



## Telecom Decision CRTC 2013-71

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Ottawa, 21 February 2013

### **Bell Aliant Regional Communications, Limited Partnership and Bell Canada – Application to review and vary Telecom Regulatory Policy 2011-703**

File number: 8662-B54-201202259

*In this decision, the Commission denies a request from Bell Aliant and Bell Canada to review and vary certain elements of Telecom Regulatory Policy 2011-703 related to the Commission's cost adjustments used in the development of residential wholesale high-speed access services.*

*The Commission notes that Telecom Regulatory Policy 2013-70, which frames a series of decisions in regard to wholesale HSA services, is a companion document to this decision.*

#### **The application**

1. The Commission received an application from Bell Aliant Regional Communications, Limited Partnership (Bell Aliant) and Bell Canada (collectively, the Bell companies), dated 1 March 2012, in which they requested that the Commission review and vary its rate decisions in Telecom Regulatory Policy 2011-703 related to the access rate component of residential wholesale high-speed access (HSA) services offered over fibre-to-the-node (FTTN) technology.<sup>1</sup> (For ease of reference, wholesale HSA services offered over FTTN are referred to as wholesale HSA services for the remainder of this decision.)
2. The Bell companies submitted that there is substantial doubt as to the correctness of the cost adjustments that the Commission made in Telecom Regulatory Policy 2011-703 to their cost studies for these wholesale HSA services. The Bell companies therefore requested that the access rates for these services be varied based on the costs resulting from reversing certain cost decisions in Telecom Regulatory Policy 2011-703.
3. The Commission received comments regarding the Bell companies' application from the Canadian Network Operators Consortium Inc. (CNO), MTS Inc. and Allstream Inc. (collectively, MTS Allstream),<sup>2</sup> Primus Telecommunications Canada Inc. (Primus), Shaw Cablesystems G.P. (Shaw), and Vaxination Informatique (Vaxination).

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<sup>1</sup> FTTN technology upgrades the telephone company's access network by extending fibre-based facilities closer to the customer's premises in order to provide increasingly higher speed access services.

<sup>2</sup> MTS Allstream Inc. was the entity that participated in the proceeding that led to Telecom Regulatory Policies 2011-703 and 2011-704. However, as of early January 2012, MTS Allstream became known as two separate entities, namely, MTS Inc. and Allstream Inc.

The public record of this proceeding, which closed on 12 April 2012, 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.

4. In Telecom Information Bulletin 2011-214, the Commission outlined the criteria it would use to assess review and vary applications that are filed pursuant to section 62 of the *Telecommunications Act* (the Act). Specifically, the Commission stated that applicants must demonstrate that there is substantial doubt as to the correctness of the original decision, due to, for example, one or more of the following: i) an error in law or in fact, ii) a fundamental change in circumstances or facts since the decision, iii) a failure to consider a basic principle which had been raised in the original proceeding, or iv) a new principle which has arisen as a result of the decision.
5. The Commission identified the following issues to be addressed in this decision:
  - I. Did the Commission err in excluding certain costs incurred before July 2011?
  - II. Did the Commission err in setting the annual unit cost change for the FTTN digital subscriber line access multiplexer (DSLAM)<sup>3</sup> access equipment? (For ease of reference, FTTN DSLAM is referred to as DSLAM for the remainder of this decision.)
  - III. Did the Commission err in making adjustments to DSLAM-related costs?
  - IV. Did the Commission err in using a 10-year study period?

- I. Did the Commission err in excluding certain costs incurred before July 2011?**
6. The Bell companies submitted that the Commission erred when it excluded historical FTTN service development<sup>4</sup> and FTTN network conditioning<sup>5</sup> costs from the wholesale HSA cost studies. The Bell companies further submitted that whether these costs were incurred prior to July 2011 is not relevant in determining their causality to the provisioning of wholesale HSA services.
7. The Bell companies submitted that deployment of the FTTN technology in their local networks is necessary to provide increasingly higher-speed access services to their customers. From the Bell companies' perspective, the most cost-effective solution is to perform service development and network conditioning activities in an entire distribution area. The Bell companies further submitted that, with the exception of Bell Aliant in its Atlantic Canada territory, they are being financially punished for having conditioned accesses prior to offering wholesale HSA services

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<sup>3</sup> A DSLAM is a network device which connects multiple customer interfaces to a high-speed digital communications channel using multiplexing techniques.

<sup>4</sup> FTTN service development costs relate to activities such as standardization and deployment of equipment.

<sup>5</sup> FTTN network conditioning costs relate to the activities incurred to remove bridge taps on the copper facilities between the DSLAM and the end-user premises.

compared to other incumbent local exchange carriers (ILECs) that perform and incur network conditioning costs as the demand arises and are, therefore, able to include these costs in their cost studies.

8. CNOC, MTS Allstream, Primus, and Vaxination submitted that the costs in question are not causal to the provision of wholesale HSA services since these costs are historical in nature and represent sunk costs.<sup>6</sup> Primus submitted that, based on the record of the proceeding that led to Telecom Regulatory Policy 2011-703, the Bell companies' service development and network conditioning costs received full and explicit consideration. CNOC, MTS Allstream, and Primus also submitted that the Bell companies did not provide any evidence to justify a deviation from the long-established principle of excluding such costs from Phase II cost studies.

### **Commission's analysis and decisions**

9. Based on the view that the historical costs in question incurred by the Bell companies before July 2011 were neither prospective nor causal to the introduction of wholesale HSA services, the Commission concluded, in Telecom Regulatory Policy 2011-703, that these costs would be removed from the relevant wholesale HSA service regulatory cost studies.
10. The Commission considers that the Bell companies have failed to provide any evidence in this proceeding demonstrating that the costs in question should not be treated in a manner consistent with the established methodology set out in Bell companies' approved Regulatory Economic Study Manuals (Study Manuals).<sup>7</sup> Accordingly, the Commission considers that the costs in question constitute sunk costs and should be excluded from the relevant cost studies.
11. In light of the above, the Commission finds that it did not err in excluding the Bell companies' FTTN service development costs and FTTN network conditioning costs incurred prior to July 2011 from the relevant Bell companies' wholesale HSA service regulatory cost studies. The Commission concludes that the Bell companies have failed to demonstrate substantial doubt as to the correctness of this decision.

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<sup>6</sup> Sunk costs are defined as costs that have already been incurred and cannot be changed as a result of a future course of action and are excluded from regulatory economic studies (see paragraph 1-10 of Bell Canada's Regulatory Economic Studies Manual for a detailed explanation).

<sup>7</sup> See Telecom Decision 2008-14 and Telecom Order 2008-237.

## **II. Did the Commission err in setting the annual unit cost change for the DSLAM access equipment?**

12. The Bell companies submitted that the Commission erred when it set the annual unit cost change<sup>8</sup> to minus five percent for the access-driven equipment costs.<sup>9</sup> They advanced the following reasons: (i) it used historical equipment price changes as a proxy for future price changes, (ii) it used annual equipment unit cost changes that differed from the asset-class factors specified in the Bell companies' Study Manuals, (iii) it used a reduction in the price of equipment that is not reasonable, and (iv) it did not consider the impact of cost changes due to the use of smaller-capacity DSLAM equipment compared to legacy digital subscriber line access multiplexer equipment (legacy equipment).
13. The Bell companies argued that it is inappropriate to use the larger-capacity legacy equipment price changes as a proxy for the smaller-capacity DSLAMs because the legacy equipment price change is not expected to be similar to that of the DSLAMs. The Bell companies further submitted that the Commission, in setting the annual equipment unit cost change at minus five percent, did not consider that the deployment of smaller-capacity DSLAMs, which replace the legacy equipment, are expected to increase the average equipment unit cost over time.
14. The Bell companies argued that it is unreasonable for the Commission to set the annual equipment unit cost change to minus five percent to reflect future price reductions, as this contradicts the Bell companies' forecasts. The Bell companies' forecasts of annual equipment unit cost changes are documented in the Bell companies' Study Manuals.
15. Primus and CNOIC submitted that the Commission's adjustments are reasonable considering the recent historical equipment cost changes and the expected future increase in equipment capacity combined with the prospect for further significant reductions in equipment unit costs over time.
16. Primus also submitted that the Bell companies' Study Manuals do not state or imply that the Commission cannot adjust the input data documented in the Study Manuals. Primus further submitted that the Commission approves the methodology documented in the Study Manuals and the data is updated as warranted reflecting current conditions. Primus noted that the Commission may review the cost study inputs proposed in a cost study and make changes as it deems appropriate.

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<sup>8</sup> Annual unit cost changes reflect forecasts of year-over-year cost level changes for equipment net of productivity improvements (e.g. anticipated efficiencies in provisioning equipment over time); these were also referred to as net capital increase factors in Telecom Regulatory Policies 2011-703 and 2011-704.

<sup>9</sup> Equipment such as the telephone company's DSLAMs are access-driven. For this type of equipment, capacity is apportioned to retail customers and expressed as number of accesses.

## **Commission's analysis and decisions**

17. As noted in Telecom Regulatory Policy 2011-703, the Commission considers that there are significant differences between the historical annual unit cost change associated with DSLAM equipment and the average annual unit cost change forecasts for the corresponding asset class as set out in the Bell companies' Study Manuals and proposed in their cost studies. The Commission notes that current costing practice permits the Commission to deviate from the use of the Bell companies' Study Manual average annual unit cost changes when more appropriate cost information, specific to a piece of equipment that is under study, is available. Accordingly, the Commission considers that it is appropriate, in this case, to use historical equipment-specific information rather than the Bell companies' Study Manual average asset-class data.
18. The Commission notes that, contrary to the Bell companies' assertion, the unit cost inputs associated with the smaller-capacity DSLAM equipment were used as the initial starting point in the Commission's analysis. Subsequently, cost adjustments were applied to account for the anticipated annual unit cost changes associated with DSLAM equipment. Further, the Commission considers that no evidence was provided in the initial proceeding, or in the present proceeding, to demonstrate that unit cost changes after the initial unit cost setting exercise would not be similar to those historically experienced for legacy equipment. Accordingly, the Commission remains of the view that, in the absence of evidence to suggest otherwise, historical annual unit cost changes provide reasonable estimates of future DSLAM unit cost reductions over the study period.
19. Moreover, the Commission notes that this historical cost information indicated that Bell Canada experienced a reduction in this total cost per unit over a four-year period that was in excess of the five percent per year level set by the Commission in Telecom Regulatory Policy 2011-703. The Commission therefore considers that its use of a minus five percent annual unit cost change for the DSLAM equipment is conservative and would allow for recovery of those costs incurred by the Bell companies.
20. In light of the above, the Commission finds that it did not err in using an annual unit cost change of minus five percent for the DSLAM equipment used to provision the Bell companies' FTTN accesses. The Commission concludes that the Bell companies have failed to demonstrate substantial doubt as to the correctness of this decision.

### **III. Did the Commission err in making adjustments to DSLAM-related costs?**

21. The Bell companies submitted that the Commission erred when it made adjustments to DSLAM costs by capping the labour component<sup>10</sup> and increasing the life estimate

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<sup>10</sup> The labour component reflects cost of engineering and installation activities associated with placement of FTTN DSLAM equipment.

for the civil work portion<sup>11</sup> of their labour costs. The Bell companies further submitted that the costs used to set the rates at issue should instead be based on the costs that the Bell companies submitted as part of their cost studies.

22. With regards to capping the labour component of the costs, the Bell companies submitted that the Commission-imposed caps are inappropriate due to the following erroneous Commission assumptions: (i) the DSLAM labour costs incurred by Saskatchewan Telecommunications (SaskTel) and TELUS Communications Company (TCC), which are the lowest-cost wholesale HSA service providers, are more appropriate than the Bell companies' proposed labour costs which are based on detailed costing assumptions and approved costing methodology, (ii) labour costs should be similar across ILECs, which is unfounded as multiple company-specific factors must be taken into account, and (iii) proposed costs were based on time estimate inputs from subject-matter experts, which the Bell companies submitted was not the case.
23. With regards to increasing the life estimate for the civil work portion of the labour costs, the Bell companies submitted that the Commission-adjusted life estimate is unjustified due to the following erroneous Commission assumptions: (i) it used a life estimate that differed from the approved asset-class life estimate specified in the Bell companies' Study Manuals, (ii) the Bell companies' life estimate for the civil work portion of the DSLAM equipment should be comparable to MTS Allstream's life estimate for similar activities, and (iii) the useful life of the civil work portion of DSLAM labour costs is similar to the useful life of copper cable. The Bell companies submitted that the life estimate of the DSLAM equipment should not be equal to that of copper cable because growth technology may render existing DSLAM locations obsolete, and there is no guarantee that existing concrete pads and fibre splices can continue to be used as the Bell companies are no longer permitted to place additional pieces of equipment or replace equipment with different-sized equipment in certain urban locations.
24. Primus and CNOC submitted that, when a company files DSLAM equipment cost information on the record of a proceeding, it is appropriate for the Commission to compare that cost information to the DSLAM equipment cost information filed by the other ILECs and to adjust the company's proposed costs when another ILEC's estimates are more reasonable.
25. Primus further submitted that the evidence filed by the Bell companies during the initial proceeding demonstrates that they relied heavily on subject-matter experts to estimate DSLAM equipment engineering and installation costs and to develop associated time estimates. Primus also submitted that the Commission is not under any obligation to adhere to the methodology set out in the Study Manuals.

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<sup>11</sup> The civil work portion of FTTN DSLAM labour costs is comprised of activities such as copper cable splicing, trenching, site excavation, concrete pad construction, electrical power installation, and inspection.

26. CNO further submitted that the Bell companies' claim that the civil work portion of DSLAM labour costs is unlikely to exceed the life estimate of the DSLAM equipment is purely speculative and not consistent with claims made by other similarly-situated ILECs.

### **Commission's analysis and decisions**

27. The Commission notes that the labour cap it set for the DSLAM equipment, applicable to the Bell companies and MTS Allstream took into account each of these four ILECs' DSLAM detailed cost assumptions, and was not derived solely from DSLAM labour costs proposed by SaskTel and TCC. The Commission considers that the labour cap it set had regard to each ILEC's cost assumptions and was set at a significantly higher level than those proposed and approved for SaskTel and TCC.
28. With respect to the Bell companies' position that subject-matter experts' input was not used to determine the DSLAM labour costs, the Commission notes that, in the initial proceeding, the Bell companies did submit that their engineering expense estimates were based on a sample of representative jobs and subject-matter expert inputs. Further, according to their submission, engineering expense estimates reflected the time associated with the Bell companies' first installation of DSLAM equipment.
29. In setting a labour cap, the Commission considers potential efficiency gains that the Bell companies' engineers and/or third-party suppliers would achieve as they gain experience in DSLAM installation over the study period.
30. Accordingly, the Commission is of the view that the labour cap it set for the DSLAM equipment remains appropriate in the absence of any new evidence.
31. The Commission considers that the issues raised by the Bell companies in this proceeding related to the civil work portion of the DSLAM labour costs were debated in the initial proceeding and that no new evidence was filed in this proceeding. The Commission further considers that current costing practice permits changes to the use of the Bell companies' Study Manual asset-class life estimates when more appropriate information, specific to a piece of equipment that is under study, is available. The Commission notes that the Bell companies provided no evidence to demonstrate that future DSLAM replacements will cause the Bell companies to change the location of the DSLAM equipment in the foreseeable future, nor that the useful life of the activities associated with the civil work portion of DSLAM labour costs (i.e. those indicated by the Bell companies related to building copper cable splices, trenching, site excavation, concrete pad construction, electrical power installation and inspection) could not be the same as the useful life of the copper cable to which the DSLAM is attached.

32. In light of the above, the Commission finds that it did not err in capping the labour component of their FTTN DSLAM costs, or in adjusting the life estimate of the civil work portion of the FTTN DSLAM labour costs. The Commission concludes that the Bell companies have failed to demonstrate substantial doubt as to the correctness of this decision.

#### **IV. Did the Commission err in using a 10-year study period?**

33. The Bell companies submitted that the Commission erred in using a 10-year study period because (i) the Commission could achieve its objectives using a 5-year study period; (ii) the Commission failed to support its position, and (iii) using a 10-year study period hinders their ability to recover costs incurred.
34. The Bell companies noted that the Cable carriers<sup>12</sup> proposed a 10-year study period, most of the ILECs<sup>13</sup> proposed a 5-year study period, and TCC proposed a 3-year study period. The Bell companies submitted that the Commission's objective of using the same study period for both the Cable carriers and ILECs could have been equally achieved if it had selected a 5-year study period.
35. Shaw supported the Bell companies' request to use a 5-year study period, submitting that previously approved third-party Internet access (TPIA) service rates have been revised before the end of a 10-year study period, and that reviews of TPIA service rates have tended to occur at roughly 5-year intervals (i.e. 2000, 2006, and 2011). As a result, Shaw submitted that the Cable carriers have not been able to fully recover their service introduction costs associated with TPIA service.
36. CNOC submitted that using a 10-year study period to set rates is appropriate. CNOC also indicated that it supported annual rate reviews to ensure that forecasts regarding peak traffic patterns and costs remain appropriate going forward. Primus submitted that the Bell companies made the same objections and arguments in the initial proceeding and did not submit any new information to demonstrate that the Commission erred.
37. The Bell companies noted that in past cost studies, they have used a 5-year study period in situations where service introduction costs represented a significant percentage of total costs.
38. The Bell companies argued that it is not reasonable to approve rates based on costs developed using a 10-year study period as this study assumption does not take into account rapid technological changes and competitive pressures that lead service providers to frequently change their service offerings, including service speeds.

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<sup>12</sup> In this decision the Cable carriers are Cogeco Cable Inc., Rogers Communications Partnership, Shaw Cablesystems G.P., and Videotron G.P.

<sup>13</sup> The Bell companies, MTS Allstream, and SaskTel.

## **Commission's analysis and decisions**

39. The Commission considers that the length of the study period should be determined based on an appropriate balance between the anticipated life of the service, the accuracy of cost inputs over time, and the recovery of the significant service start-up costs over the life of the service, thus ensuring that all significant cash flows that are causal to the service are included in the cost study.
40. In Telecom Regulatory Policy 2011-703, the Commission found that a shorter study period would not permit the significant start-up costs for the service to be spread over an appropriate life for these costs and that a longer study period of 10 years would reflect potential reductions in capital unit costs that may occur over the years due to technological advancements and increases in network usage.
41. The Commission notes that it addressed the issue of unrecovered introduction costs in Telecom Regulatory Policy 2009-274. In that decision, the Commission found that incumbents are permitted to recover any unrecovered introduction costs when an update of a cost study associated with a mandated wholesale service is required before the end of the study period. The Commission considers that should a review of a wholesale HSA service occur prior to the end of the 10-year study period, the issue of any other unrecovered costs, including those that could potentially occur when a wholesale HSA service speed is withdrawn, could similarly be addressed in the context of a future cost study.
42. In light of the above, the Commission finds that it did not err in using a 10-year study period for the Bell companies' FTTN wholesale HSA services and associated costs. The Commission concludes that the Bell companies have failed to demonstrate substantial doubt as to the correctness of this decision and associated costing decisions.

## **Other matters**

43. The Commission notes that on the record associated with CNOC's application to review and vary Telecom Regulatory Policies 2011-703 and 2011-704 dated 2 March 2012, the Bell companies proposed certain changes to the FTTN wholesale HSA monthly access service costs, which were accepted by the Commission. The Commission further notes that those cost adjustments are reflected in the revised wholesale HSA rates approved in Telecom Decision 2013-73, also issued today.

## **Policy Direction**

44. The Policy Direction states that the Commission, in exercising its powers and performing its duties under the Act, shall implement the policy objectives set out in section 7 of the Act, in accordance with paragraphs 1(a), (b), and (c) of the Policy Direction.

45. The Commission considers that its findings in this decision advance the policy objectives set out in section 7 of the Act, including paragraphs 7(a), 7(b), 7(c), 7(f), and 7(h).<sup>14</sup> The Commission considers that the rates approved for the Bell companies' residential FTTN wholesale HSA services were established with a view to ensuring that competitors pay rates constituting Phase II costs<sup>15</sup> plus a reasonable markup, while the incumbent providers legitimately recover the costs that are incurred, over a reasonable time frame. The Commission therefore considers that in accordance with subparagraphs 1(a)(ii) and 1(b)(ii) of the Policy Direction,<sup>16</sup> the rates for these services (a) are efficient and proportionate to their purpose and interfere with competitive market forces to the minimum extent necessary to meet the policy objectives noted above, and (b) neither deter economically efficient competitive entry into the market nor promote economically inefficient entry.

46. In light of the above, the Commission **denies** the Bell companies' application.

Secretary General

## Related documents

- *Canadian Network Operators Consortium Inc. – Application to review and vary Telecom Regulatory Policies 2011-703 and 2011-704*, Telecom Decision CRTC 2013-73, 21 February 2013
- *Disposition of review and vary applications with respect to wholesale high-speed access services: Introductory statement*, Telecom Regulatory Policy CRTC 2013-70, 21 February 2013
- *Billing practices for wholesale business high-speed access services*, Telecom Regulatory Policy CRTC 2011-704, 15 November 2011
- *Billing practices for wholesale residential high-speed access services*, Telecom Regulatory Policy CRTC 2011-703, 15 November 2011, as amended by Telecom Regulatory Policy CRTC 2011-703-1, 22 December 2011

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<sup>14</sup> The 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(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(c) to enhance the efficiency and competitiveness, at the national and international levels, of Canadian telecommunications; 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; and 7(h) to respond to the economic and social requirements of users of telecommunications services.

<sup>15</sup> Phase II costing is an incremental costing approach used by the Commission to assess the incumbent carrier's costs of providing wholesale service to competitors.

<sup>16</sup> *Order Issuing a Direction to the CRTC on Implementing the Canadian Telecommunications Policy Objectives*, P.C. 2006-1534, 14 December 2006

- *Revised guidelines for review and vary applications*, Telecom Information Bulletin CRTC 2011-214, 25 March 2011
- *Review of the use of company-specific working fill factors and the recovery of past introduction costs not fully recovered*, Telecom Regulatory Policy CRTC 2009-274, 14 May 2009
- *Regulatory Economic Studies Manuals – Follow-up proceeding to Telecom Decision 2008-14*, Telecom Order CRTC 2008-237, 25 August 2008
- *Review of certain Phase II costing issues*, Telecom Decision CRTC 2008-14, 21 February 2008, as amended by Telecom Decision CRTC 2008-14-1, 11 April 2008