



## Telecom Decision CRTC 2006-10

Ottawa, 24 February 2006

### Northwestel Inc. - Supplemental funding requirement for 2006

Reference: 8695-N1-200511974

*In this Decision, the Commission **approves, on a final basis**, supplemental funding for Northwestel Inc. of \$9.8 million for 2006.*

#### Background

1. In *Long-distance competition and improved service for Northwestel customers*, Decision CRTC 2000-746, 30 November 2000, the Commission established, effective 1 January 2001, the terms and conditions for long distance competition in Northwestel Inc.'s (Northwestel) territory. The competitive framework for Northwestel included a bundled carrier access tariff rate of \$0.07 per minute. The Commission determined that it would continue regulating Northwestel on a rate base/rate of return basis and set the company's rate of return on equity at 10.5 percent. The Commission approved a four-year service improvement plan (SIP) for the years 2001 to 2004 to improve and extend service in the North. The Commission also approved supplemental funding from the National Contribution Fund of \$15.1 million for 2001 and determined that it would conduct annual reviews of the supplemental funding required by Northwestel.
2. In *Northwestel Inc. - Initial annual review of supplemental funding*, Telecom Decision CRTC 2003-39, 20 June 2003, the Commission approved supplemental funding of \$13.4 million for 2002. The Commission determined, among other things, that Northwestel's existing regulatory framework would remain in place at least until the completion of the company's SIP at the end of 2004.
3. In *Northwestel Inc. - Supplemental funding requirement for 2003*, Telecom Decision CRTC 2004-64, 30 September 2004, as amended by *Northwestel Inc. - Supplemental funding requirement for 2003*, Telecom Decision CRTC 2004-64-1, 18 October 2004, the Commission approved \$9.6 million of supplemental funding for 2003 and determined that it was appropriate to extend Northwestel's existing regulatory regime to the end of 2006.
4. In *Northwestel Inc. - Supplemental funding requirements for 2004 and 2005*, Telecom Decision CRTC 2005-54, 15 September 2005 (Decision 2005-54), the Commission approved supplemental funding of \$9.3 million for 2004 and \$9.1 million for 2005. The Commission considered that in order to allow it to issue decisions relating to the 2006 supplemental funding amount and the company's regulatory framework on a timely basis, it would have to address these matters in separate proceedings. The Commission directed Northwestel to file an application for its 2006 supplemental funding.

## **The application**

5. The Commission received an application by Northwestel, dated 17 October 2005, requesting \$9.8 million in supplemental funding for 2006. In support of its application, Northwestel filed its financial statements for 2004 and its forecasted financial statements for 2005 and 2006. The company also provided an update to the 2005 forecast that it had provided in support of the supplemental funding review for 2004 and 2005.

## **Process**

6. Commission interrogatories were issued to Northwestel on 31 October 2005. Responses to the interrogatories were received on 16 November 2005. Additional comments were filed by the company on 28 November 2005.
7. The Commission received no comments with respect to the application.

## **Issues**

### ***Operating revenues***

8. Northwestel forecasted total operating revenues of \$144.2 million for 2006. Northwestel noted that its 2006 revenue growth was forecast at a moderate 1.3 percent, and that in the past the company had experienced revenue growth in excess of 3 percent. Northwestel submitted that the company's decreasing share of the long distance market and the emergence of lower-cost Internet protocol-based services would have a significant impact on 2006 revenues.
9. The Commission has reviewed Northwestel's revenue forecast for 2006 and the associated assumptions, and considers that Northwestel's forecast for total operating revenues of \$144.2 million for 2006 is reasonable.

### ***Operating expenses***

10. Northwestel submitted that its total 2006 forecast allowable operating expenses of \$77.5 million was based on the methodology established by the Commission which adjusts for growth/load, price/inflation and a 2 percent total implied productivity (TIP) factor. Northwestel noted that it used the 2005 forecast total operating expense base of \$75.7 million approved in Decision 2005-54 as the starting point for determining its 2006 operating expenses.
11. Northwestel noted that it set its 2006 load factor at 1.5 percent, comprising total estimated network access service (NAS) growth/load of 0.7 percent, adjusted for NAS displaced by asymmetric digital subscriber lines (ADSL). Northwestel submitted that this treatment is consistent with the Commission's past decisions which found that it was appropriate for the company to adjust the growth/load factor by adding to the NAS the estimated NAS displaced by ADSL.
12. Northwestel forecasted voice bandwidth requirements to increase by 1.5 percent, and data bandwidth utilization to increase by 6 percent in 2006, largely due to the growth in regional frame relay service and Internet protocol virtual private networks. Northwestel submitted that

it applied a higher growth factor to satellite transponder expenses for data services than the load factor used for voice expenses, noting that this was also consistent with the Commission's past determinations.

13. Northwestel proposed a price/inflation factor of 2.2 percent for 2006, which was calculated by averaging the consumer price index forecasts obtained from six Canadian banks.
14. The Commission finds that Northwestel's adjustments used in determining the allowable operating expenses are consistent with the Commission's past decisions.
15. The Commission notes that the company's proposed price/inflation factor is in line with current forecasts from Canadian financial institutions. Accordingly, the Commission finds 2.2 percent an appropriate price/inflation factor to use in the determination of the 2006 supplemental funding requirement.
16. The Commission is of the view, having considered the above components of Northwestel's 2006 forecast of total operating expenses, that Northwestel's allowable operating expense forecast of \$77.5 million is reasonable for the determination of the 2006 supplementary funding requirement.

***Pension, interest and depreciation expenses***

17. Northwestel submitted that its pension, interest and depreciation expenses would total \$49.6 million in 2006, compared to \$49.8 million in the 2005 forecast. Northwestel further submitted that it estimated its 2006 expenses in accordance with the Commission's determinations in Decision 2005-54, which permitted the company to exclude the pension expense component from the TIP calculation on a going-forward basis.
18. Northwestel submitted that pension expense had increased substantially in the past several years and that this trend was forecast to continue in upcoming years. The company noted that 2005 pension expense was estimated to be \$1 million higher than the forecasted pension expense used to determine the 2005 supplemental funding in Decision 2005-54, and was expected to increase an additional \$1.3 million, to \$3.1 million, in 2006.
19. Northwestel noted that pension expense was made up of a number of components, including service/interest costs, expected return on plan assets, and amortization of experience losses. The company indicated that the cost of the pension plan, comprised of service/interest costs plus amortization of experience losses, was growing at a greater pace than the expected income generated by the plan assets.
20. Northwestel proposed no changes to depreciation life characteristics in this proceeding, submitting a forecast depreciation expense of \$38.0 million for 2006, relatively unchanged from the depreciation expense estimated for 2005.
21. In response to a Commission interrogatory, Northwestel provided further information relating to the assumptions and calculations driving the pension expense increase. The Commission has reviewed the key actuarial assumptions used to estimate Northwestel's pension expense forecast, and finds these to be reasonable.

22. The Commission has examined the factors used by Northwestel to estimate its 2006 pension, interest and depreciation expenses, and considers the company's forecast for these expenses to be reasonable for the determination of the 2006 supplementary funding requirement.

### **Commission's determination**

23. In light of the above, the Commission **approves, on a final basis**, \$9.8 million of supplemental funding for 2006 for Northwestel.

### **Directions to the Central Fund Administrator (CFA)**

24. The Commission directs the CFA to distribute to Northwestel, effective 1 January 2006, monthly supplemental funding equivalent to one-twelfth of the approved final supplemental funding amount for 2006 of \$9.8 million.

Secretary General

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