

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on October 11, 2000

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman
Thomas J. Dunleavy
James D. Bennett
Leonard A. Weiss
Neal N. Galvin

CASE 00-C-1945 - Proceeding on Motion of the Commission to
Consider Cost Recovery by Verizon, New York Inc.
fka New York Telephone Company and Modification
of Performance Regulatory Plan Under Merger
Standards and to Investigate the Future
Regulatory Framework.

ORDER INSTITUTING PROCEEDING

(Issued and Effective November 3, 2000)

BY THE COMMISSION:

By this order, we institute a proceeding to resolve
outstanding issues regarding the recovery of certain costs
sought by Verizon, New York, Inc.¹; to consider the potential
modification of the company's Performance Regulatory Plan (PRP),
pursuant to conditions included in our approvals of its past
mergers; and to consider emerging issues related to the
development of a vibrant competitive marketplace and the future

¹ Verizon New York, Inc. was formerly New York Telephone Company,
which also did business under the name Bell Atlantic-New York.
For simplicity, we refer to the company as "Verizon"
throughout this order.

regulatory regime that may be appropriate following the conclusion of the PRP.

BACKGROUND

Performance Regulatory Plan

On August 16, 1995, we approved the Performance Regulatory Plan (PRP) for Verizon.² The PRP covers a seven-year period beginning September 1, 1995 and ending August 31, 2002.

Under the PRP, Verizon is permitted to recover or required to flow back the impacts related to legislative tax changes affecting only utilities, costs associated with jurisdictional separations changes and cost changes due to Commission mandates. These impacts are exogenous to the company's control and not covered by the general inflation provisions of the PRP.

Merger Orders

In 1997, we approved the merger of NYNEX Corporation, the parent company of New York Telephone Company, and Bell Atlantic Corporation, subject to certain conditions.³ The NYNEX/Bell Atlantic merger order modified the PRP by adopting new standards for review of requests for recovery or deferral of any costs, including exogenous costs, cost onsets related to the opening of competitive markets, and revenue losses from access charge reductions. Specifically, the order provided,

² Case 92-C-0665, New York Telephone Company - Performance-Based Incentive Regulatory Plan, Opinion No. 95-13 (August 16, 1995).

³ Cases 96-C-0603 et al., NYNEX-Bell Atlantic Merger, Opinion No. 97-8 (issued May 30, 1997), incorporating Order Approving Proposed Merger Subject To Conditions (issued March 21, 1997).

Our determinations on such requests will include consideration of whether the company's conduct has promoted the development of competition within the state, whether consumers have benefited from competition, including price reductions greater than contained in the PRP, and whether consumers have shared in the cost savings resulting from the merger.⁴

The order noted that these standards would "ensure that anticipated savings and other benefits of the merger are appropriately flowed through to customers."⁵ The merger order clarified that recovery of exogenous costs under the PRP was not automatic, but rather discretionary.⁶

Further, the merger order provided the Commission the authority to terminate or modify the PRP at the fifth year checkpoint, based upon the same standards for reviewing cost recovery.⁷ The same conditions regarding cost recovery and PRP modification were specified in the order approving the subsequent merger of Bell Atlantic with GTE Corporation.⁸

OSS Development Costs

On January 31, 1997, Verizon filed for recovery of about \$67 million of costs for the development of an operational support system (OSS) interface so that competitive local exchange carriers could access Verizon ordering systems, as part of Phase 2 of the

⁴ March 21, 1997 Merger Order, supra, p. 6.

⁵ Id.

⁶ Id., p. 7.

⁷ Id., p. 8.

⁸ Case 98-C-1443, Petition of Bell Atlantic Corporation for Approval of Agreement and Plan of Merger with GTE Corporation, Order Granting Approval of Merger (issued August 12, 1999), p. 7.

Unbundled Network Elements proceeding.⁹ Both the Administrative Law Judge's Recommended Decision and a Staff Report appended to it raised a number of concerns regarding Verizon's request. These related not only to what the Judge termed "traditional conditions to cost recovery," but also the legal standards for recovery of such costs under the PRP and the NYNEX/Bell Atlantic merger order.¹⁰ In December 1997, we ordered that the costs be denied for the interim, but gave the company two years to make another filing.¹¹

On December 22, 1999 Verizon again filed for recovery of OSS development costs. The OSS development costs allocated to New York for which Verizon is seeking recovery doubled since 1997, from approximately \$67 million to about \$125 million (for 1996 through 2000). Verizon also requested to recover \$2.8 million for other competitive cost onsets. Verizon's filing addresses NYNEX/Bell Atlantic merger savings as part of its request for recovery of OSS development costs.

Exogenous Cost Filings by Bell Atlantic

Until its most recent (June 1, 2000) exogenous cost filing, Verizon has submitted annual accountings of its exogenous costs but had not been able to calculate merger savings by which the costs should be offset. Having made its NYNEX/Bell Atlantic merger savings filing in December 1999, the

⁹ Cases 95-C-0657, 94-C-0095 & 91-C-1174, First Network Elements Proceeding - Phase 2, Panel Testimony on Behalf of New York Telephone Company, January 31, 1997.

¹⁰ Cases 95-C-0657, et al., Recommended Decision on Phase 2 Issues (issued October 2, 1997) at 50, 52 & Appendix B.

¹¹ Cases 95-C-0657, et al., Opinion 97-19 (issued December 22, 1997).

company believes it has now met the prerequisites to seek recovery of exogenous costs.

The most recent data submitted by Verizon on exogenous costs were contained in the June 1, 2000 filing. In total, the company seeks recovery of \$646 million in what it alleges are exogenous costs due to PSC mandates.

Renewal of PRP

Verizon had the option to terminate the PRP at the end of the fifth year (August 31, 2000) or, alternatively, opt to extend the term for two additional years. On June 30, 2000 Verizon New York, Inc. filed for a two-year extension of the PRP from September 1, 2000 through August 31, 2002.¹²

In its June 30, 2000 filing electing to extend the PRP, Verizon also filed a plan for the disposition of the revenue streams, expense credits and accumulated deferral revenue balance associated with the Regulatory Asset Recovery Plan along with an accounting of its employee pension plan. In sum, the company proposes to use a \$53 million revenue stream to offset exogenous costs.

¹² Extension of the plan also required the company to reduce rates by \$25 million in September 2000 and another \$25 million in September 2001. On June 1, 2000 the company filed its proposal for a \$25 million dollar rate reduction and in July 2000 Verizon filed a rate proposal to pass back to ratepayers approximately \$23 million in funds from the intrastate portion of the profit from the sale of Bellcore. In August 2000 the Commission consolidated these reductions and directed Verizon to file a \$50 million rate reduction for basic line charges. Cases 92-C-0665 & 97-C-1297, Order Directing Rate Reduction (issued August 30, 2000).

SCOPE OF NEW PROCEEDING

The matters currently pending before the Commission are Verizon's requests: (1) for recovery of competitive cost onsets; (2) for recovery of exogenous costs; and (3) to allow it to use the \$53 million revenue stream to offset exogenous costs. As noted, recoveries of these costs and the use of the revenue stream are subject to the cost recovery standards set forth in the orders approving the NYNEX/Bell Atlantic and Bell Atlantic/GTE mergers. In addition, we have the option to consider termination or modification of the PRP at the fifth year checkpoint based on those same standards.

Because many of these issues are interrelated and may lead to the development of a new regulatory regime for Verizon during the remaining term of the PRP or beyond, we are instituting a new proceeding to consider these matters collectively. Specifically, the proceeding should resolve the matter of Verizon's outstanding requests for exogenous costs and OSS development costs, and to use the revenue from the Regulatory Asset Recovery plan to offset some of these costs. Because these issues cannot be definitively resolved without consideration of the cost recovery standards set forth in our orders approving the NYNEX/Bell Atlantic merger and the Bell Atlantic/GTE merger, the proceeding should consider the quantification of savings resulting from the mergers. This inquiry should lead as well to consideration of whether, and if so how, we should modify the PRP. Thus the new proceeding will take over consideration of issues currently pending or initially

raised in Cases 92-C-0065, 95-C-0657, et al., 96-C-0603, and 98-C-1443.¹³

Further, it is important that the future regulatory framework for Verizon be assessed in this process in order to ensure that our decisions on these matters are compatible with that future regulatory framework. Indeed, the resolution of the matters now before us may become an integral part of that future regulatory framework. The status and effectiveness of future competition, as well as the nature of our future efforts to ensure effective competition, are critical factors in the future regulatory framework for Verizon. While our actions to date have created an environment for open entry and robust competition throughout Verizon New York's service territory, the competitive transition and our efforts have not been completed. We are now at an appropriate point to turn our attention to the next generation of competitive issues -- namely determining what else must be done to ensure that meaningful and permanent telecommunications competition flourishes. The assessment of Verizon's future regulatory framework should examine whether or not our current approach to competition is conducive to the growth of facilities-

¹³ Case 92-C-0065, Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company; Cases 95-C-0657, et al., Joint Complaint of AT&T Communications of New York, Inc., MCI Telecommunications Corporation, WorldCom Inc. Against New York Telephone Company Concerning Wholesale Provisioning of Local Exchange Service by New York Telephone Company and Sections of New York Telephone's Tariff No. 900; Case 96-C-0603, Proceeding on Motion of the Commission as to the Joint Petition of New York Telephone Company, NYNEX Corporation and Bell Atlantic Corporation for a Declaratory Ruling that the Commission Lacks Jurisdiction to approve a Proposed Merger Between NYNEX and a Subsidiary of Bell Atlantic or, in the Alternative, for Approval of the Merger; Case 98-C-1443, Petition of Bell Atlantic-NY Corporation for Approval of Agreement and Plan of Merger with GTE Corporation.

based competitive alternatives and should identify what measures are needed to complete the transition to full and effective competition.

ADMINISTRATION OF PROCEEDING

We will refer this proceeding to the Office of Hearings and Alternative Dispute Resolution for exploration and resolution of the issues using whatever means are deemed appropriate. To focus the issues, Staff should begin the process by issuing a white paper setting forth its preliminary analysis of the proper quantification of the OSS costs, exogenous costs and merger savings. This step reflects our hope that these issues are resolved expeditiously so that efforts can be dedicated primarily to consideration of the larger issues of PRP modification and the future regulation of Verizon. We will leave it to the Administrative Law Judge to establish a process appropriate to achieve these objectives.

The Commission orders:

1. A new proceeding is instituted to consider the issues set forth in this Order.
2. This proceeding is continued.

(SIGNED)

JANET HAND DEIXLER
Secretary