accept line-side interconnection, where no other form of interconnection is available, in the short term. The Commission considers that, although a competitor would generally prefer trunk-side interconnection because it supports CCS7, competitors, such as SSi, could begin offering local service using line-side interconnection. Since SSi is willing to provide local service prior to the implementation of number portability, the Commission expects that these types of interconnections, absent number portability, should be operational within three to four months from the date a competitor requests to become a CLEC to offer local service in a particular location.
73. The Commission notes that many local competition implementation issues have already been addressed by CISC in the implementation of local competition in Southern Canada. The Commission expects that any technical issues, such as Northwestel's concern regarding loss of satellite connectivity, will be resolved solely through the implementation process. Accordingly, absent the implementation of number portability, the Commission expects that many northern residents will have a choice of local service provider in Northwestel's territory beginning 1 May 2012.

III. Whether changes should be made to Northwestel's subsidy

74. Currently, Northwestel receives \$20.8 million in annual subsidy from the NCF. This amount is comprised of \$10.7 million for the provision of residential PES in HCSAs and \$10.1 million to fund the ongoing requirements associated with the non-access portion¹³ of Northwestel's service improvement plan (SIP) that was completed in 2005.
75. In this proceeding, Northwestel requested an increase of \$3.5 million in annual funding from the NCF. This proposed increase is comprised of
 - an additional \$2.8 million to fund a reduction in its Carrier Access Tariff (CAT) rate;¹⁴
 - an additional \$1.0 million to fund its proposed SIPs; and
 - a reduction of \$0.3 million for the provision of residential PES in HCSAs.

¹² Trunk-side connections are used by carriers to interconnect their respective voice networks usually with high-capacity lines that use CCS7. Line-side connections are generally used to connect a customer's equipment to the serving end-office switch in the telephone network, but can also be used by competitors to connect their network to the telephone company's network. While line-side connections do not support the same functionality (e.g. CCS7) as trunk-side connections, they can usually be provisioned in a shorter time frame depending on the availability of facilities.

¹³ Dial-up Internet, transport, switching, and long distance.

¹⁴ The CAT consists of Commission-approved rates, terms, and conditions for interconnection services provided to competitors. Northwestel's CAT rate is a per minute per end charge for toll (i.e. long distance) interconnection services in Northwestel's territory (i.e. charged to long distance service providers). The costs include the toll-connect trunks, switching, and equal access. Northwestel has one CAT rate for its territory.

CAT rate

76. Northwestel submitted that, since satellite technology is used to serve over 40 percent of its communities, the long distance network is essentially an extension of the local network. Northwestel further submitted that the current CAT rate of \$0.0415 per minute per end is based on the average cost to provide all customers across the North with comparable rates for long distance services. Northwestel submitted that this leads to a degree of cross-subsidy since its two centres in Whitehorse and Yellowknife do not incur toll-connect costs but are charged the same CAT rate.¹⁵ Northwestel further submitted that, with the current evolution of Internet Protocol technologies, the reliance on such internal cross-subsidy is no longer sustainable.
77. Northwestel proposed a CAT rate of \$0.029 per minute per end, which excluded residential satellite toll-connect link costs. Northwestel proposed to recover the impact of the reduction to its CAT rate with subsidy of \$2.8 million from the NCF.
78. TCC and the three territorial governments supported Northwestel's proposal to exclude the residential satellite toll-connect link costs from the CAT rate and to recover these costs from the NCF.¹⁶
79. PIAC/CAC and the UCG opposed Northwestel's proposal. PIAC/CAC indicated that the recovery of toll-connect link costs from the NCF was denied in Telecom Decision 2007-5 since toll-connect facilities are not required for the provisioning of local services.

Commission's analysis and determinations

80. The Commission notes that, in the proceeding that led to Telecom Decision 2007-5, it denied a similar proposal from Northwestel stating that toll-connect link costs were to be recovered from toll service providers, consistent with previous determinations on this issue.
81. The Commission continues to be of the view that toll-connect link costs should be recovered from toll service providers. The Commission therefore **denies** Northwestel's proposal to exclude residential satellite toll-connect link costs from its CAT rate and recover these costs from the NCF.
82. During the proceeding, Northwestel indicated that the CAT rate would be \$0.038 per minute per end if the residential satellite toll-connect link costs were included.¹⁷

¹⁵ These two centres have Class 4/5 switches for which toll-connect trunks are not required and, therefore, do not incur these costs.

¹⁶ TCC supported further reductions to the CAT rate. TCC proposed that business satellite toll-connect link costs and terrestrial toll-connect link costs should be recovered through a single revenue-neutral adjustment to the Business Services and Other Capped Services baskets over a transition period.

¹⁷ See the response to interrogatory NWTel(CRTC)07Jul11-1602.

83. The Commission considers that a CAT rate of \$0.038 per minute per end is reasonable for Northwestel, and **approves** this CAT rate effective 1 January 2012.

SIPs

84. During the proceeding, Northwestel proposed two SIPs: 1) the provision of enhanced calling features, and 2) the replacement of a subscriber radio access network (SR500 system). Northwestel also proposed that, since these two SIPs were not economically viable, they should be funded from the NCF.
85. Northwestel proposed a two-year SIP to provide enhanced calling features to the 29 communities which do not currently have these services. The plan would require an initial total capital investment of \$2.6 million to replace three switches and upgrade the remaining switches, and an annual subsidy of \$421,000 from the NCF.
86. Northwestel submitted that privacy call features are of particular importance to citizens in remote communities, and that over the years the company has received numerous letters from community leaders requesting access to call display, largely due to issues within the community related to abusive calling.¹⁸
87. Northwestel also proposed a SIP to replace the SR500 system, which provides service in the Halfway River Valley and other rural areas in Northern British Columbia. Northwestel submitted that the replacement of the SR500 system would require an estimated \$3.9 million in capital investment and an annual subsidy of \$581,000 from the NCF.
88. Northwestel submitted that the current radio system does not comply with Industry Canada's Spectrum Utilization Policy as some of the radio frequencies used by this network are in a spectrum block that has been reallocated by Industry Canada. Northwestel stated that it could be forced to abandon these frequencies at any time, with limited notice. Northwestel further submitted that the equipment is manufacturer discontinued and unsupported.
89. The GNWT, YG, the UCG, and several small northern communities generally supported Northwestel's proposed SIPs. The GNWT and YG submitted that the availability of enhanced calling features is essential to meeting the basic telecommunications requirements of northerners and Northwestel should be directed to undertake the proposed expansion regardless of whether a further subsidy is provided.
90. GNWT submitted that, consistent with previous Commission decisions, it would be appropriate that these SIPs receive subsidy funding. However, YG submitted that the enhanced calling features proposal fell short of providing customers with access to comparable services in the South, since not all customers would have access to voice

¹⁸ During this proceeding, six communities (Burwash Landing, Enterprise, Gjoa Haven, Tsiigehtchic, Wekweeti, and Whati) filed comments requesting that enhanced calling features be provided in their communities.

mail and because the calling features would only be available locally. YG also submitted that there is nothing in Northwestel's evidence to indicate why provisions were not made, through network planning, to replace the SR500 system facilities at the end of their scheduled life.

91. PIAC/CAC submitted that any cost estimates in relation to new SIPs should be carefully assessed to ensure that there are no costs included that are properly funded through Northwestel's normal capital expenditure plan for replacing existing equipment. TCC submitted that the proposed SIPs should be denied on the basis that the initiatives should be completed and funded as part of Northwestel's capital plan and should not be funded by the NCF.

Commission's analysis and determinations

92. The Commission acknowledges that the proposed SIPs are important initiatives to maintain a minimum level of service for customers and to provide beneficial services, especially regarding privacy features.
93. However, the Commission considers that Northwestel currently receives adequate compensation through service rates and subsidy for the switches serving the 29 communities. The Commission further considers that, given that the SR500 system had become obsolete and the system no longer complies with Industry Canada's Spectrum Utilization Policy, the company should have had a plan in place several years ago for the appropriate capital investments to replace this system. The Commission is of the view that Northwestel has the flexibility to manage its modernization/replacement programs to appropriately prioritize these expenditures.
94. Accordingly, the Commission finds that the proposed SIPs should be part of Northwestel's regular capital plan and should not be funded by other telecommunications service providers via the NCF.
95. In light of the foregoing, the Commission **denies** Northwestel's request for supplemental funding from the NCF for the proposed SIPs regarding (a) the 29 communities that do not have enhanced calling features, and (b) the SR500 system.
96. The Commission notes that, during the proceeding, six of the 29 communities had filed comments requesting that enhanced calling features, such as call display, be provided to address privacy and safety concerns.¹⁹ Notwithstanding the denial of SIP funding from the NCF, the Commission expects that Northwestel will make the enhanced calling features available to these six communities within six months of the date of this decision. The company is required to include details of these projects, as well as the provision of enhanced calling features to the remaining 23 communities, and the replacement of the SR500 system in its modernization plan discussed earlier in this decision.

¹⁹ See footnote 18.

Residential PES subsidy in Band H1

97. In Telecom Decision 2007-5, the Commission approved a two-band structure for Northwestel. Its wire centres in Whitehorse and Yellowknife were grouped into one band consisting of wire centres having total NAS greater than 8,000 and designated as Band D, a non-HCSA band. All of its other wire centres were grouped together into one band and designated as Band H1, an HCSA band.
98. The Commission further determined that Northwestel's subsidy would be calculated on a subsidy per residential NAS basis. The basic components of Northwestel's calculation are (a) the cost of providing service in Band H1 plus a 15 percent markup to cover fixed and common costs less (b) the residential local rate charged to customers plus a fixed implicit contribution target amount of \$4 per NAS per month from other local services.

Band H1 residential PES costs

99. Currently, the subsidy for providing residential service in Band H1 is calculated using an approved cost of \$65.35 per NAS per month.²⁰
100. In Northwestel's initial submission, the company filed proposed residential Phase II PES costs for Band H1 of \$72.26 per NAS per month.²¹ Northwestel subsequently amended its proposal, which resulted in a Band H1 residential PES cost of \$68.30 per NAS per month.
101. The Commission notes that Northwestel's proposed monthly maintenance expenses per residential customer are significantly higher than those currently approved. The Commission also notes that Northwestel's proposed maintenance expenses include additional preventative maintenance activities, which are not reflected in the current Band H1 residential PES costs.
102. The Commission notes that Northwestel's proposed capital costs per residential customer for Band H1 have not significantly changed from the approved costs. The Commission considers that changes to maintenance expenses generally correspond to changes to capital costs. The Commission also considers that Northwestel has not adequately supported the proposed increase to its maintenance expenses.
103. The Commission has reviewed Northwestel's proposed preventative maintenance expenses and finds them to be reasonable. The Commission further considers that for the remaining maintenance expenses, it would be appropriate to base these costs on the average of the amount in Northwestel's amended proposal and the amount approved in Telecom Decision 2007-127.

²⁰ Approved in Telecom Decision 2007-127.

²¹ This amount excludes Northwestel's proposal to include the residential satellite toll-connect link costs as part of the Band H1 PES costs. This amount does include proposed changes to certain cost components.

104. Therefore, the Commission determines that the subsidy for providing residential service in Band H1 is to be calculated using a cost of \$66.71 per NAS per month.

Annual adjustment to Band H1 residential PES costs

105. Northwestel submitted that, similar to the large southern ILECs, its Band H1 residential PES costs should be adjusted annually for inflation and that no productivity offset factor should be applied.²²

106. While PIAC/CAC submitted that, based upon the information provided, there can be no conclusion that a productivity offset is not appropriate, YG submitted that it would be appropriate to exclude the productivity factor.

107. The Commission considers that it would be appropriate to treat Northwestel's Band H1 residential PES costs in a manner similar to the other ILECs' HCSAs for subsidy purposes.

108. Accordingly, the Commission determines that, effective 1 January 2012, Northwestel's Band H1 residential PES costs will be adjusted annually for inflation.

Implicit contribution

109. Northwestel submitted that the \$4 per NAS per month implicit contribution amount should remain unchanged.

110. TCC submitted that the implicit contribution amount should be increased if the enhanced calling feature SIP is rolled out.

111. Given that many optional features are not currently available to all communities, the Commission considers that Northwestel's implicit contribution amount should remain at \$4 per NAS per month at this time.

Band H1 PES 2011 subsidy

112. Based on the determinations in this decision, the Commission **approves on a final basis** a subsidy of \$10.4 million²³ for Northwestel's Band H1 residential PES for the year 2011.

NCF funding for 2011

113. Based on the Commission's determinations in this decision, Northwestel is entitled to \$20.5 million²⁴ in funding from the NCF for the year 2011.

²² See Telecom Regulatory Policy 2011-291.

²³ This amount is based on a per NAS per month Band H1 residential PES cost of \$66.71 (plus a 15 percent markup for fixed and common costs), the cost recovery of the revenue-percent charge, a residential rate of \$31.33, and an implicit contribution amount of \$4.

²⁴ Includes \$10.4 million subsidy for Band H1 residential PES and \$10.1 million to fund the ongoing requirements associated with the non-access portion of Northwestel's previously approved SIP.

114. The Commission directs the Central Fund Administrator (CFA) to adjust the distribution of monthly funding to Northwestel to an amount equivalent to 1/12th of \$20.5 million, on a final basis, effective 1 January 2011.

NCF funding for 2012 and 2013

115. In order to streamline the reporting requirements for Northwestel during the next two years, the Commission considers that the company should receive an annual fixed subsidy amount for 2012 and 2013 using the preceding year's 31 December Band H1 residential NAS count.

116. Therefore, the Commission directs Northwestel to file a Band H1 subsidy calculation by 31 March of each year based upon the previous year's 31 December Band H1 residential NAS counts.

117. Accordingly, the Commission directs the CFA to remit a monthly amount equivalent to 1/12th of \$20.5 million to Northwestel, on an interim basis, effective 1 January 2012. The Commission notes that the 2012 funding amount will be finalized in the annual revenue-percent decision.

Policy Direction²⁵

118. The Commission considers that the determinations in this decision are consistent with the Policy Direction and the policy objectives set out in section 7 of the Act.

119. Consistent with subparagraph 1(a)(i) of the Policy Direction, in all cases where the Commission has maintained regulatory requirements, whether in existing or modified form, it has done so because market forces alone cannot be relied upon to achieve the policy objectives set out in section 7 of the Act. Consistent with subparagraph 1(a)(ii) of the Policy Direction, the Commission considers that the regulatory measures approved in this decision are efficient and proportionate to their purpose, and minimally interfere with market forces.

120. The Commission considers that the policy objectives set out in paragraphs 7(a), (b), (c), (f), (g), (h), and (i) of the Act are advanced by the regulatory measures established in this decision.²⁶ For example, the requirement for Northwestel to file a network modernization plan is consistent with the objective that Canadians in both urban and rural areas have access to reliable and affordable telecommunications services of high quality. As well, the determinations to introduce facilities-based

²⁵ *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

²⁶ The additional cited policy objectives of the Act are

7 (a) to facilitate the orderly development throughout Canada of a telecommunications system that serves to safeguard, enrich and strengthen the social and economic fabric of Canada and its regions;

7 (c) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications; and

7 (f) to foster increased reliance on market forces for the provision of telecommunications services and to ensure that regulation, where required, is efficient and effective.

local competition in Northwestel's operating territory and to extend the current regulatory framework with minor modifications for the next two years will enhance the efficiency and competitiveness of telecommunications and foster increased reliance on market forces for the provision of telecommunications services and will ensure that regulation, where required, is efficient and effective.

Secretary General

Related documents

- *Review of price cap regulatory framework for Northwestel Inc. and related matters*, Telecom Notice of Consultation CRTC 2011-302, 6 May 2011, as amended by Telecom Notice of Consultation CRTC 2011-302-1, 22 June 2011
- *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
- *Northwestel Inc. - Residential primary exchange service costs for Band H1*, Telecom Decision CRTC 2007-127, 10 December 2007
- *Price cap regulation for Northwestel Inc.*, Telecom Decision CRTC 2007-5, 2 February 2007

Northwestel's regulatory framework established in Telecom Decision 2007-5

As explained below, the framework, which includes six baskets, allowed for annual adjustments based on the inflation factor²⁷ and/or the exogenous factor,²⁸ as applicable:

- Residential Services which includes all residential access services. Rates for services in this basket were frozen for the duration of the price cap period. An annual rate element constraint of five percent would apply in circumstances where an exogenous adjustment was permitted on the basket;
- Business Services which includes all business access services. An overall constraint of inflation was applied to the basket on an annual basis, with a rate element constraint limiting increases for individual services to 10 percent per year;
- Services with Frozen Rate Treatment which includes services that address social issues such as privacy, emergency, and special needs. The rates for these services were frozen for the duration of the price cap period;
- Other Capped Services which includes retail services such as optional features, digital private line, analogue private line, and non-recurring installation and construction charges. The company would have the flexibility to restructure rates for individual services in the basket on a revenue-neutral basis.²⁹ A rate element constraint of 10 percent per year would apply for exogenous events;
- Competitor Services which includes all competitor type services. Proposals for rate changes for these services would be considered on a case-by-case basis; and
- Uncapped Services which includes all remaining rate regulated retail services. This basket generally includes services which are competitive or have identifiable service substitutes such as toll-free service, Centrex, and special assembly services.

²⁷ The inflation factor is the gross domestic product – price index (GDP-PI), which is a measure of the national output price change published by Statistics Canada.

²⁸ Exogenous events or initiatives satisfy the following criteria: (a) they are legislative, judicial, or administrative actions which are beyond the control of the company; (b) they are addressed specifically to the telecommunications industry; and (c) they have a material impact on the company. Adjustments to the price cap for such events are represented by the exogenous factor.

²⁹ Specifically, the weighted-average price of all the services in the Other Capped Services basket cannot increase on an annual basis. Northwestel is permitted to increase rates for services in this basket to match the rate for the same service provided by another ILEC. For rate increases beyond this level, or for rate decreases, a cost study is required in order to justify the proposed rates.