STATE OF NORTH CAROLINA
UTILITIES COMMISSION
RALEIGH

DOCKET NO. P-55, SUB 1013
DOCKET NO. P-55, SUB 1161
DOCKET NO. P-100, SUB 72

BEFORE THE NORTH CAROLINA UTILITIES COMMISSION

DOCKET NO. P-55, SUB 1013 In the Matter of Application by BellSouth Telecommunications, Inc., For, and Election of, Price Regulation DOCKET NO. P-55, SUB 1161 In the Matter of Complaint of AT&T Communications of the Southern States, Inc., Requesting that the Commission Reduce BellSouth Telecommunications, Inc.'s Intrastate Switched Access Rate DOCKET NO. P-100, SUB 72 In the Matter of Investigation to Determine Whether Competitive Long Distance Service Should Be Allowed in North Carolina and What Rules and Regulations Should Be Applicable to Such Service if Authorized	ORDER REGARDING JOINT STIPULATION

HEARD IN: Commission Hearing Room 2115, Dobbs Building, Raleigh, North Carolina, on April 27 and May 2, 2000

BEFORE: Chairman Jo Anne Sanford, Presiding, and Commissioners Ralph A. Hunt, Judy Hunt, William R. Pittman, J. Richard Conder, Robert V. Owens, Jr., and Sam J. Ervin, IV

APPEARANCES:

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BY THE COMMISSION: This matter arose on July 28, 1999, upon the filing of a complaint by AT&T Communications of the Southern States, Inc. (AT&T), seeking a reduction in the rates charged by BellSouth Telecommunications, Inc. (BellSouth), for intrastate switched access service. In its complaint, AT&T alleged that BellSouth's rates for switched access service in North Carolina are the highest in the nine-state BellSouth region and are well above their cost. AT&T further alleged that these rates are discriminatory and anticompetitive. AT&T requested that BellSouth's switched access rates be reduced to $.01 a minute.

By Order issued August 3, 1999, the Commission served the complaint on BellSouth. On September 7, 1999, BellSouth filed an answer and motion to dismiss requesting the Commission to consolidate the issues set forth in the complaint with the universal service docket, No. P-100, Sub 133g. By Order issued September 9, 1999, the Commission, having determined that the issues raised by AT&T warranted immediate investigation, set the matter for hearing on December 6, 1999.

On November 4, 1999, AT&T and BellSouth filed a joint motion requesting the Commission to stay its procedural order and continue the hearing until January 10, 2000. The movants stated that they had agreed to terms and conditions satisfying the complaint and were in the process of creating a joint stipulation regarding proposed changes in BellSouth's Price Regulation Plan. By Order entered November 10, 1999, the motion was granted.

On December 21, 1999, AT&T and BellSouth filed a joint motion requesting a further stay and continuance. By Order issued December 29, 1999, the Commission granted the motion and continued the hearing until March 13, 2000. A third joint motion was filed on February 4, 2000, requesting that the hearing be continued until March 20, 2000.

On February 15, 2000, AT&T, BellSouth, and the Public Staff (the Stipulating Parties) filed a Joint Stipulation settling AT&T's complaint, revising BellSouth's Price Plan, establishing an enhanced infrastructure fund to further deployment of Asymmetric Digital Subscriber Line (ADSL) technology, and adopting service objectives with self-enforcing penalties.

On February 16, 2000, the Public Staff filed a Petition requesting the Commission to require facilities-based interexchange carriers (IXCs) to flow through, on a dollar-for-dollar basis, the intrastate switched access charge reductions made by BellSouth pursuant to the Joint Stipulation.

On February 17, 2000, the Commission issued an Order scheduling a hearing on the Joint Stipulation for March 27, 2000, and requiring the Stipulating Parties to file testimony. On March 10, 2000, Carolina Utility Customers Association, Inc. (CUCA), filed a motion for an extension of time and continuance asking that the hearing be held on or

after May 29, 2000. The hearing was rescheduled for April 24, 2000. The hearing was subsequently rescheduled for April 25, 2000, at the request of BellSouth and AT&T, and for April 27, 2000, on the Commission's own motion.

The matter came on for hearing on April 27, 2000, before the Full Commission. BellSouth presented the testimony and exhibits of Linda P. Cheatham, Director of Regulatory for BellSouth in North Carolina. AT&T presented the testimony of Gregory R. Follensbee, a Director in AT&T's Law and Government Affairs organization. The Public Staff presented the testimony of Ben Johnson, Ph.D., a consulting economist and President of Ben Johnson Associates, Inc. Neither the Attorney General nor CUCA presented testimony. One public witness, Catherine Williams Pitts, testified concerning the quality of service provided by BellSouth to Internet service providers.

Summaries of the Briefs and/or Proposed Orders of the Parties

Summary of the
Attorney General's Brief and Proposed Order

The Attorney General's position is that the proposed Stipulation should not be approved. He argued that (a) there is no basis in the record for premature revisions to the Price Regulation Plan; and (b) there is no basis in the record, nor is there any reason to believe, that residential rates (including rates for residential services in the various baskets) should be increased.

Regarding the proposed revisions to the Price Regulation Plan, the Attorney General argued that BellSouth's Price Plan was designed to be a reasonable way of transitioning to a competitive market that would provide tangible benefits to consumers. For instance, BellSouth's witness Dr. Lewis J. Perl testified in 1996, when the Price Regulation Plan was first considered by the Commission, that ". . . the Plan will not only ensure that rates will continue to be affordable; it will make basic telephone service even **more** affordable than it is today. The primary issue here is to ensure affordable rates for **residence** basic exchange service." (Emphasis in original). Other BellSouth witnesses assured the Commission in 1996 that quality of service to consumers would not deteriorate if the Price Plan were adopted.

BellSouth's Price Plan itself provides that the Commission shall undertake a review of the operation of the Plan before it expires and is up for renewal. Because the Price Plan expires in approximately one year (June 24, 2001), those proceedings must necessarily begin within the next few months. When conducting a review of the Price Plan, the Commission's evaluation should consider how the Plan's operation has affected citizens of North Carolina and specifically whether the Plan: ". . . (i) protects the affordability of basic local exchange service, as such service is defined by the Commission; (ii) reasonably assures the continuation of basic local exchange service that meets reasonable service standards that the Commission may adopt; (iii) will not unreasonably prejudice any class of telephone customers, including telecommunications companies; and (iv) is otherwise consistent with the public interest." G.S. 62-133.5(a) and/or G.S. 62-133.5(c). Following this review, ". . . the Commission may make modifications to the Plan consistent with the public interest." Section IX of the Price Plan.

G.S. 62-133.5(c) prescribes a specific procedure that the Commission must follow when a local exchange company seeks to modify its price plan prior to expiration. Pursuant to such provision, the local exchange company is required to file an application with the Commission, and in considering the proposed modifications, the Commission, as provided by G.S. 62-133.5(c), must evaluate whether the modified plan comports with the four statutory conditions as set forth above.

The Attorney General stated that when the Commission reviews the Price Plan in the coming months, it will consider a number of factors. Public Staff witness Dr. Ben Johnson testified that when the Commission conducts its full review of a price plan, it should consider the company's return on common equity. He testified that if there is a flaw in the plan that is causing a company to have excessive earnings, then the Commission should fix the flaw in some fashion. Witness Johnson testified that the review needs to be thorough - there needs to be full opportunity for discovery so the Commission can determine if there are improvements that could be made to the plan in order to accomplish public interest goals. He testified that the Commission needs to compare how each of the three major local exchange companies (LECs) have done under their respective price plans in order to determine how best to craft modifications to the plans. Witness Johnson testified that the Commission must have an appropriate evidentiary basis for making decisions regarding modifications to price plans so that such decisions are not arbitrary. He testified that the Commission needs to consider the significant revenue generated by vertical services such as call waiting and caller

identification, and not just revenue generated by basic local exchange service, when it is considering modifications to a LEC's price plan. Finally, in this regard, witness Johnson testified that the Commission should examine how management behaved - what rates were increased, what rates were decreased, what happened to costs, and what happened to revenues.

Notwithstanding the foregoing, the proposed Joint Stipulation asks the Commission to significantly modify BellSouth's Price Plan without conducting even a portion of the full review of the Plan required by G.S. 62-133.5(c). Among other things, the proposed Joint Stipulation would directly result in a $1.50 increase in basic local exchange rates for residential consumers, to be imposed in three separate increments. BellSouth's annual revenues from the proposed increases in residential basic local exchange service rates would be increased by a total of $24 million, once fully implemented over a two-year period. In addition, the proposed Joint Stipulation would modify the Price Plan by moving some services (or portions of services) such as Complete Choice and Area Plus from one category of services to another. It would also create a new category of services, Non-Basic 1.5 (NB1.5) Service. Such changes would allow BellSouth to substantially increase other residential rates and charges. BellSouth has, in fact, indicated that, for example, the rates for Complete Choice and Area Plus would increase as a result of the Joint Stipulation.

The law and the public interest require that changes to the Price Plan be based on a fully developed record and the criteria set forth above. The Attorney General does not believe that there is evidence in the record to support any of the proposed modifications to the Plan. For example, there is no evidence in the record to support the notion that BellSouth needs additional authority or flexibility under the Plan to raise residential rates or make substantive changes to its Price Plan. In fact, BellSouth's witness testified that ". . . price regulation is working as it was intended." Moreover, no studies were done by either BellSouth or the Public Staff regarding competition in the market for the services which would be moved from one category to another. Certainly, no studies have been presented to or considered by the Commission. Furthermore, witness Johnson even testified that he would not characterize vertical services - which under the proposed Joint Stipulation would be moved from the Basic to the Non-Basic 1 (NB1) Category - as being competitive. In fact, the evidence indicates that services were moved from one category to another in an arbitrary fashion ". . . as part of a negotiation." It is clear from the record that "negotiation" was substituted for formal examination of market conditions.

Both BellSouth and the Public Staff testified that, at one point and while under the Plan, BellSouth cut costs at the expense of service quality. Such action clearly does not support an increase in residential rates. If anything, it indicates that full review of the Plan should come sooner rather than later as proposed in the Joint Stipulation, that is, under the Joint Stipulation, the Commission's full review of BellSouth's Price Regulation Plan would be deferred for approximately one year so that it would not occur prior to June 24, 2001. The existing Plan currently provides for full review of its provisions by the Commission prior to the expiration of its fifth and final year on June 24, 2001, which as previously indicated, would imply that proceedings in that regard should be commenced by the Commission in the very near term.

Regarding the proposed $1.50 increase in residential rates for basic local exchange service and the additional residential rate increases that would occur as a result of the changes in services between categories, the Attorney General observed that such increases come at a time when BellSouth is earning record profits and making an estimated 27.75% return on common equity, according to the Commission's most recent *Quarterly Review*. Before the Commission can find that the Price Plan should be modified and the proposed residential rate increases allowed, it must first find that all of the statutory criteria are met, including a finding that the rate increases are in the public interest.

With respect to the argument that it is necessary to increase basic local exchange service rates to foster competition for telecommunications services, both AT&T witness Gregory R. Follensbee and Public Staff witness Johnson testified that local exchange rates do not have to be increased in order to encourage competition in the local exchange market. Further, witness Johnson testified that the telecommunications industry is a declining cost industry and that local service for residential customers is now priced **above** its direct cost.

At least one other Commission in BellSouth's territory has taken the opposite approach from that advocated by the Joint Stipulation with respect to rates for basic local exchange service. In an Order dated May 2, 2000, the Louisiana Public Service Commission ordered that "BellSouth shall not increase any basic local exchange rates pursuant to any rate rebalancing effort either under its consumer price protection plan or through any other mechanism for a minimum of three years from the effective date of this Order."

In short, there is no evidence whatsoever in the record that residential rates and charges should be increased. Indeed, such rates and charges are still for monopoly services and therefore should be the last to be increased.

BellSouth does have the authority, under its current Plan, to make increases in residential rates provided it makes the appropriate corresponding reductions. Furthermore, once the full review of the Plan occurs, the Commission will have every opportunity, pursuant to Section IX of the Plan, to evaluate whether the Plan is "consistent with the public interest" and whether rates are set at appropriate levels under the circumstances.

In concluding, the Attorney General asserted that the Commission should not approve the proposed Joint Stipulation as it has been presented. He reiterated that the evidence of record does not support allowing BellSouth to prematurely change its Price Plan, for example, by moving certain services from one service category to another and by creating a new price plan service category, both of which provide BellSouth with increased flexibility for imposing higher levels of increase in local service rates than presently exists under its current Price Plan.

The Attorney General further stated that the Joint Stipulation does contain a number of potentially beneficial provisions, including reduced access charges, self-enforcing service penalties, and increased deployment of ADSL. However, he observed that modifications to the Price Plan and increased residential rates need not be part of this package. The Commission can consider those matters separately without involving the Price Plan.

Finally, the Attorney General stated that he had carefully considered recommending specific modifications to the Joint Stipulation to preserve the benefits of the Plan without requiring residential consumers to accept unwarranted rate increases. For example, he considered a proposal which would include the service penalties, ADSL enhancements, no modifications to the Price Plan, and a somewhat smaller reduction in access charges, so that the net revenue to BellSouth would be the same as under the Joint Stipulation. However, in light of the fact that this was a three-party stipulation, that the Attorney General was not a party to the negotiations, and that modifications to BellSouth's Price Plan require BellSouth's approval, it was concluded that unilateral recommendations by any one party were not desirable.

Summary of
BellSouth's and AT&T's Brief and Proposed Order

In a Joint Proposed Order, BellSouth and AT&T (collectively BellSouth) argued that the Joint Stipulation should be approved for the following reasons:

1. Consumers of local exchange and intrastate long distance services in North Carolina will benefit more from its approval than its disapproval.

BellSouth cited to the testimony of witness Johnson in support of its proposal that the Commission should decide whether to approve the Joint Stipulation on the basis of whether ratepayers were "better off implementing this stipulation or not implementing it," and that the Commission should weigh the Joint Stipulation against "broad public interest standards," and that "what matters is what would next year be with or without the stipulation?" Further, BellSouth cited to the testimony of witness Johnson in support of its proposal that while the Joint Stipulation touched on issues that the Commission will consider in more depth during its full review of the Plan, the current proceeding was not the appropriate forum in which to deal with those issues.

2. BellSouth's access charge reductions and AT&T's commitment to flow those reductions through to its customers on a dollar-for-dollar basis, as proposed by the Joint Stipulation, will translate into real savings on most consumers' monthly toll bills.

BellSouth explained that a major feature of the Joint Stipulation is a substantial, phased-in reduction of BellSouth's intrastate switched access charges and AT&T's commitment to flow through those reductions to its North Carolina long distance customers on a dollar-for-dollar basis. In its prefiled testimony and again at the hearing, AT&T confirmed its commitment to flow through its share of the access reductions if the Joint Stipulation is approved. This $83 million reduction, and related flow-through to AT&T's customers, will only occur if the Joint Stipulation is approved.

BellSouth explained that its current composite per minute rate of $.062658, including both originating and terminating

charges, will be reduced to a composite rate of $.02 per minute over a two-year period. The total amount of the access charge reduction is $83 million and will be phased in as follows:

Upon Effective Date of Revised Plan	$.04 per minute
First Anniversary of the Revised Plan	$.03 per minute
Second Anniversary of the Revised Plan	$.02 per minute

If the Joint Stipulation is approved, the access reductions will make North Carolina's access rate among the lowest in the BellSouth region rather than among the highest. Moreover, based on the current average monthly bills for AT&T's residential customers in North Carolina, the access charge reductions will allow AT&T to lower residential customer bills on average by $.85 per month, or a reduction of more than 14%. The actual reduction experienced by each customer will depend upon what long distance services he or she purchases from AT&T. BellSouth explained that because federal law precludes AT&T from reducing its toll rates to only BellSouth customers who subscribe to AT&T's long distance service, the average reductions for each customer are not as great as the reductions could have been if they had been confined only to BellSouth customers. However, if the Commission were to order similar reductions in access rates of other local carriers, AT&T could pass through those savings to its statewide customers as well.

BellSouth further cited to witness Johnson's testimony that another benefit to consumers from the access charge reductions will be a lessening in the disparity between intrastate and interstate toll rates. Because the per minute interstate access rates have declined sharply in recent years, many interstate calling plans have lower per minute rates than the lowest analogous intrastate rates. Reducing the intrastate access rates will lessen this discrepancy, thereby reducing consumer confusion and irritation over disparate toll rates. Further, witness Johnson testified that lower prices for toll service will serve to stimulate toll calling. Consumers will benefit when they respond to price reductions by increasing the frequency or duration of their toll calls.

BellSouth pointed out that approval of the Joint Stipulation will result in the dismissal of AT&T's access charge complaint in Docket No. P-55, Sub 1161, thus saving the parties and the Commission the time and expense of litigating this complaint case and any appeals or other proceedings resulting from it. BellSouth pointed out that this will allow the Commission to deliver the benefits of reduced access charges immediately to North Carolina consumers, rather than months later if it rejected the Joint Stipulation and then decided to reduce access charges after hearing AT&T's complaint case.

3. The self-enforcing service quality penalty mechanism proposed by the Joint Stipulation will provide immediate, monetary incentives for BellSouth to improve and maintain service quality standards.

A second major feature of the Joint Stipulation is the creation of a self-enforcing penalty mechanism wherein BellSouth must meet eight service quality objectives to avoid the imposition of significant monetary penalties. Under the Joint Stipulation, BellSouth will change its Plan to provide for the payment of penalties if the objectives for the following service measurements are not met:

a. Operator "0" answer time.
b. Directory assistance answer time.
c. Initial customer trouble reports per 100 access lines.
d. Repeat customer trouble reports per 100 access lines.
e. Out-of-service trouble cleared within 24 hours.
f. Regular service orders completed within five working days.
g. New service installation appointments not met for company reasons.
h. New service held orders not completed within 30 days.

The objective for each of these measurements will be those currently specified by Commission Rule R9-8, except for out-of-service troubles cleared within 24 hours. Penalties for that service objective will be assessed only if BellSouth fails to achieve a 90% objective.

Under the proposal, if BellSouth's yearly average statewide service result for a given service measurement falls below the established objective, the amount of the penalty is calculated by applying the monthly penalty amount ($10,000) to each unit missed. For example, assuming the yearly average statewide result for regular service orders completed within five working days is below 90%, if BellSouth completed 84% of regular service orders within five working days in June, but the objective is 90%, then the penalty for June would be $60,000.

In addition to the per-unit penalties, additional penalties would apply depending on the number of months the objective is missed. Such penalties would exceed $1 million for a specific measure if the monthly performance objective is missed for nine or more months in the year. For example, if BellSouth were to miss three of the eight objectives by 25% for the year, the penalty would be over $11 million. After the total penalties for the year are calculated, they will be issued as a credit on the bill of all residence and business customers of record within 60 days after the end of the applicable period. If this had been in place in 1999, BellSouth would have paid over $3 million in penalties.

BellSouth argued that, in addition to providing an incentive for BellSouth to meet its service quality standards, the self-enforcing mechanism is administratively superior to the usual penalty process, where the maximum amount is $1,000 per day, per violation, but may have to be collected through actions instituted in Superior Court. Amounts remitted under the traditional process go to the State, not the consumers. BellSouth's proposed mechanism may also furnish useful precedent for other companies in the future.

4. BellSouth's commitment to substantially enhance its investment in ADSL technology, as proposed by the Joint Stipulation, will bring high-speed Internet access to rural and urban areas of North Carolina much faster than originally planned.

BellSouth explained that a third major feature of the Joint Stipulation is the commitment by BellSouth to establish a $97.8 million ADSL enhanced infrastructure fund. This represents an increase of $60 million over BellSouth's current budget for ADSL deployment in North Carolina and guarantees almost ubiquitous deployment of the fast-access Internet technology years earlier than planned. The enhanced fund will be used to equip 95 central offices and more than 2,100 remote terminal sites for ADSL by year-end 2002. Eleven of those central offices have been identified as being in economically disadvantaged areas.

BellSouth contended that reporting requirements associated with the deployment will allow the Commission and Public Staff to monitor BellSouth's adherence to its deployment schedule. Beginning January 31, 2001, BellSouth will file the first of three reports with the Commission detailing BellSouth's progress in deploying ADSL capability. The second and third reports will be filed on January 31, 2002, and January 31, 2003, respectively.

BellSouth further cited to witness Johnson's testimony that the enhanced ADSL investment "is clearly a win" for consumers because "we're spreading that investment much more rapidly and much more broadly across the state than what BellSouth would do on its own." According to witness Johnson, "rapid deployment of ADSL will help meet the ever-growing demand for bandwidth by both business and residential customers." Witness Johnson further testified that merely the increased awareness of the availability of the new technology will benefit rural customers as well.

5. Creation of a NB1.5 basket and movement of services from the Basic basket to NB1 basket provides BellSouth with necessary pricing flexibility in the emerging competitive local exchange environment.

BellSouth's rationale for this proposal is that, in the context of increasing competition, a new Plan basket known as NB1.5 should be created which contains services that are more discretionary and/or more competitive than NB1. Thus, sixteen services currently categorized as NB1 will be moved to NB1.5. The Joint Stipulation also calls for moving a sub-subgroup of services from the Basic to the NB1 category-- specifically, the nonaccess line portion of optional residential packages (vertical features) would be shifted to the NB1 Category to reflect their more discretionary nature.

For individual rate elements, the NB1.5 Category of services will have the same pricing rules as the NB1 Category, with the maximum increase in any given rate element in a single year limited to the change in the GDP-PI plus 17%; but there will be a revenue cap on the NB1.5 Category equal to the change in the GDP-PI plus 3%, as opposed to the GDP-PI minus 3% cap that exists for the NB1 Category.

BellSouth cited especially to the testimony of witness Johnson in support of its proposal where he spoke of increasing competition and the desirability of giving BellSouth additional pricing flexibility without giving it complete pricing freedom. For example, while MTS and WATS services are not fully competitive, they are becoming more so. Similarly, data transport services are definitely becoming more competitive.

6. Allowing BellSouth to offset basic rate increases against access charge reductions as proposed in the Joint Stipulation is reasonable and in the public interest.

The Joint Stipulation would allow BellSouth to offset approximately $32.5 million of the $83 million access charge reduction through increases in Basic Services. Of the $32.5 million, approximately $24 million is in residence basic local exchange service, equating to a per line increase of approximately $1.50 per month, by the end of the phase-in period. Moreover, NB1 Services will be increased by $15 million, and the remaining $35.5 million will either be funded by productivity offsets in other categories or by BellSouth absorbing the decreases with no offset.

BellSouth argued that it was reasonable to allow it to offset the access reductions in this manner for several reasons. First, the existing Plan already allows BellSouth to increase rates for the same service proposed to be increased under the Joint Stipulation, since the three-year cap on residential rates expired in June 1999. In fact, BellSouth has already notified the Commission that, should the Joint Stipulation be rejected, it would propose to increase the basic residence local exchange rate in an amount greater than that proposed in the first step of the phase-in period of the Joint Stipulation. Second, BellSouth noted that the existing GTE and Sprint Price Regulation Plans already allow them to offset basic rate increases against access charge reductions. Third, as witness Johnson pointed out, allowing the residential increases to offset the access reductions is "a clear win [for consumers]." The lower access charges will lower the consumers' toll bills. Fourth, although the proposed offset may cause some business customers not to see reductions they otherwise would have seen in the absence of the Joint Stipulation, competitive pressures will exercise a downward pressure on business rates in any case. Fifth, the proposed changes to local rates are quite moderate and spread over two years. The resulting monthly charge will be slightly below the price that was charged in 1984 for the most expensive local calling service then available. Sixth, the increase in local rates will tend to decrease the rate shock that may occur as the Commission, in response to the universal service mandates, moves to more cost-based rates. Finally, a collateral benefit to the higher rates is that they will create more incentives for competition in the local service market.

7. Granting BellSouth a one-year extension of the Commission's full Price Regulation Plan review provides the Commission and the Public Staff with additional time to study the effects of the changes caused by the Joint Stipulation and prepare for a full review of the Plan.

BellSouth argued that delaying the review for one year will, as witness Johnson testified, give the Public Staff and the Commission "an opportunity to review the effects of the various provisions which have been added or amended by virtue of the Joint Stipulation." Conducting the review any sooner would not give adequate time to observe the effects of any changes.

Summary of CUCA's Brief

Note: CUCA filed a confidential version of its Brief Opposing the Joint Stipulation, along with a redacted public form of the Brief. This summary is a synopsis of the redacted version.

In its Brief, CUCA requested that the Commission reject the Joint Stipulation on the bases that it is (i) unreasonably prejudicial to the residential and business customers of BellSouth; and (ii) inconsistent with the public interest. CUCA maintained that G.S. 62-133.5(c) permits BellSouth to modify the form of its price regulation, subject to four requirements. The two requirements which CUCA believes are relevant to this proceeding are that the Plan as proposed "will not unreasonably prejudice any class of telephone customers, including telecommunications companies" and "is otherwise consistent with the public interest". CUCA supported its position that the Joint Stipulation is unreasonably prejudicial and inconsistent with the public interest by providing (a) an evaluation of the direct costs and benefits of the Joint Stipulation for each relevant group; (b) an evaluation of the "equities" relevant to this proceeding because fairness should be a part of the public interest determination; and (c) an evaluation of other miscellaneous factors relating to the Joint Stipulation.

I - Unreasonably Prejudicial to Residential and Business Customers

CUCA stated that prior to an evidentiary hearing in the Complaint Docket (Docket No. P-55, Sub 1161), AT&T and BellSouth engaged in settlement negotiations that were expanded to include the Public Staff. CUCA remarked that both BellSouth and the Public Staff characterize the Joint Stipulation as beneficial to customers because a rate increase of approximately $47.5 million would be offset by the flow-through of $83 million in access charge reductions, leaving BellSouth to absorb the differential to the extent it was not funded by productivity offsets. However, CUCA asserted that the testimony elicited through cross-examination and the exhibits in the record demonstrate that BellSouth's and the Public Staff's characterization is not accurate because if the Joint Stipulation is adopted, BellSouth's customers will actually incur $66 million to $84 million in increased telecommunications charges and forsaken productivity-related cost reductions and will receive only approximately $41.5 million in access charge related reductions. CUCA stated that this is even assuming that AT&T and other carriers flow-through 100% of the access charge reductions to customers. CUCA argued that the approximate $41.5 million in remaining access charge reductions will reduce the telecommunications charges paid by customers of other LECs, such as GTE and Carolina, and competing local providers (CLPs). CUCA stated that the reason for the disparity between costs and benefits is that for each additional dollar paid by BellSouth's customers in higher rates under the Joint Stipulation, BellSouth's customers will receive only $.50 in benefits from each dollar reduction in switched access charges. CUCA argued that the remaining $.50 for every dollar in access charge reductions will go to other LEC and CLP customers.

In its Brief, CUCA stated that on cross-examination, witness Johnson acknowledged that a point his analysis failed to recognize was that under the Joint Stipulation, if BellSouth were to offset revenue increases with revenue decreases in one of its own categories (such as Basic rates), the impact on ratepayers would be dollar-for-dollar, whereas when the offset is allocated to switched access, the offset is only $.50 on the dollar because the reduction is allocated to the entire state, not just BellSouth's customers. CUCA asserted that on an overall basis, adoption of the Joint Stipulation would be unreasonably prejudicial to BellSouth's residential and business customers because it would require those customers to fund a windfall of more than $40 million to the customers of other LECs and CLPs without any offsetting benefit. CUCA maintained that BellSouth's customers are already funding BellSouth's annual return on equity which is in excess of 27% and that those customers should not be asked to bear an additional financial burden to pay for a windfall to other LEC and CLP customers.

II - Inconsistent with the Public Interest

(A) Direct Costs and Benefits of the Joint Stipulation

CUCA maintained that the Joint Stipulation will modify the structure of BellSouth's Price Regulation Plan primarily by allowing intercategory offsets and the movement of rate elements into other categories.

CUCA stated that witness Cheatham verified on cross-examination that the Public Staff's analysis of the Joint Stipulation, identified as CUCA Cheatham Cross-Examination (Exhibit 12), was reasonable. CUCA noted that witness Cheatham acknowledged that Exhibit 12 presents the revenue increases to be implemented by BellSouth in the following areas during the years 2000-2002:

Basic Exchange Rates	$ 29.65 million
DA Allowance	$ 2.86 million
NB1 Rebalance	$ 15.10 million
Productivity Offsets (B+NB1)	$ 17.61 million
Total	$65.22 million

CUCA stated that witness Cheatham also agreed that Exhibit 12 presents the cost of the Joint Stipulation to BellSouth during the years 2000-2002 as follows:

Productivity Offsets (SwAcc)	$ 1.56 million
Give Up	$ 16.34 million
Total	$17.90 million

Consequently, CUCA maintained, the Joint Stipulation will actually increase the cost to BellSouth's customers by at least $65 million, reduce BellSouth's revenues by less than $18 million, and produce switched access charge reductions of approximately $83 million. CUCA asserted that the $83 million in access charge reductions are to be shared by BellSouth and other LEC and CLP customers, assuming a 100% flow-through by AT&T and other IXCs.

However, CUCA stated that Exhibit 12 neglects to reflect an important element of the Joint Stipulation that will allow BellSouth to move certain services totaling $125 million from the existing Non-Basic 1 Category to a new Non-Basic 1.5 Category. CUCA argued that revenues in the Non-Basic 1.5 Category can be increased 6% per year more than revenues can be increased in the Non-Basic 1 Category. CUCA maintained that as a result, the Joint Stipulation will allow BellSouth to *increase its revenues* from the Non-Basic 1.5 Category by $18.8 million during the years 2000-2002. CUCA asserted that according to witness Cheatham, the only factor that will preclude the exercise of BellSouth's discretion to increase revenues in the Non-Basic 1.5 Category is competition. CUCA stated that the only information offered by BellSouth about the competition that witness Cheatham claimed would preclude BellSouth from exercising the discretion to increase Non-Basic 1.5 rates was derived from anecdotal sources of information such as websites without the benefit of any formal study.

Nevertheless, CUCA noted that witness Cheatham acknowledged that if BellSouth had *no intention* of raising the revenues associated with the Non-Basic 1.5 Category, BellSouth could have set the revenue cap increase at zero rather than at inflation plus 3%. CUCA further stated that if BellSouth chooses to exercise the discretion afforded by the Joint Stipulation to increase Non-Basic 1.5 Category revenues, the burden on BellSouth's customers may be as much as $84.02 million ($18.8 million plus $65.22 million from Exhibit 12), and BellSouth will enjoy a revenue increase of almost $1 million more than the revenue reduction associated with switched access charges ($83 million). CUCA maintained that witness Cheatham admitted on cross-examination that the Joint Stipulation actually allows BellSouth to achieve *a net increase in revenues if* BellSouth exercised the discretion to increase Non-Basic 1.5 revenues in the absence of competition.

CUCA also stated in its Brief that the testimony of witness Johnson supports CUCA's assertion that an evaluation of the direct costs and benefits of the Joint Stipulation confirms that the Joint Stipulation is inconsistent with the public interest. CUCA stated that witness Johnson testified that the Joint Stipulation provides BellSouth "with roughly $47.6 million of additional revenues, substantially less than the $83 million reduction in access revenues." CUCA maintained that witness Johnson indisputably relied upon a comparison of the results under the Joint Stipulation with BellSouth's 1999 Price Plan costs when he identified a $47 million revenue increase and an $83 million revenue decrease as a material basis for concluding that the Joint Stipulation was beneficial to consumers.

CUCA presented the following table, of amounts in millions, showing the impact of the Joint Stipulation during the years 2000-2002, on relevant Groups [known as CUCA Johnson Cross-Examination Exhibit 12]:

Group	BellSouth Revenue Increase	BellSouth Revenue Decrease	Net Effect (Savings - Cost)
BST Residential	$39	$18	($21)
BST Business	$27 - $45	$23.5	($3.5 - $21.5)
NonBST Customers	$0	$41.5	$41.5
BellSouth	$66 - $84	$83	($17) - $1
AT&T	$41	$41	$0

Other IXCs	$42	$42	$0

CUCA commented that witness Johnson stated that CUCA's Exhibit 2 as shown above "only shows the effects of the stipulation relative to 1999." CUCA noted that witness Johnson testified that Exhibit 2 "doesn't tell us what either 1999 or 2000 would look like without the stipulation or more importantly 2000 because it takes effect in 2000." CUCA referenced a quote by witness Johnson wherein witness Johnson, in response to a question from Commissioner Ervin, recommended that the Commission look at two scenarios, one with the Stipulation and one without the Stipulation. Witness Johnson asserted that last year's results are largely irrelevant.

CUCA quoted witness Johnson's testimony that, "[I]t's not possible until we see the [late-filed] exhibit [regarding what the May, 2000 Price Plan filing would have been in the absence of the Joint Stipulation] that the Commissioners have asked for. What you're really asking me is, can I read BellSouth's mind. And the answer is no, I can't." CUCA argued that the record is simply devoid of the evidence that witness Johnson claimed is crucial to the Commission's decision of whether to adopt the Joint Stipulation. CUCA stated that the Commission's May 3, 2000 Order Rescinding Requests for Late-Filed Exhibits and Denying Joint Motion to Hold Price Regulation Annual Filing in Abeyance, rescinded a request from a Commissioner for BellSouth to provide a study of what would have occurred under the Price Plan in the absence of the Joint Stipulation, thereby closing the record. CUCA argued that witness Johnson's assertion that the necessary comparison is between the Joint Stipulation and what would happen in the absence of the Joint Stipulation, if correct, conclusively demonstrates that the Joint Stipulation is not adequately supported by the record evidence. CUCA maintained that if witness Johnson is not correct in his assertion about the crucial comparison, then the Joint Stipulation produces the results identified in the table above and is unreasonably prejudicial to BellSouth's residential and business customers and inconsistent with the public interest.

CUCA pointed out that the Commission ordered BellSouth to file its annual price plan filing prior to the issuance of an order in this proceeding. CUCA noted that the Commission obviously cannot rely upon information that is not in the record without revealing such reliance. CUCA asserted its rights under G.S. 62-65(b) to request a rehearing, after the opportunity for discovery, in order to contest the evidence outside of the record if the Commission ultimately reviews and relies upon BellSouth's year 2000 price plan filing in this proceeding.

CUCA maintained that since the Joint Stipulation allows intercategory offsets, and specifically switched access reductions, in place of intracategory offsets, BellSouth's customers will be unreasonably prejudiced by the Joint Stipulation. CUCA concluded that a final analysis of direct costs and benefits shows that BellSouth's customers who are already financing BellSouth's 27.75% return on equity will be materially harmed by the Joint Stipulation.

Further, CUCA asserted that the other direct cost and benefit issue the Commission must address, which CUCA maintained witness Johnson neglected to investigate, is whether AT&T will flow-through 100% of the switched access charge reductions and how the flow-through will be identified and confirmed. CUCA argued that the risks associated with the flow-through make the decision to reject the Joint Stipulation even easier. CUCA maintained that the limited benefits to be derived from the Joint Stipulation by BellSouth customers are indisputably heavily dependent upon how AT&T accomplishes the flow-through of those access charge reductions. CUCA argued that the record evidence should create concerns for the Commission as to the adequacy of AT&T's flow-through proposal.

(B) Equitable Considerations

CUCA maintained that an evaluation of the "equitable" considerations relevant to the Joint Stipulation include:

(1) BellSouth's return on equity;
(2) Competition in the provision of telecommunications services;
(3) The amount paid by BellSouth's business customers to subsidize basic residential service;
(4) The ability of AT&T to pursue allegations of anticompetitive pricing without raising BellSouth's residential and business rates; and
(5) Political consequences.

CUCA argued that a review of these "equitable" considerations confirms that the Joint Stipulation is unreasonably prejudicial to BellSouth's customers generally, and to its business customers specifically, and inconsistent with the

public interest.

(1) BellSouth's Return on Equity

CUCA stated that BellSouth's return on equity was more than 25% in calendar year 1998 and more than 27% in calendar year 1999. CUCA maintained that allowing BellSouth to continue to earn such profits in the context of a stipulated settlement is particularly distressing because a material share of BellSouth's excessive profitability has been borne on the backs of BellSouth's customers through poorer service quality from BellSouth. CUCA argued that witness Johnson acknowledged a correlation between BellSouth's reduced service quality and higher profitability. CUCA maintained that BellSouth's current return on equity is so excessive that the Commission could actually reduce BellSouth's revenues by the aggregate amount of switched access charge reductions ($83 million), and BellSouth would still be able to earn in excess of a 20% return on equity. CUCA stated that this fact raises the fundamental question as to why price plan modifications of the magnitude proposed in the Joint Stipulation are being proposed in the same year the Commission is scheduled to undertake a comprehensive review of BellSouth's Price Plan.

(2&3) Competition in the Provision of Telecommunications Services and the Amount Paid by BellSouth's Business Customers to Subsidize Basic Residential Service

CUCA argued that one area that was largely glossed over by the Stipulating Parties rather than studied sufficiently was the absence of effective competition within BellSouth's North Carolina territory. CUCA maintained that if effective competition existed in the provisioning of business telecommunications services, it is self-evident that BellSouth would not be able to maintain profit margins on business service rates sufficient to subsidize residential services. CUCA argued that both BellSouth and the Public Staff acknowledged that business service rates are set at a level that subsidizes residential rates but that neither could identify the amount of the subsidy because they both neglected to address the issue. CUCA asserted that the fact that BellSouth's business-derived subsidies remain in place confirms the existence of little or limited competition in BellSouth's service territory.

CUCA also made further arguments concerning market penetration and competition in various facets of BellSouth's services by referencing matters addressed in CUCA Cheatham Cross-Examination Exhibit 8 (Exhibit 8). However, the information in Exhibit 8 was provided by BellSouth to CUCA on a proprietary and confidential basis, consequently, the assertions by CUCA in this regard are not provided herein.

(4) The Ability of AT&T to Pursue Allegations of Anticompetitive Pricing Without Raising BellSouth's Residential and Business Rates

CUCA stated that AT&T's complaint concerning switched access charges can stand alone without the Joint Stipulation. CUCA pointed out that G.S. 62-133.5(e) provides that "[a]ny allegation of anticompetitive activity by a competing local provider or a local exchange company shall be raised in a complaint proceeding pursuant to G.S. 62-73." CUCA concluded that AT&T's ability to address switched access charges through a complaint allows BellSouth's rates to be reduced without commensurate increases in residential and business rates for the purpose of preserving BellSouth's 27.75% return on equity.

(5) Political Consequences

CUCA stated that another consideration for the Commission to evaluate is that telecommunications rate increases in an era of declining costs will undoubtedly confuse and upset some customer groups. CUCA asserted that adoption of the Joint Stipulation will give BellSouth a political shield to deflect criticism for rate increases by asserting that BellSouth is just following the orders of the Commission. CUCA stressed that if BellSouth has the discretion to raise customer rates even without the Joint Stipulation, as BellSouth claims, then BellSouth rather than the Commission ought to suffer the consequences of rate increases in an era of declining telecommunications costs. CUCA asserted that the record does not reveal any clear reason for the Commission to bear the brunt of the political consequences of increasing customer rates for BellSouth's benefit, especially since the result of the rate increases under the Joint Stipulation would be to preserve a 27.75% return on equity that most customers would find difficult to swallow or even

comprehend.

(C) Other Miscellaneous Factors

CUCA maintained that three other miscellaneous factors should be evaluated by the Commission in considering whether to adopt the Joint Stipulation.

First, CUCA maintained that the failure of the parties supporting the Joint Stipulation to undertake adequate supporting studies necessary to evaluate the impact of the Joint Stipulation clearly warrants rejection of the Joint Stipulation. CUCA asserted that the parties' failure to conduct studies to support the Joint Stipulation raises concerns about the propriety of the substantial basket switching proposed in the Joint Stipulation, the reduction of switched access charges, and the customer rate increases. CUCA stated that through the Joint Stipulation, BellSouth is proposing to move more than $200 million in telecommunications products and services from existing baskets to other existing or new baskets, which will provide BellSouth with greater pricing discretion. CUCA argued that witnesses Cheatham and Johnson both admitted that the parties' respective decisions to include this basket shifting was the product of "eyeballing", general knowledge, and compromise, rather than formal study.

Second, CUCA argued that the benefits supposedly offered by the performance guarantees are largely illusory. CUCA argued that before customers are subject to the onerous cost increases associated with the Joint Stipulation, it would seem more reasonable to attempt to enforce existing rules, particularly given the fact that BellSouth has admitted that it has been out of compliance with the applicable service standards set out in Rule R9-8. CUCA asserted that with a 27.75% return on equity, it is not as if BellSouth is suffering a cash shortage that would limit its ability to achieve compliance. CUCA further maintained that it would appear to be a shrewd trade-off on BellSouth's part to forestall Commission review of BellSouth's Price Regulation Plan for an additional year while earning another $250 million to $300 million in exchange for possibly paying a few million dollars in penalties through the Joint Stipulation.

Third, CUCA stated that witness Johnson acknowledged that the entire additional $60 million, BellSouth ADSL investment is not a net win for consumers. CUCA maintained that none of the Stipulating Parties identified any quantifiable benefit to customers associated with the ADSL investment, and that BellSouth's unsubstantiated estimate that it will incur net additional costs of $15 million annually over ten years as a result of its ADSL investment suggests that customers will enjoy little, if any, benefit because apparently few, if any, customers will be using it. CUCA argued that even if the ADSL service is entirely unused, it is difficult to conceive of how BellSouth could lose $150 million by spending $60 million, even with the inclusion of accrued interest. CUCA concluded that the costs associated with BellSouth's ADSL investment are effectively unsubstantiated and that the benefits are unquantified. CUCA asserted that hypothetically, "BellSouth could agree in the Joint Stipulation to burn $15 million per year in a barrel -- it would cost BellSouth a lot of money but would not benefit customers." Further, CUCA remarked that an added long-term benefit to BellSouth of early ADSL deployment will also likely be the limitation of competition from other DSL providers as BellSouth fills its central offices with its own equipment, increasing its opportunity to tell competitors that "the inn is full" and secure a collocation waiver from the Commission. Consequently, CUCA asserted that early deployment may have a negative impact on some groups of customers because it will ultimately limit competition.

Overall, CUCA requested that the Commission reject the Joint Stipulation and proceed with a comprehensive review of BellSouth's Price Regulation Plan. Additionally, CUCA recommended that the Commission also either coordinate switched access charge reductions through the price plan reviews to which the other LECs will be subject or initiate a generic proceeding for the same purpose.

Summary of the
Public Staff's Proposed Order

In its Proposed Order, the Public Staff asserts that there are compelling reasons for approving the Joint Stipulation. It offers the Commission a unique opportunity to deal with a number of pressing issues: access charge reform, service quality improvement, and infrastructure enhancement. The access reductions will take BellSouth's access rates in North Carolina to $.02 per minute in 2002 and place it in the middle of the range for BellSouth's nine-state region instead of at the top. These reductions will total $83 million and will be flowed through dollar for dollar to IXC customers. The cost of these reductions to BellSouth is expected to be at least $16.3 million. The remainder will come from three sources: rate increases that are already permitted and would otherwise be made under the Price Plan, rate increases that

are made possible from reclassifications as permitted under the Plan, and productivity offsets that would otherwise be used to reduce the most competitive rates in the respective baskets under the Plan. The quality of customer service should improve under the system of self-enforcing penalties proposed in the Joint Stipulation. The proposed penalty structure should bring most of BellSouth's performance measurements to the levels established by the Commission. BellSouth will have to invest in service personnel to meet these objectives. If it does not, it will have to credit customer bills by predetermined amounts. The infrastructure enhancement fund will take BellSouth closer toward the goal of bridging the digital divide. BellSouth will have to make an unprofitable investment to deploy ADSL technology at this rate and scope.

The Public Staff further asserted that, given AT&T's persistent desire for access charge reductions, there is good reason to expect it to go forward with its complaint if the Joint Stipulation is rejected and access charges are not reduced. There is also good reason to expect BellSouth to assert a governmental action claim if the Joint Stipulation is rejected and access charges are reduced. Either way, absent the Joint Stipulation, the Commission almost certainly will be faced with the prospect of protracted litigation without any assurance of a better result than the one that is already presented in the Joint Stipulation. Thus, it is clear that rejecting the Joint Stipulation is not a viable option if the benefits of access charge reductions are to be realized. That fact alone would tend to justify approval. When the added benefits of self-enforcing penalties and ADSL deployment are taken into account, the case for approval becomes almost overwhelming.

While the Public Staff recognizes that it is doubtful that the Commission, on its own, would have crafted a proposal identical to the Joint Stipulation in every respect, the Public Staff stated that it considers each component to be reasonable, lawful, and in accordance with the public interest. The Public Staff stated that the Joint Stipulation is in the public interest and should be approved in its entirety. More specifically, the Public Staff sets forth the following reasons and justification in support of its recommendation that the Joint Stipulation be approved:

1. AT&T, BellSouth, and the Public Staff are properly before the Commission seeking approval of the Joint Stipulation pursuant to G.S. 62-133.5(a), G.S. 62-80, and the provisions of BellSouth's Price Plan.

G.S. 62-133.5(a) provides that "[a]ny local exchange company subject to G.S. 62-110(f1), that is subject to rate of return regulation pursuant to G.S. 62-133 or a form of alternative regulation authorized by subsection (b) of this section, may elect to have the rates, terms, and conditions of its services determined pursuant to a form of price regulation, rather than rate of return regulation." Pursuant to this provision, BellSouth elected in 1995 to have its rates regulated under a price regulation plan. G.S. 62-133.5(a) requires the Commission to approve price regulation upon finding that a proposed plan "(i) protects the affordability of basic local exchange service, as such service is defined by the Commission; (ii) reasonably assures the continuation of basic local exchange service that meets reasonable service standards that the Commission may adopt; (iii) will not unreasonably prejudice any class of telephone customers, including telecommunications companies; and (iv) is otherwise consistent with the public interest." By Order issued May 2, 1996, the Commission found that BellSouth's proposed Price Regulation Plan, as modified by agreement between BellSouth and the Public Staff and as further modified by the Commission, satisfied the four statutory criteria. Order Authorizing Price Regulation, 86 N.C.U.C. 570 (1996) (the 1996 Order). BellSouth submitted a Plan with the Commission's modifications on June 3, 1996, and began operation under the Plan effective June 24, 1996. Since then, BellSouth's rates have been regulated pursuant to its Price Plan rather than on the basis of its earnings and an authorized rate of return.

The Commission now has before it a Joint Stipulation that includes certain proposed revisions to BellSouth's Price Plan. A question was raised earlier concerning whether this proceeding is pursuant to G.S. 62-133.5(c), which provides in part: "Any local exchange company subject to price regulation under the provisions of subsection (a) of this section may file an application with the Commission to modify such form of price regulation or for other forms of regulation." The Public Staff takes the position that the Joint Stipulation does not constitute an application to modify the form of price regulation for BellSouth and therefore subsection (c) is inapposite to this proceeding.

In the 1996 Order, the Commission concluded, among other things, that it retained sufficient authority to protect the public interest. The Commission noted that BellSouth had agreed to a review of the Plan within five years and to file earnings surveillance reports annually. The Commission further noted that it retained authority to monitor and maintain service quality, authority to review rate structures and terms and conditions of tariffs against a public interest standard,

and oversight over classification and reclassification of services. Finally, the Commission noted that it has the power to modify the Plan during its term pursuant to G.S. 62-80 and other relevant provisions. 86 N.C.U.C. at 607-608.

The Price Plan revisions proposed by the Joint Stipulation include the reclassification of services, a waiver of the implicit prohibition against intercategory revenue offsets, the addition of self-enforcing penalties for failure to meet service objectives, and a one-year extension of the term of the Plan. Except for the additional constraints imposed on the Switched Access basket, none of the basket or revenue constraints is affected by the Joint Stipulation. Although this is the first time BellSouth has proposed to reclassify services, reclassification is clearly permitted under the Plan. The creation of a new category is a type of reclassification, as is the waiver of restrictions on intercategory revenue offsets. This is not the first time BellSouth has proposed to reduce rates in one category to offset revenues in another category. Last summer, when the Commission ordered BellSouth to reflect the amount of the reductions required by the net inflation-productivity adjustment of approximately $3.1 million as a result of removing the cap on certain services in the Basic Category, BellSouth was allowed to make those reductions in the Switched Access Category. The one-year extension affects the term of the Plan, not its form. Self-enforcing penalties are an addition to the Plan to insure service quality rather than a modification of the form of price regulation itself.

According to the Public Staff, instead of looking to G.S. 62-133.5(c) for authority to consider and approve the proposed Price Plan revisions, the Commission has ample authority under G.S. 62-133.5(a) and the terms of the Plan itself. The Public Staff noted, however, that the criteria for approval of another form of regulation under G.S. 62-133.5(c) are the same as the criteria for approval of price regulation under G.S. 62-133.5(a). Since those are the criteria that were applied to the Price Plan when it was initially approved, the Public Staff believes they should also be applied to the revisions proposed in the Joint Stipulation.

The Public Staff stated that the practical difference between proceeding under G.S. 62-133.5(a) and proceeding under G.S. 62-133.5(c) lies in the interpretation of the following language in subsection (a): "Upon approval [of a price plan], and except as provided in subsection (c) of this section, price regulation shall thereafter be the sole form of regulation imposed on the electing local exchange company, and the Commission shall thenceforth regulate the electing local exchange company's prices, rather than its earnings." (Emphasis added.) It has been suggested that this language confers upon the Commission the authority to regulate the electing company's earnings in a proceeding under subsection (c). The Public Staff does not believe that such a reading was intended by the Legislature. It is the view of the Public Staff that subsection (c) was intended to allow a company that has received price plan approval the option of seeking approval of another kind of price plan or another form of regulation under subsection (b) or even for rate of return regulation. If the company chose the subsection (b) option, it could thenceforth be subject to earnings regulation; if it chose G.S. 62-133, it would be subject to earnings regulation. Thus, the need for the language "except as provided in subsection (c)." Otherwise, the company's earnings would not be regulated. The Public Staff asserted support for this view in G.S. 62-133.5(g), which contains a list of statutes that do not apply to a local exchange company that has elected price regulation under subsection (a). This list includes G.S. 62-81, 62-130, 62-131, 62-132, 62-133, and 62-137, all of which relate to the Commission's general ratemaking authority under traditional rate of return regulation.

2. BellSouth's aggregate intrastate switched access rates in North Carolina are currently $.063 per minute, the highest in the Company's nine-state region. The proposed reduction in BellSouth's switched access rates to $.02 per minute will make significant benefits available to long distance customers in North Carolina.

BellSouth's Price Plan provided for scheduled rate and revenue reductions of approximately $15 million each, a total of $60 million, on the effective date of the Plan and on the next three anniversaries of the Plan. As a result of these reductions, and other revisions in the access rates, BellSouth's switched access rates went from $.1016 per minute at the inception of the Plan to $.0648 per minute on the third anniversary of the Plan. A further reduction to $.063 per minute was accomplished through the $3.1 million revenue offset from the Basic Category discussed above. The Commission required AT&T and the other facilities-based long distance carriers to flow-through these access charge reductions to their customers on a dollar-for-dollar basis.

AT&T argued in its complaint that BellSouth's access rates should be reduced to $.01 per minute. The total annual revenue impact of such a reduction is approximately $99 million. Under the Joint Stipulation, these charges will be reduced to $.04 per minute at the inception of the revised Price Plan, $.03 on the first anniversary, and $.02 on the second anniversary. The total annual revenue impact of these reductions is approximately $83 million. The record shows that $47 million of this impact will occur during the year immediately following the initiation of the revised

Price Plan, $19 million during the year immediately following the first anniversary, and $17 million during the year immediately following the second anniversary.

Witness Cheatham testified that, in addition to the scheduled rate reductions, under the revised Price Plan the revenue in the Toll Switched Access category will become subject to a constraint equal to the change in the GDP-PI minus 2.5%. She explained that the anticipated results of this constraint were incorporated into the scheduled reductions. She further noted that rates in the Toll Switched Access Category will be capped at the aggregate rate in effect upon initiation of the revised Plan and on each subsequent anniversary. If the rates for switched access should reach $.01 per minute, the aggregate rate cap will be removed and the aggregate rate element constraint will become inflation plus 17%, the same constraint that applies to NB1 Services.

AT&T witness Follensbee testified that BellSouth's current access rates range from a high of $.063 per minute in North Carolina to a low of $.025 per minute in Alabama. Witness Follensbee stated that effective January 1, 2001, BellSouth's intrastate access rates in Tennessee will fall to $.015 per minute. He further stated that the scheduled reduction to $.02 per minute under the Joint Stipulation would place BellSouth's access rates in North Carolina in the middle of the nine BellSouth states, which are expected to range from $.01 per minute in Mississippi to $.061 per minute in Florida.

Witness Follensbee cited several benefits to customers that will result from the proposed reduction. The first is lower rates and better pricing plans for long distance customers. AT&T has agreed to flow-through on an aggregate dollar-for-dollar basis the access savings resulting from approval of the Joint Stipulation. Based on current average monthly bills for residential customers, the access reductions contained in the Joint Stipulation will allow AT&T to lower residential customers' bills by an average of $.85 per month. Because AT&T is prohibited from passing along these reductions solely to BellSouth's local customers, these reductions in toll bills will apply statewide. Moreover, even customers who do not make long distance calls will benefit because calls will now be more affordable. Finally, witness Follensbee testified that lower long distance rates will enable North Carolina to compete with surrounding states for businesses that depend on long distance service.

Witness Follensbee stated on cross-examination that flow-through is in AT&T's interest for one main reason: unless access is priced as close to cost as it can be, when BellSouth is granted interLATA long distance relief, AT&T will be unable to compete with BellSouth using its own facilities unless AT&T installs its own facilities as well. Witness Follensbee agreed that prices charged by IXCs are determined by a number of factors, but he stated that for a residential customer, access is half the cost and the predominant driver of what is offered.

Regarding the flow-through to business customers who are served by AT&T pursuant to contract, witness Follensbee explained on cross-examination that the amount of the flow-through depends on the specific contract. If it involves service that is dedicated at one or both ends, the customer would see very little reduction because the customer is already receiving reduced prices. However, the full access charge reductions would be passed on to other customers. In response to questions from the Commission, witness Follensbee offered no flow-through proposal but said that AT&T might leave rates at $.07 under its $.07-Plan and instead lower MTS rates that are distance and time-of-day sensitive.

Witness Johnson testified that the flow-through provisions of the Joint Stipulation will translate into real savings on most customers' bills, including those living outside BellSouth's service area. He stated that another benefit will be a reduction in the disparity and confusion between intrastate and interstate toll rates. In addition, lower prices will stimulate toll calling, and, because the telecommunications business is a declining cost industry, when traffic is stimulated prices can be expected to decline even further under competitive conditions.

On cross-examination, witness Johnson explained that the access reduction in the first year of approximately $.023 converts to a $.025 change for minutes that take place in BellSouth's territory, but the number is adjusted downward to $.012 when looking at an average for all minutes across the state. Thus, a customer making 40 minutes of toll calls would see a $.50 per month reduction the first year, which is consistent with AT&T's estimate of $.85 per month after the second year. He estimated, however, that the cumulative reduction, based on usage of 45 to 50 minutes a month, would be between $.90 and $1.00 at the end of three years.

According to the Public Staff, the uncontroverted evidence in this proceeding supports a reduction in BellSouth's switched access charges. Although the Commission concluded in the 1996 Order that there is no language in the

General Statutes requiring it to reduce access charges to cost, the Commission indicated an expectation that competition would drive BellSouth's rates gradually toward cost. 86 N.C.U.C. at 587. In the case of switched access, that has not happened. Moreover, the record indicates that in recent years switched access charges have declined more rapidly in other states than they have in North Carolina. As a result, the Public Staff takes the position that long distance customers in this State have failed to enjoy the benefits of toll competition to the same extent as their neighbors. AT&T has committed to flow through the entire access charge reduction to its long distance customers on a dollar-for-dollar basis in accordance with procedures authorized by the Commission. The Public Staff has asked that other facilities-based long distance carriers be required to do likewise.

Because the access charge reductions proposed in the Joint Stipulation are contingent upon approval of the proposed revisions to BellSouth's Price Plan, the Public Staff stated that the question then is whether the Price Plan, with those revisions, including the reclassification of certain services, continues to meet the criteria set forth in G.S. 62-133.5(a).

3. BellSouth's Price Plan with the proposed revisions will protect the affordability of basic local exchange service.

In the 1996 Order, the Commission defined "basic local exchange service" to mean "basic residence and business local exchange service." 86 N.C.U.C. at 577. The Commission concluded that BellSouth's rates for basic local exchange service were and would remain affordable under the approved Price Plan. To support this conclusion, the Commission cited several factors: the elimination of Touchtone charges, the three-year cap on residence basic local exchange rates, the availability of Lifeline and Link-up assistance, the gradual rebalancing of rates, the constraint of competition in addition to the pricing rules, and the rising per capita income in North Carolina. 86 N.C.U.C. at 578-79.

The record shows that the current rate for a basic residence line in BellSouth's highest rate group is $12.51 per month. Witness Cheatham testified that, under the Joint Stipulation, BellSouth proposes to offset $24 million of the $83 million in access charge reductions with increases in basic monthly residence rates of approximately $.50 each year or $1.50 by the end of the sixth year of the Price Plan. She emphasized that these increases are in accordance with the pricing rules in the Price Plan that was approved in 1996. Witness Johnson described these increases as moderate, noting that for most customers they will be ameliorated or completely offset by the toll rate reductions. He added that the resulting monthly charge will still be below the $14.77 price charged in 1984 for the highest rate group. To place the proposed increases in further perspective, the Public Staff noted that, in its annual Price Plan filing, BellSouth proposes to increase its basic monthly residence rates by amounts ranging from $.45 to $.57, depending on rate group.

The Public Staff asserted that the decision to give BellSouth the flexibility to raise rates for basic residence and business services was made in the first instance by the General Assembly when it opened BellSouth's franchised areas to competition under G.S. 62-110(f1) and allowed BellSouth to elect price regulation under G.S. 62-133.5. One of the statutory requirements of any price regulation plan is that the carrier must be allowed to adjust its prices in the aggregate or for various aggregated categories of services based on changes in price indices. Another requirement is that the carrier be allowed to rebalance its rates. While BellSouth's Price Plan reflects both of these requirements, it also protects the affordability of basic local exchange service by capping residence rates for the first three years and permitting gradual rebalancing with moderate rate increases that are offset by decreases in rates for other services. The Plan includes both rate element and revenue constraints for the Basic Service Category. The Joint Stipulation does not affect these constraints.

According to the Public Staff, it has been implied during the course of this proceeding that the Joint Stipulation constitutes a proposal to increase basic local rates solely for the purpose of offsetting access charge reductions. However, it is clear from a reading of BellSouth's Price Plan and from the testimony in the record that this is not the case. It is true that the Joint Stipulation contemplates and makes use of increases in rates for basic local exchange service, but those increases are already permitted under the Price Plan as part of the gradual rebalancing anticipated in the 1996 Order. Absent the Joint Stipulation, basic local exchange rates could and would increase by even greater amounts. In other words, the access charges reductions under the Joint Stipulation are not necessary to justify the price changes proposed by BellSouth.

For the foregoing reasons, as well as the reasons stated in the 1996 Order, the Public Staff asserted that BellSouth's Price Plan, with the proposed revisions, will protect the affordability of basic local exchange service.

4. BellSouth's Price Plan with the proposed revisions will reasonably assure the continuation of basic local exchange service that meets reasonable service standards.

The Commission noted in the 1996 Order that its Rule R9-8 prescribes service objectives for all local exchange companies in North Carolina. The Commission further noted that it retains the statutory authority under G.S. 62-42 to compel efficient service and can investigate service problems either on its own motion or upon complaint. The Commission said the record was clear that BellSouth was providing excellent service in North Carolina. 86 N.C.U.C. at 579. The Public Staff asserted that the record today, however, indicates that BellSouth's service has deteriorated and that BellSouth is not meeting all of the Commission's service objectives. To remedy this problem, BellSouth has agreed in the Joint Stipulation to a system of self-enforcing penalties for failure to meet certain service objectives on an annual basis.

Under the Joint Stipulation, Section XI. SERVICE MEASUREMENTS will be added to BellSouth's Price Plan. Penalties will be assessed if objectives are not met for eight service measurements based on yearly statewide service results. The objectives are a subset of those currently specified in Commission Rule R9-8 except for one, out-of-service troubles cleared within 24 hours. If the yearly statewide average service result for a given measurement satisfies the objective, no penalty will be assessed even though one or more monthly measurements may have been missed. If the yearly statewide average falls below the objective, a $10,000 monthly penalty will accrue for every unit by which the objective is missed. Additional penalties will apply depending on the number of months in which the objective is missed: $250,000 if there are 3 - 5 monthly performance misses for a service measurement, $500,000 if there are 6 - 8 monthly performance misses, and $1,000,000 if there are 9 - 12 monthly performance misses. BellSouth may ask the Commission to waive the penalty for any objective for any month it believes a special circumstance beyond its control has prevented it from meeting one or more objectives. Penalty amounts at the end of the year will be credited to bills of all residence and business customers.

All service results provided by BellSouth will be considered proprietary except those currently provided on a nonproprietary basis. BellSouth will begin providing the number of Commission complaints monthly on an exchange basis. BellSouth will also begin providing on a proprietary basis for Commission and Public Staff inspection the results of regular service orders completed within five working days and new service orders held over 30 days on an exchange basis. BellSouth will continue to provide initial trouble reports per 100 access lines on an exchange basis.

Witness Cheatham testified that at one point BellSouth probably cut too many people and service suffered. She added, however, that she thinks BellSouth has learned from this and it is not going to happen again. In her opinion, the self-enforcing penalties are a little insurance policy that it does not happen. Although witness Cheatham was unable to give the results of service quality measurements that are proprietary, she did state that if the self-enforcing penalty provision had been in effect in 1999, BellSouth would have been subject to over $3 million in penalties. Witness Cheatham acknowledged that these self-enforcing penalties for failure to meet certain objectives are in addition to any penalties the Commission might impose for failure to meet the objectives in its rules.

Witness Johnson testified that the majority of the service complaints involve price plan companies, which no longer have to fear rate of return penalties and have every incentive to cut costs. He stated that since the implementation of price regulation, BellSouth's service measurements have deteriorated while complaints have escalated. He noted that, while theoretically customers could turn to a competitor if they are not satisfied with BellSouth's service, we are still at an early stage in the transition toward a more competitive market. Furthermore, competitors may resell BellSouth service or depend on BellSouth for various network elements, so the quality of service they offer may be limited to that of BellSouth.

Witness Johnson explained that the remedies for compelling adequate service are few. The Commission can impose rate of return penalties for service inadequacies due to mismanagement in general rate cases for LECs that are not under price regulation. The Commission can also order a LEC to show cause why it should not be subject to fines and penalties for failure to meet the standards in Rule R9-8. However, actions to collect penalties must be instituted in Superior Court and monies forfeited are remitted to the State. The only other remedy would be to specify penalties in the Rule itself, but that would be time consuming and likely to be contested.

Witness Johnson stated that the self-enforcing mechanism should be preferable to the normal penalty process, since it will allow BellSouth, the Commission, and the Public Staff to direct their resources where they will do the most good

for consumers. It gives BellSouth both the incentive and the opportunity to meet the Commission's objectives and lower the incidence of service complaints.

The Public Staff asserted that the Commission should be seriously concerned about the deterioration of service quality since BellSouth elected price regulation. It is all too apparent, as witness Johnson noted, that BellSouth has had every incentive under its Price Plan to cut costs at the expense of service. It is the opinion of the Public Staff that the system of self-enforcing penalties proposed in the Joint Stipulation provides a much needed remedy and improves the Plan significantly. It will be both an incentive to BellSouth and an assurance to customers that service quality will improve. The Public Staff emphasizes, however, that it considers the objectives in Rule R9-8 to be the minimum standards for all LECs and that all LECs should be expected to meet or exceed those standards. According to the Public Staff, the Commission should continue to monitor service measurements and take whatever additional action is necessary within its powers to ensure that BellSouth's customers receive the quality of service to which they are entitled.

For the foregoing reasons, the Public Staff asserted that BellSouth's Price Plan with the proposed revisions will reasonably assure the continuation of basic local exchange service that meets reasonable service standards.

5. BellSouth's Price Plan with the proposed revisions will not unreasonably prejudice any class of telephone customers, including telecommunications companies.

BellSouth's Price Plan provides for services to be reclassified to less restrictive categories as competition develops. Under the Joint Stipulation, the nonline portion of certain package services (Frequent Caller, Complete Choice, Area Plus, and Area Plus with Complete Choice) will be reclassified from the Basic Category to the NB1 Category. In addition, certain services will be reclassified from the Non-Basic 1 Category to a new category, Non-Basic 1.5, where they will be subject to a rate element constraint of inflation plus 17%, the same as Non-Basic 1, and a revenue constraint of inflation plus 3%.

Witness Cheatham stated in response to questions from the Commission that the services to be moved into the Non-Basic 1.5 Category were selected using degree of competitiveness as the criterion. She further stated that the list was developed as part of a negotiation with the Public Staff. She offered no formal studies to support this selection but referred to various competitors' websites as evidence of competition. As for the nonline portion of certain packages of vertical services that are to be moved from Basic to Non-Basic 1, also the product of negotiation, witness Cheatham explained that vertical services individually are already in the Non-Basic 1 Category. She further stated that, in her opinion, packages are where competition is going to go.

Witness Johnson agreed that the services being transferred into the new category are becoming more competitive, MTS and WATS, for example. He stated that by moving these services to Non-Basic 1.5, the Public Staff has given BellSouth some increased pricing flexibility but not without constraints and only for a relatively brief period until the full plan is reviewed. He stated that data transport services are also increasingly competitive because of the unbundled network environment and that competitors are well positioned to offer the value added functions. As for packages of vertical services, witness Johnson said they are not necessarily competitive but are discretionary. He noted that as a result of the move of the nonline portion to Non-Basic 1, the rate element constraint will be much broader but the productivity offset will increase from 2% to 3%.

The Public Staff takes the position, as witness Cheatham noted, that reclassification is more of an art than a science. However, the Public Staff stated that it has agreed to support only those reclassifications which it believes are justified under current market conditions. Based on the testimony of the witnesses, and on an examination of the services that will be reclassified, the Public Staff is of the opinion that the proposed reclassifications, including the creation of the new basket, are consistent with the principles of price regulation embodied in the Price Plan from the outset.

According to the Public Staff, in the 1996 proceeding, three customer groups challenged various aspects of the proposed plan under this criterion. Two of those groups, interexchange carriers and business customers, are represented in this proceeding. The interexchange carriers, of course, have largely achieved their objective of access charge reductions under the Joint Stipulation. The IXCs also argued in the earlier proceeding that switched access charges should be capped on a rate element basis rather than in the aggregate. Under the Joint Stipulation, a rate element constraint of inflation plus 17% will take effect in the Switched Access Category if the aggregate rate for switched access reaches $.01.

According to the Public Staff, CUCA argued that business customers are prejudiced because many rates for business services are priced above cost and because both competitive and noncompetitive services are in the same basket. The Commission agreed, however, with BellSouth's witness that competition makes further increases in rates for business services unlikely. 86 N.C.U.C. at 582. CUCA has raised essentially the same arguments in this proceeding, and the Public Staff urges the Commission to reach the same conclusion. The Public Staff asserts that nothing in the record in this case indicates that rate increases for complex business services are any more likely today.

CUCA has also suggested that BellSouth's customers will be prejudiced by experiencing rate increases under the Price Plan while customers of other LECs receive reductions in their toll rates. Similarly, BellSouth's business customers will experience rate increases but will not receive the benefit of toll rate reductions. The Public Staff finds no unreasonable prejudice or disadvantage in either instance. The witnesses accurately cited both state and federal law that requires AT&T and other interexchange carriers to charge uniform toll rates. To do otherwise would indeed be to subject one group of customers to unreasonable prejudice. Moreover, the Public Staff notes that GTE and Sprint already have the ability to offset local rate increases with access charge reductions in the Basic basket under their Price Plans, and these reductions would be flowed through to toll rates paid by BellSouth's customers. As for businesses who may not receive the benefits of the flow-through, because they already receive discounted toll service under contract, the Public Staff notes that their local rates are unlikely to increase for the same reason -- competition. Finally, the Public Staff asserts that while the Joint Stipulation proposes price plan revisions to enable BellSouth to offset a portion of the access charge reductions, BellSouth could have implemented many of the increases anyway and could have requested reclassifications that would have permitted the remaining ones regardless of whether access charges were reduced.

For the foregoing reasons, the Public Staff asserted that BellSouth's Price Plan with the proposed revisions will not unreasonably prejudice any class of telephone customers, including telecommunications companies.

6. BellSouth's Price Plan with the proposed revisions will be otherwise consistent with the public interest.

Witness Cheatham testified that, under the Joint Stipulation, BellSouth will be allowed to offset $12.2 million of the $47 million first year access revenue reduction with revenues from rate increases in the Basic Category. In response to questions from the Commission, she explained that revenues include $6.9 million from residence rate increases, $4,000 from increases in NARS associated with Thrifty Caller Service, $1.7 million from increases in the line portion of optional packages, $1.4 million from the reduction in the number of free DA allowance from five to four, and $2.2 million from increases in rates for single line business services in the lower rate groups. By contrast, BellSouth's most recent annual filing includes rate increases totaling $17.8 million and revenue decreases totaling $20.8 million in the Basic Category. Under the Joint Stipulation, BellSouth will be allowed to offset an additional $15.1 million of the access reduction with revenues from rate increases in NB1. These include $7.7 million from increases in the nonline portion of Complete Choice and Area Plus, $7.1 million from increases in vertical features, $200,000 from Frequent Caller Service, and $19,000 from Toll Terminals and Residential ISDN. By contrast, the annual filing shows total revenue increases in NB1 of $3.9 million and revenue decreases totaling $7.9 million.

According to the Public Staff, information provided by the Public Staff and entered by CUCA on cross-examination shows that in addition to the $27.3 million from rate increases under the Plan, BellSouth will also be allowed to use $8.3 million in required productivity offsets in these two categories to reduce switched access charges. Another $855,000 will come from productivity offsets in the Toll Switched Access Category itself. The remaining $10.7 million will be "give up" by BellSouth. In the second year, the revenue increase offsets will total $10.8 million, the productivity offsets total $5.5 million, and the "give up" is $1.7 million. In the third year, the increases will total $8.5 million, the offsets $4.5 million, and the "give up" $4 million. These numbers, however, are only estimates. The record shows that the productivity offset calculation assumes a revenue growth rate of 4% per year. The rate of inflation is estimated at 1.3% for 2000, 1.7% for 2001, and 1.9% for 2002. Witness Cheatham testified that the 2000 rate is actually 1.6%, which means a smaller productivity offset and a correspondingly larger "give up" by BellSouth under the Joint Stipulation.

All three witnesses were questioned about the relevance of BellSouth's earnings in this proceeding. Witness Follensbee was asked about the allegation in AT&T's complaint that "BellSouth's earnings are so overwhelmingly healthy that its switched access rate could be reduced with no need to offset the reductions with higher rates for other services" and the statement in his testimony in support of the complaint to the effect that access rates could be reduced without affecting local residential rates. He emphasized that AT&T's concern was to achieve access reductions, which the

Joint Stipulation does.

Witness Cheatham testified on cross-examination that BellSouth's current earnings level indicates that price regulation is working as intended. BellSouth is doing a good job of introducing new services and keeping expenses under control. She conceded that at one point BellSouth probably cut too many jobs, which affected service quality, but said that BellSouth is not cutting costs at the expense of quality today.

In response to questions from the Commission, witness Cheatham agreed that a 1% change in BellSouth's jurisdictional return on common equity equates to a change of $15.1 million in gross revenues. She also agreed that if BellSouth absorbed the entire $83 million reduction in access revenues, its return on equity would be reduced by about 5½%, bringing it down to about 22¼%. When asked why, in view of its earnings, BellSouth should be allowed to recover the lost revenues proposed in the Joint Stipulation, witness Cheatham responded that BellSouth is not recovering all of those revenues under the Stipulation. She stated that there is a $35 million buy-in, plus the ADSL infrastructure fund. In addition, she stated that BellSouth's earnings were primarily achieved through increased revenues, the bulk of which came from the sale of competitive services, such as MegaLink and ISDN, and less-competitive but discretionary vertical services.

According to the Public Staff, witness Johnson testified on cross-examination that earnings are something the Commission can and should consider when it reviews BellSouth's Price Plan. He stated that the proper way to look at earnings is to look at all of the price plan companies and try to understand why some are making higher returns than others. Witness Johnson noted that price regulation is supposed to break the linkage between prices and earnings. He stated that if management does a good job of cutting costs or generating revenues and increases profitability, taking away those profits removes the incentive to cut costs or grow revenues. Witness Johnson also questioned whether the Commission has the clear-cut legal right to demand that BellSouth lower particular rates without giving any compensating relief. He further stated that if a company has excessive earnings because of a flaw in the plan, that flaw should be fixed. For example, the productivity offsets might not have been deep enough or the rate element constraints might not have been set properly. In witness Johnson's view, however, if a company's earnings are high, that does not automatically mean its rates need to be reduced to bring the return to a particular level. He stated that the process is more sophisticated and recommended that the Commission identify what is causing the high returns and what is the appropriate response to them.

Witness Johnson testified that the upcoming price plan reviews for GTE and Sprint give the Commission the opportunity to begin this process, and he recommended that these reviews be very thorough. As to the relationship between this proceeding and the end of plan review, witness Johnson stated that the Commission could in good conscience approve the Joint Stipulation and, if it is troubled by some aspects, give the parties fair warning of what it will study more deeply in a full review. But this is not the forum to deal with issues like rate of return.

He stated that a one-year delay in the review for BellSouth gives the Commission in effect two years in which to review BellSouth's data. Then, after focusing generically on GTE's and Sprint's plans, the Commission can focus more intensely on BellSouth and any necessary improvements in its Plan.

According to the Public Staff, undisputed data indicate that BellSouth's earnings are much higher today than they were four years ago. The Public Staff recognized that the Commission might well be troubled, to say the least, by the prospect of rate increases in face of such earnings. Nevertheless, the Public Staff asserted that earnings have a different relevance in cases involving price regulation than they do in cases involving rate of return regulation. For example, if BellSouth's rates were still regulated pursuant to G.S. 62-133, the Commission would clearly have the authority to order rate reductions if, after investigation and hearing, it found BellSouth's current level of earnings to be in excess of a reasonable rate of return. The Commission's authority to order reductions in the context of this case is more problematic.

Although AT&T has alleged that BellSouth's access charges are unlawfully high, the Public Staff stated that BellSouth had denied those allegations and presumably would contest them in a hearing on the merits of the complaint. Furthermore, BellSouth has indicated that if the Commission ordered it to reduce access charges, it would seek to recover the associated revenues under the governmental action provision of its Price Plan. As an alternative, BellSouth has agreed to access charge reductions as part of the Joint Stipulation.

The Public Staff asserted that it would be inappropriate to decide whether to accept or reject the proposed Price Plan revisions based on BellSouth's earnings. Both AT&T and CUCA argued that the Commission should conduct a general rate case for BellSouth going into the Price Plan, but the Commission rejected those arguments in its 1996 Order, citing G.S. 62-133.5(a) and (g). 86 N.C.U.C. at 594. While the Commission did say that BellSouth's earnings were relevant to the proceeding and had been considered in developing the Price Plan, it also found and concluded that there was no justification for revenue or rate reductions in addition to the $60 million agreed to by BellSouth as a buy-in.

In this proceeding, the Public Staff noted that BellSouth has also agreed to a buy-in. The record shows that there is $16.3 million in pure "give up" and, as witness Cheatham testified, if the productivity offsets decrease because inflation is higher than expected, that give up increases. The carrying charges on accelerated ADSL deployment are also "give up", as witness Cheatham explained. The Public Staff asserts that to determine that BellSouth's earnings are sufficient to fund an additional buy-in and still leave BellSouth the opportunity to earn a reasonable rate of return would come close to having a general rate case which is beyond the Commission's authority under price regulation.

However, even without authority to regulate earnings *per se*, the Public Staff stated that the Commission is not required to ignore earnings, particularly when reviewing the Price Plan as a whole. The Public Staff cites witness Johnson's testimony that a full review of the Plan is the context in which to evaluate the effect of the Plan on earnings and to make modifications to the Plan. According to the Public Staff, a detailed understanding of how and why BellSouth's earnings have increased since price regulation was implemented will serve as an indication of whether certain service classifications and pricing constraints are appropriate under current market conditions.

The Joint Stipulation calls for the term of BellSouth's Price Plan to be extended by one year, until June 24, 2002. The Public Staff stated that this will allow time to gain experience with the self-enforcing penalties and other revisions and to conduct the kind of earnings analysis that is relevant in a price regulation environment and to take appropriate action within the scope of our authority. According to the Public Staff, with the case that is before the Commission today, the Commission has little choice but to accept BellSouth's earnings as a consequence of the decisions which were made in 1996. BellSouth has clearly taken advantage of price regulation to the benefit of its stockholders. The Public Staff took the position that it does not necessarily follow that this has been detrimental to the interests of ratepayers, particularly those whose rates have been capped and proposed to go up for the first time this year and that the only indication that earnings have grown at ratepayer expense is in the area of service quality, where BellSouth concedes it cut costs and service suffered. BellSouth has agreed to a system of self-enforcing penalties to insure that the proper incentives are in the Price Plan.

Based on the foregoing, the Public Staff asserted that BellSouth's Price Plan with the proposed revisions will be otherwise consistent with the public interest.

7. The proposed infrastructure enhancement fund for deployment of ADSL technology will make ADSL available to over 50% of BellSouth's access lines and will further the goal of bridging the "digital divide" between rural and urban areas of the State.

Under the Joint Stipulation, BellSouth will deploy approximately $97.8 million in ADSL in North Carolina by the end of 2002, an increase of $60 million over its previous investment plans. This added investment will result in 95 central offices and 2,100 remote terminal sites being equipped with ADSL technology. BellSouth will file annual reports beginning January 1, 2001, detailing its progress in deploying ADSL. Witness Cheatham testified that this deployment will make ADSL accessible to over 50% of BellSouth's lines in North Carolina.

Witness Cheatham explained on cross-examination that BellSouth's planning for ADSL is done on a regional basis with very little of it being state specific. She stated that during the negotiations BellSouth went back to the regional budget and looked at how it could be allocated to North Carolina and what central offices and remote sites would be equipped through that allocation. She stated that the $60 million represents completely new investment. She further stated that BellSouth had planned to deploy $37.5 million over five years, which is now included in the $97.8 million BellSouth has agreed to deploy by the end of 2002. As for the profitability of this investment, she stated that an analysis of revenues versus expenses versus investment and carrying charges over a ten-year period did not show a positive contribution but instead showed that the Joint Stipulation requires an additional "give up" by BellSouth.

In response to questions from the Commission, witness Cheatham stated that the net carrying charges associated with

the additional investment in ADSL will be $15 million annually, which includes an offset for revenues that would be derived from the sale of these services. She also explained that the proposal includes all but four of BellSouth's central offices -- the Raleigh and Charlotte Airport central offices, which are exclusively business customers, and the Milton and Gatewood central offices, which are in the Virginia LATA.

Witness Johnson testified that the addition of $60 million to BellSouth's previous investment plans represents a net additional cost to BellSouth of $15 million annually over ten years. He also stated that customers will benefit from more rapid deployment of ADSL in three ways. First, infrastructure improvements will be more widely spread across the state, including areas where the potential revenues alone would not necessarily be sufficient to encourage BellSouth to invest in this technology. He noted that 11 of the central offices listed in the Joint Stipulation are in areas that have been identified as economically disadvantaged. Second, rapid deployment of ADSL will help meet the growing demand for bandwidth by business and residence customers. And third, this investment may lead to additional investment in DSL-type technology by other carriers as well as by BellSouth as experience is gained with this technology.

The Public Staff argued that the establishment of an infrastructure enhancement fund for the accelerated deployment of ADSL is a significant commitment on the part of BellSouth. The Public Staff stated that it is satisfied that the scheduled installation of ADSL equipment under this Plan is well beyond what would have occurred in the ordinary course of business. It will clearly take the company and its customers much closer to the public policy goal of making Internet access equally available in both rural and urban areas.

8. The Joint Stipulation is in the public interest and should be approved in its entirety.

According to the Public Staff, it is clear from the all of the testimony that the Joint Stipulation is the product of give and take negotiation among the parties. Witness Cheatham described it as an integrated package. She also described it as a "win-win-win" proposition. On cross-examination, she explained that BellSouth benefits by being able to reduce access charges as well as from the creation of a new basket that recognizes the transition of services from slightly less competitive to increasingly competitive. AT&T receives lower access charges, which it has agreed to flow through, so customers receive the benefit of lower toll rates. The Public Staff benefits in that BellSouth has agreed to self-enforcing penalties. Finally, the public benefits from an almost $100 million ADSL infrastructure fund.

Witness Johnson also described the benefits to consumers. The first thing is the self-enforcing penalty provision, which is accomplished immediately. He noted that it would probably take a year or more to get such a plan in effect through the normal course of the regulatory process. The second is the movement downward in switched access rates at a moderate pace, a sort of controlled decline towards greater parity with the interstate jurisdiction as well as neighboring state jurisdictions. This is accomplished without a lengthy argument before the Commission and a likely appeal. In addition, instead of raising residence rates and offsetting them with business reductions, lowering access will flow through directly to residence customers, while BellSouth will still be under pressure to lower business rates in the long run. Another benefit, witness Johnson said, is the ADSL deployment, because it spreads that investment more rapidly and more broadly than BellSouth would do on its own. He added that once this technology is available, it will create pressure on BellSouth to deploy it to the rest of the people in the area.

CUCA sought, on cross-examination of witness Johnson, to compare the proposed effects of the Joint Stipulation, including the proposed revisions to the Price Plan, with experience during 1999. Witness Johnson, however, insisted that the proper comparison is between the effect of the Joint Stipulation and the operation of the Price Plan today without the proposed revisions. Witness Johnson further stated, in response to questions from the Commission, that the question is whether the public is better off implementing the Joint Stipulation or not implementing it. The Public Staff further asserted that many of the rate changes that will occur under the Joint Stipulation will also occur if the Joint Stipulation is rejected, that access rates will remain at current levels, as will intrastate toll rates, that service quality will remain unaddressed in the Price Plan, and that ADSL deployment will remain a laudable but significantly underfunded goal.

For all of the reasons set forth above, the Public Staff asserted that the Joint Stipulation is in the public interest and should be approved in its entirety.

Based on the foregoing, the evidence adduced at the hearing, and the entire record in these dockets, the Commission

now makes the following

FINDINGS OF FACT

1. BellSouth is an incumbent local exchange company serving approximately 2.3 million customers, including 1.6 million residential customers, in North Carolina. BellSouth's rates are regulated under a Price Regulation Plan approved by the Commission pursuant to G.S. 62-133.5.

2. AT&T is a facilities-based interexchange carrier serving customers of BellSouth and other local exchange companies in North Carolina. AT&T's rates are regulated under a ceiling rate plan pursuant to Commission Orders.

3. AT&T, BellSouth, and the Public Staff are properly before the Commission seeking approval of the Joint Stipulation pursuant to G.S. 62-133.5(c), G.S. 62-80, and the provisions of BellSouth's Price Plan.

4. BellSouth's aggregate intrastate switched access rate in North Carolina is currently $.063 per minute, the highest in the Company's nine-state region. The proposed reduction in BellSouth's aggregate switched access rate to $.02 per minute will make significant benefits available to intrastate long distance customers in North Carolina.

5. BellSouth's Price Plan with the proposed revisions set forth in this Order will, in accordance with G.S. 62-133.5 (c):

(a) Protect the affordability of basic local exchange service.

(b) Reasonably assure the continuation of basic local exchange service that meets reasonable service standards.

(c) Not unreasonably prejudice any class of telephone customers, including telecommunications companies.

(d) Be otherwise consistent with the public interest.

6. The proposed infrastructure enhancement fund for deployment of ADSL technology will make ADSL available to over 50% of BellSouth's access lines and will further the goal of bridging the "digital divide" between rural and urban areas of North Carolina.

7. The Joint Stipulation as modified by the provisions of this Order is in the public interest and should be approved.

WHEREUPON, the Commission reaches the following

CONCLUSIONS

The Commission commends all of the parties to this proceeding for the manner in which they have addressed some of the most difficult and complex issues the Commission has ever been called upon to decide. This case offers the Commission and the parties a unique opportunity to address and constructively resolve, in particular, the very important and difficult issues of access charge reform, service quality improvement, and infrastructure enhancement. The Joint Stipulation, as proposed by BellSouth, AT&T, and the Public Staff, has many aspects and features which are very beneficial to consumers and which are therefore very attractive to the Commission, including the following:

I. The Joint Stipulation settles AT&T's complaint concerning the current level of BellSouth's intrastate switched access charges:

(1) BellSouth agrees to reduce its aggregate intrastate switched access rate from $.063 to $.02 per minute over a two-year period.

(2) AT&T agrees to flow through to North Carolina consumers on an aggregate dollar-for-

dollar basis the resultant intrastate access charge savings:

(a) AT&T's North Carolina residential customer intrastate long distance bills on average will be reduced by $.85 per month or more than 14%.See footnote 1

(b) AT&T's North Carolina intrastate long distance rate reductions should increase the number of customers who can afford to make such calls and enhance the competitiveness of the state in attracting industry.

(3) The total annual revenue impact of the access charge reductions, once fully implemented, will be approximately $83 million. These intrastate reductions will be flowed through dollar-for-dollar to customers of IXCs who pay access charges to BellSouth.

(4) The disparity between intrastate and interstate long distance rates will be lessened and lower prices for intrastate long distance services should stimulate toll calling.

II. The Joint Stipulation establishes service objectives with associated self-enforcing penalties See footnote 2 if such objectives are not met:

BellSouth will change its Price Regulation Plan to provide for the payment of penalties if objectives established for the measurement of certain quality of service standards are not met.

(1) The provisions for penalties will be applicable to eight service quality measures. The objectives for each of these eight measurements will be those currently specified by Commission Rule R9-8, except for out-of-service trouble reports cleared within 24 hours. Penalties for that service objective will be assessed only if BellSouth fails to achieve a 90% objective. See footnote 3

(2) Penalties, if any, arising in this regard will be self-enforcing (i.e., BellSouth will calculate and determine penalty) and will be credited to the bills of all retail residential and business customers receiving retail services from BellSouth.

The Commission certainly anticipates and expects that the quality of service currently being provided by BellSouth to its customers in North Carolina will improve under the system of self-enforcing penalties proposed in the Joint Stipulation. The Commission will carefully monitor BellSouth's ongoing compliance with the quality of service measures set forth in the Joint Stipulation and Rule R9-8 to ensure that the Company does in fact meet the specified service objectives and also takes all appropriate actions, including investing in additional personnel as necessary, to provide good and reliable service to its customers which meets reasonable service standards on a consistent and continuing basis.

III. The Joint Stipulation establishes an enhanced infrastructure fund to further ADSL deployment throughout North Carolina:

BellSouth agrees to deploy approximately $97.8 million in investment in ADSL in North Carolina by year-end 2002. This represents an investment plan that exceeds BellSouth's previous plans for North Carolina by $60 million. Because of this added incremental investment, 95 central offices will be equipped for ADSL in advance of BellSouth's preexisting baseline schedule.

The Commission applauds and strongly endorses this aspect of the Joint Stipulation based upon a belief that BellSouth's stated commitment to this investment in enhanced telecommunications infrastructure is vitally important to the rural areas of North Carolina in particular. This is an important step which will bring North Carolina closer to meeting the goal of bridging the digital divide for all citizens of the State. The Commission will carefully monitor BellSouth's deployment of ADSL through the reports on deployment which will be submitted under the Joint Stipulation to ensure that the benefits of such investment are in fact made available to consumers according to the schedule committed to by the Company.

IV. The Joint Stipulation postpones the Commission's comprehensive review of BellSouth's Price Regulation Plan such that the review would be deferred for approximately one year so that it would not occur prior to June 24, 2001:

(1) Postponement for a year would allow the Commission an opportunity to evaluate the impact of the revised Plan over a longer period of time.

(2) Postponement will allow additional time to prepare for a comprehensive review of the revised Plan, the purpose of which is to ensure that the operation of the Plan comports with the General Statutes, particularly from the standpoint of ensuring that it continues to meet the following conditions:

a. protects the affordability of basic local exchange service, as such is defined by the Commission,

b. reasonably assures the continuation of basic local exchange service that meets reasonable service standards that the Commission may adopt,

c. will not unreasonably prejudice any class of telephone customers, including telecommunications companies, and

d. is otherwise consistent with the public interest.

Notwithstanding the obvious benefits contained in the Joint Stipulation, there are nevertheless certain aspects and features of the Stipulation which are troubling to the Commission and which the Commission is unable to endorse at this time.

First, in consideration of BellSouth's current level of earnings, the Commission can find no compelling justification to allow the Company to increase any revenues, in either the Basic or NB1 Categories, effective on the date of initiation of a revised Plan. See footnote 4 The Commission recognizes that changing this part of the Joint Stipulation will require BellSouth to forego the revenue increase in the total amount of $27.3 million which the Company proposed to immediately implement for services in the Basic and NB1 Categories. Such action will clearly serve to further protect the affordability of basic local exchange service while promoting the public interest. Nevertheless, as a matter of fundamental fairness to BellSouth and in order to ameliorate the immediate financial impact of this decision on the Company, the Commission finds good cause to allow BellSouth to initially reduce its aggregate intrastate switched access rate from $.063 to $.045 per minute on the day a revised Plan will, hopefully, be initiated in response to this Order. See footnote 5 More specifically, if the modifications set forth in this Order are accepted by BellSouth, the Company's total potential "give up" under the Joint Stipulation, as so revised, will more than double, increasing from approximately $16.3 million to $43.6 million. See footnote 6 This provides further benefit to consumers, who would see no rate increases upon initiation of the revised Plan, in addition to the significant benefits already contained in the Joint Stipulation, without unreasonably impacting BellSouth in an unfair, prejudicial, or unlawful manner.

Second, the Commission can find no compelling justification to authorize creation of the new NB1.5 Service Category at this time. See footnote 7 Creation of this new service category is a matter which BellSouth will be free to pursue during the comprehensive review of the Company's Price Regulation Plan. Deferral of a decision on the merits of whether to allow BellSouth to implement the new NB1.5 Service Category at this time will serve to further ensure that there will be no unreasonable prejudice against any class of telephone customers as a result of these proceedings. The Commission is unable, on the basis of the record in this case, to conclude that the services proposed for inclusion in the new NB1.5 Service Category are sufficiently competitive at this time to justify their transfer from the NB1 Category. Such action, if justifiable, is better considered and allowed in the context of the upcoming comprehensive review of BellSouth's Price Regulation Plan. The Commission must ensure that customers who will be affected by this very significant change do not experience unreasonable disadvantage or prejudice.

Accordingly, the Commission is hopeful that BellSouth will accept the revisions to the Joint Stipulation as set forth in this Order and that the Company will file a statement notifying the Commission that it accepts and agrees to

revise and refile its Commission-approved Price Regulation Plan with an effective date of not later than August 1, 2000. The revisions to the Joint Stipulation and BellSouth's Price Regulation Plan as requested by the Commission in this Order strengthen the final outcome of this case by balancing the interests of all affected parties while not unfairly penalizing BellSouth or its customers. The Commission is also hopeful that all of the other parties to this proceeding will endorse and support the revisions requested by the Commission so that this matter can be successfully resolved without the need for further proceedings, which would likely be both contentious and protracted in nature. The Commission is convinced that a revised Price Regulation Plan filed in conformity with the provisions of this Order will be reasonable, lawful, and consistent with the public interest. Furthermore, such revised Plan will not subject any class of customers to unreasonable prejudice or disadvantage.

Once BellSouth has had an opportunity to respond to this Order, the Commission will rule on the petition filed by the Public Staff on February 16, 2000, in Docket No. P-100, Sub 72, seeking a flow through of access charge reductions.

IT IS, THEREFORE, ORDERED that BellSouth shall file a statement in these dockets not later than August 1, 2000, notifying the Commission whether the Company (a) accepts and agrees to all of the terms, conditions, and provisions of this Order and (b) is willing to revise and refile its Commission-approved Price Regulation Plan, including any necessary tariff revisions, with an effective date of not later than August 1, 2000.

ISSUED BY ORDER OF THE COMMISSION.

This the 24th day of July, 2000.

NORTH CAROLINA UTILITIES COMMISSION
Gail L. Mount, Deputy Clerk

mz072400.03

Commissioner Robert V. Owens, Jr., dissents in part and concurs in part.

DOCKET NOS. P-55, SUB 1013; P-55, SUB 1161; AND P-100, SUB 72
AT&T/BELLSOUTH/PUBLIC STAFF ACCESS CHARGE
AND PRICE PLAN JOINT STIPULATION

COMMISSIONER ROBERT V. OWENS, JR., DISSENTING IN PART AND CONCURRING IN PART: I respectfully dissent in part from the Majority's decision in this case. I would have disapproved the Joint Stipulation in its entirety, and I would have proceeded immediately with comprehensive investigations of AT&T's access charge complaint and BellSouth's Price Regulation Plan. I would have done those things essentially for the very same reasons that disapproval of the Joint Stipulation was recommended by the North Carolina Department of Justice. I firmly believe that to do otherwise is to act in a manner that is contrary and detrimental to the public interest.

Currently, BellSouth's rates are regulated under a Price Regulation Plan. Under that form of regulation, in theory, it is argued that competitive market forces will operate to prevent firms, such as BellSouth, from charging excessive monopolistic prices for their goods and services. Unfortunately, however, there appears to be a major obstacle in place that continues to thwart the effectiveness of price regulation in this instance; the market for basic local exchange service appears to be far less than fully competitive, and it appears to be dominated, particularly in certain instances, by an entrenched BellSouth. See footnote 1 While I do not disagree with economic theory regarding the pricing behavior of firms operating in competitive markets, I do strongly disagree with those who would aver that the telecommunications market for basic local exchange service, and closely related services, See footnote 2 within BellSouth's franchised territory is effectively competitive, for it clearly is not, most especially with respect to residential services, as the record in this case plainly reveals. Because of the absence of meaningful competition, BellSouth's Price Plan, in its present form, does not appear to be working as intended by the North Carolina Legislature and should, at the very least, be subjected to an immediate, comprehensive review by this Commission.

A major, if not the preeminent, factor to be considered in assessing the need for immediate review of BellSouth's Price Plan, is the level of profitability that the Company has achieved in recent years. For calendar years 1998 and 1999, based on information provided by the Company, BellSouth has earned returns on common equity of 25.24% and 27.75%, respectively, from its North Carolina jurisdictional operations. In responding to questions on cross-examination regarding the common equity returns that BellSouth has enjoyed in recent years, BellSouth witness Linda Cheatham stated that " ***[i]t appears clear to me that price regulation is working as it was intended . . . ."*** (emphasis added). I wholeheartedly agree with witness Cheatham that the degree of a Company's profitability is an integral factor to be considered in evaluating the efficacy of BellSouth's Price Plan and more generally the appropriateness of price regulation. However, from my perspective as a regulator, I am compelled to disagree with witness Cheatham's interpretation of what such earnings reveal.

To me, the 25.24% return on common equity achieved by BellSouth in 1998 and the 27.75% return on common equity achieved in 1999 strongly suggest that the Company's Price Regulation Plan is seriously flawed due to the absence of a competitive market structure and as such is in need of substantive change, but not the kind of change that is contemplated under the Joint Stipulation and/or the Majority decision. Indeed, I consider the Company's excessive returns to constitute a clarion call for prompt and in-depth Commission action - that is, an immediate and comprehensive investigation of BellSouth's Price Plan. I take that view because those returns, which appear to be grossly excessive, are classic symptoms of the absence of an effectively competitive market structure. Without such a market structure, BellSouth's Price Regulation Plan as presently constructed cannot produce a result that is consistent with the public interest requirement of the North Carolina General Statutes.

In a truly competitive market, prices adjust such that they reflect an economically efficient pricing structure, that is, the pricing of services is based on their economic costs, which by definition include a reasonable level of profit. Stated alternatively, lack of competition translates into lack of economic efficiency, including pricing efficiency, which translates into, and is reflected by, excessive profits. Again, such results imply a flawed BellSouth Price Regulation Plan in need of Commission modification.

To the extent, if any, a flaw exists in BellSouth's Price Plan, the impact of irreparable harm to consumers of telecommunications services that would occur prior to the Commission's taking remedial action will be exacerbated by the Majority's decision to defer review of the Price Plan for one year. That result would occur because such remedial action would apply on a prospective basis only. Thus, I am of the opinion that the Commission should not have agreed to defer its five-year comprehensive review of the Plan.

Dr. Ben Johnson, witness for the Public Staff, testified that the Commission should consider a company's return on common equity when the Commission conducts a full review of a company's price plan. He further testified that if there is a flaw in the plan that is causing a company to have excessive earnings the Commission should fix the flaw. In that regard, the following scenario gives very real perspective to one of the major exceedingly negative consequences of the Commission's having deferred its comprehensive review of the Price Plan: Let us assume that on review of the Plan the Commission finds that BellSouth's prices and consequently its profits are excessive due to flaws in the Plan - which are due to the absence of a competitive market structure. Let us also assume that the Commission finds that those prices and profits should be constrained in such a way as to prevent the Company from inappropriately capitalizing on its dominance of the market for basic local exchange service until such time as that market evolves into a robust, fully competitive market. Further, let us assume that the Commission determines that the Company's profits in addition to its prices should be capped as a transitional mechanism. Finally, let us assume that a 14% return on common equity is initially determined to be a reasonable, market-based, transitional earnings cap for BellSouth. Based on information provided by BellSouth for calendar year 1999, a change of $15.1 million in its operating revenues would produce a change of 1% in its common equity return or vice versa. Thus, under the foregoing scenario, that would mean that BellSouth's existing rates would appear to be excessive by an annual amount in excess of $207 million. See footnote 3 It would also mean, all things remaining relatively constant, that until the Commission acts BellSouth would continue to recover and retain that $207 million annually, that is, until such time as the Commission comprehensively investigates its Price Plan and takes whatever remedial action it may then consider appropriate, if any.

In consideration of the above, my concern is that consumers will be irreparably harmed due to the Majority's having agreed to a one-year delay of the Commission's comprehensive review of BellSouth's Price Plan. Should such a review ultimately reveal that the foregoing, or comparable, assumptions were reasonable, valid, and correct, the Commission will nevertheless be unable to recompense consumers, since it is unlawful for the Commission to engage in retroactive ratemaking. The very real possibility that the foregoing may one day be shown to have been correct, in all

material respects, requires me to acknowledge my profound disagreement with the Majority decision in this regard.

The foregoing is by no means my only concern from the standpoint of negative consequences to the public interest that will arise or are arising, if my concerns regarding BellSouth's Price Plan prove to be valid. If the Price Plan is flawed and operating to thwart or delay implementation of full and effective competition in the market for telecommunications services in North Carolina, and I am concerned that it is, consumers of such services will continue to be denied the many benefits that proponents of market restructuring promise that competition will bring. At the very least, the Commission should undertake an immediate and thorough review of BellSouth's Price Plan, particularly in consideration of the fact that the Plan itself provides for the completion of such a review before expiration of its fifth year on June 24, 2001. As previously noted, the Majority's decision postpones comprehensive review of the Plan for one year.

Other major concerns, in addition to the foregoing, that I have with regard to the Majority's decision are summarized below:

* If competitive market forces and BellSouth's Price Regulation Plan, which includes intrastate switched access charges, are effectively operating to "regulate" prices for telecommunications services why have such considerations not operated to lower intrastate switched access charges to cost, or at the very least caused appreciable movement in that direction? And, if competitive market forces are not effectively "regulating" BellSouth's intrastate switched access charges, then how can one ignore the fact that such a result may also be applicable to certain other BellSouth services, particularly in consideration of the fact that BellSouth's overall profitability for 1998 and 1999 realized from its North Carolina jurisdictional operations appears to indicate, as previously explained, the absence of a competitive market structure? I am of the opinion that those questions, along with related questions, need to be thoroughly investigated and explored by this Commission as soon as practicably possible.

* Notwithstanding the fact that BellSouth's 1999 calendar year return on common equity was 27.75%, which is the most recent jurisdictional earnings information available for the Company, the Majority's decision allows the Company to increase its rates for basic local exchange service on the first and second anniversaries of the revised Price Regulation Plan. The approved rate increases for basic local residential service are in the range of $.50 per month on both the first and second anniversaries of the revised Plan, for a total of $1.00 per month. The Majority's decision disapproves the Joint Stipulation's proposed increase in rates at the time of implementation of the revised Price Plan, including a proposed increase in rates for basic local residential service in the range of $.50 per month. I would have allowed no rate increase at all.

* Public Staff witness Johnson and AT&T witness Gregory R. Follensbee testified to the effect that local exchange rates do not have to be increased in order to encourage competition in the local exchange market. And, witness Johnson testified to the effect that the telecommunications industry is a declining cost industry and that local service for residential customers is now priced above its direct cost. The foregoing testimony appears to reflect valid and relevant considerations that should be further investigated and evaluated by the Commission prior to allowing significant modifications to the Price Plan, if any, including those proposed in the Joint Stipulation. I would have proceeded with such an investigation.

* BellSouth's earnings are such that it would appear that an access charge reduction to $.02 per minute, which would reduce the Company's revenues by $83 million annually, could be accommodated, all other things remaining relatively constant, without BellSouth's annual return on common equity declining to a level below 22.25% See footnote 4, a result that does not appear to be unreasonable. I would have proceeded with an investigation of this matter.

* Under existing provisions of BellSouth's current Price Plan, absent the Majority's current decision, the Company would have been required to reduce rates for the Basic Service (Basic) Category and the Non-Basic 1 Service (NB1) Category overall by a total net annual amount of $7 million ($3 million in Basic and $4 million in NB1) in this the fifth year of the Price Plan, effective June 24, 2000. Such reductions would have been required, notwithstanding the fact that the Company has the flexibility under the Price Plan - and has notified the Commission of its intentions - to "rebalance" rates for certain services within the Basic Category, that is, the Company has proposed to increase residential rates for basic local exchange service on average in a range of $.60 per month and plans to increase some business basic local service rates on average in a range of $1.35 per month. Business rates for basic local service in several exchanges

would be decreased on average in a range of $4.00 per month. Presumably, BellSouth intends to place the foregoing rate changes into effect should the Joint Stipulation, in some form, not win final Commission approval. I would have required the Company to implement the $7 million reduction in rates for the Basic and NB1 Categories.

* BellSouth's earnings have increased at the expense of reduction in its quality of service. BellSouth witness Cheatham conceded that BellSouth has cut costs and eliminated too many jobs and that service has suffered. However, she further stated that BellSouth is not cutting costs at the expense of service quality today. The foregoing implies that the Commission needs to begin an immediate and full review of the operation of BellSouth's Price Plan in conjunction with consideration of the Joint Stipulation's proposed self-enforcing penalties proposal to ensure that adequate safeguards are in place, or will be put in place, which reasonably assure that reasonable quality of service standards will be met. I would have proceeded with such an investigation.

* Public Staff witness Johnson testified that he would not characterize vertical services as being competitive - under the Joint Stipulation and the Majority's decision certain of those services are moved from the Basic to the NB1 Category. In commenting on the Joint Stipulation's proposal to transfer services between categories, the Attorney General, in his pleadings, stated that the evidence indicates that such services were moved from one category to another in an arbitrary fashion as part of a negotiation rather than based on formal examination of market conditions. I agree with both the Attorney General and witness Johnson. Thorough analyses are needed in this regard. I therefore disagree with the Majority's decision to allow the transfer of services from the Basic to the NB1 Category.

I concur in the Majority's decision to the extent that it proposes acceptance of BellSouth's commitment, and encourages BellSouth, to increase its planned investment in broadband infrastructure throughout North Carolina by year-end 2002. I also concur in the Majority's proposal to adopt those provisions of the Joint Stipulation which establish service objectives with associated self-enforcing penalties if the objectives are not met. I would note, however, that those matters could and probably should be considered separate and apart from BellSouth's Price Plan. I also concur in the Majority's decision to the extent it proposes nonacceptance of provisions of the Joint Stipulation, for example, the Majority's proposed disallowance of a portion of the total stipulated basic local exchange service rate increase - I would have allowed no rate increase - and the Majority's disapproval of the creation of a new category of services (NB1.5). Finally, I strongly endorse and support the Majority's decision to reduce access charges to $.02 per minute as proposed by the Stipulating Parties. However, I believe that the Joint Stipulation may not have gone far enough in that regard, in consideration of the fact that the cost of providing intrastate switched access is generally acknowledged by industry experts to be in the range of $.005 per minute. Thus, I am of the opinion that the Commission should have proceeded with a comprehensive investigation of AT&T's access charge complaint.

In conclusion and simply stated, there is no basis in the record for premature revisions to BellSouth's Price Regulation Plan, and there is no basis in the record, nor is there any reason to believe, that residential rates should be increased. As indicated hereinabove, I would have disapproved the Joint Stipulation in its entirety, and I would have proceeded immediately with comprehensive investigations of AT&T's access charge complaint and BellSouth's Price Regulation Plan. Further, either in conjunction with the foregoing or in another docket or dockets, I would have initiated an investigation of the reasonableness of BellSouth's capital budgeting practices with respect to facilities expansion, with emphasis in the area of broadband infrastructure, and I would have initiated an investigation of the need for modification of existing Commission rules relating to quality of service to insure that Commission quality of service standards continue to be reasonable and that they will be met. Such review would include an examination and evaluation of the need for penalties, or more stringent penalties, when service standards are not met.

For the foregoing reasons, I am firmly of the opinion that the Joint Stipulation, even after modification by the Majority, is both inconsistent with and detrimental to the public interest.

\s\ Robert V. Owens, Jr.
COMMISSIONER ROBERT V. OWENS, JR.

Footnote: 1 The actual reduction experienced by each customer will depend upon what intrastate long distance services are purchased from AT&T or any other IXCs who flow through intrastate access charge reductions.

Footnote: 2 As an aside, the Commission notes that the "penalty" proposed here, as the record clearly demonstrates, is a voluntary measure not derived from or in derogation to the Commission's authority to impose

penalties under G.S. 62-310 or any other provision of Chapter 62. As such, it is entirely appropriate that any monies derived from this process should go to ratepayers -- who may be said to have been directly or indirectly harmed by poor service -- rather than to the Commission's coffers for ultimate distribution elsewhere.

Footnote: 3 However, BellSouth will be provided a ramp-up time for the out-of-service standard with interim objectives. At the end of the initial year's penalty period, BellSouth will not be assessed any penalties for the out-of-service objective if it achieves an average statewide annual result of 86% or better.

Footnote: 4 Operation of the Price Plan will, however, be waived to the extent necessary to permit revenue decreases otherwise required by productivity offsets in the Basic, NB1, and Toll Switched Access Categories to be satisfied by reductions in access prices. Moreover, revenue increases in the Basic Category will be permitted on the first and second anniversaries of the revised Plan, if accepted by BellSouth, to offset the scheduled access rate reductions to the extent that such revenue increases are specified in the Joint Stipulation. Endorsement by the Commission of these provisions of the Joint Stipulation is necessary to ensure equitable treatment to BellSouth. BellSouth obviously made many significant concessions during negotiations which were incorporated as part of the Joint Stipulation which will materially affect the Company's earnings over the next few years; e.g., a total revenue "give up" of approximately $16.3 million, a commitment to increase its investment in ADSL by $60 million by year-end 2002, and potential financial liabilities associated with self-enforcing penalties. That being the case, the Commission can find no reasonable and fair basis upon which to disfavor the first and second anniversary revenue increases proposed in the Joint Stipulation. Further, the aforementioned increases in the Basic Category and corresponding decreases in the Toll Switched Access Category will be treated as exogenous price changes for purposes of calculating their impact on the Service Price Indices (SPIs). Any additional waivers of intercategory offsets must be requested on a case-by-case basis.

Footnote: 5 As proposed in the Joint Stipulation the aggregate access rate will drop to $.03 and $.02 per minute on the first and second anniversaries of the revised Plan, respectively.

Footnote: 6 Of course, the amount of this potential "give up" is before consideration of revenue enhancements which might arise due to increased intrastate toll calling resulting from the price elasticity of demand.

Footnote: 7 The Joint Stipulation also moves certain services from the Basic Service Category to the NB1 Service Category. The specific services that will be moved from the Basic Service Category to NB1 are "the uncapped portion of Frequent Caller, Area Plus, Area Plus with Complete Choice, and Complete Choice." For the reasons asserted by BellSouth and the Public Staff, this provision of the Joint Stipulation is deemed reasonable and consistent with the public interest.

Commissioner Owens Footnote: 1 BellSouth's prominent place in the market is explained, of course, by its - and its predecessor, Southern Bell Telephone and Telegraph Company - having effectively operated in North Carolina for more than a century, the vast preponderance of that time as a traditional government sanctioned, monopoly service provider. Generally speaking, the legal framework at the State level which provided for the introduction of competition into the local exchange service market - such market having previously been characterized by monopoly service providers with exclusive franchised territories - was put in place in the mid-1990s. BellSouth's Price Regulation Plan became effective in mid-1996.

Commissioner Owens Footnote: 2 Services which I consider to be closely related to basic local exchange service are not substitutes for such service but rather are add-on type services, for example, vertical services - call forwarding, call waiting, call return, call trace, etc. The opportunity for providing those services being dependent on the provider also being the supplier of the related basic local exchange service.

Commissioner Owens Footnote: 3 BellSouth's calendar year 1999 intrastate return on common equity of 27.75% less an assumed, reasonable, market-based, transitional, return on common equity earnings cap of 14% equals 13.75% (27.75% - 14% = 13.75%); And, 13.75% divided by 1% equals 13.75 (13.75% . 1% = 13.75); And finally, $15.1 million multiplied by 13.75 equals $207.6 million ($15.1 million . 13.75 = $207.6 million).

Commissioner Owens Footnote: 4 As noted previously, a 1% change in the Company's jurisdictional return on common equity equates to a $15.1 million change in annual revenue. Thus, the $83 million reduction in access charges divided by $15.1 million equates to a 5.50% change in BellSouth's return on common equity. And, 27.75% less 5.50% equals 22.25%.