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COMMONWEALTH OF VIRGINIA

STATE CORPORATION COMMISSION

AT RICHMOND, DECEMBER 21, 2000

APPLICATION OF

VERIZON SOUTH INC.

CASE NO. PUC000265

For approval of its
Plan for Alternative Regulation

ORDER APPROVING PLAN

On October 2, 2000, Verizon South Inc. ("Verizon South" or "Company") filed the above-captioned application with the State Corporation Commission ("Commission"). The Company requested the Commission approve a Plan for Alternative Regulation ("Plan") for the Company that employs a price indexing mechanism similar to those previously approved for Verizon Virginia Inc. and the Sprint local exchange telecommunications companies, United Telephone-Southeast, Inc. and Central Telephone Company of Virginia.

Verizon South asserted that its proposed Plan, which it attached to its motion, met the statutory requirements for approval and was in the public interest. The Company represented that it worked extensively with the Staff of the Commission to develop the Plan.

The Plan's major provisions cap prices for Verizon South's basic local exchange telecommunications services to January 1,

2004, and permit (but not require) increases to these services at no more than one half the change in the Gross Domestic Product Price Index thereafter. For services classified as discretionary, price increases would be limited to no more than 10% per year. The Plan also provides that no price increases will be permitted unless Verizon South is meeting Commission standards for service quality and reliability.

On October 18, 2000, we issued our Order for Notice and Comment inviting interested parties to file comments or requests for hearing on the application. Comments, but not requests for hearing, were received from the Office of Attorney General, Division of Consumer Counsel ("Consumer Counsel") and AT&T Communications of Virginia, Inc. ("AT&T").

Neither Consumer Counsel nor AT&T opposed the adoption of the proposed Plan, though AT&T noted that it contained features comparable to those that AT&T found objectionable when similar plans were adopted in Case No. PUC930036 for Bell Atlantic-Virginia and the Sprint companies.¹ These include the mechanism whereby revenue-neutral changes may be made in rates; an alleged deficiency in the productivity sharing mechanism; and the

¹ Commonwealth of Virginia ex rel. State Corporation Commission, Ex parte: In the matter of investigating telephone regulatory methods pursuant to Virginia Code § 56-235.5, etc., 1994 S.C.C. Ann. Rep. 262 (Final Order, October 18, 1994).

failure of the Plan adequately to prevent subsidization of competitive services with revenues from monopoly services.

Consumer Counsel opined that we should convene a "going-in" rate case for Verizon South, or else "evaluate – before approving the plan – whether the going-in rates are appropriate and do not harm consumers" on the basis of evidence to be taken at a hearing. Consumer Counsel also requested that we expressly recognize, if problems with the Plan arise, that we will issue notice and convene a hearing pursuant to Code § 56-235.5 D "to determine if [the] alternative plan is failing to meet legal requirements or expectations."

NOW THE COMMISSION, upon consideration of the application, the comments thereto, and the applicable statutes and rules finds that the Plan as proposed should be adopted and approved for use by Verizon South on and after January 1, 2001.

We have examined the revenues of the Company annually since it entered its current Plan of Alternative Regulation on January 1, 1995, through the mechanism of its annual informational filings ("AIFs"). On Friday, December 15, 2000, we approved a \$200 million refund to the Company's customers based on a settlement negotiated between our Staff, Consumer Counsel, AT&T, and the Company, resolving all issues in each AIF

case that remained pending.² Since it entered its original alternative regulatory plan, GTE South (as the Company was then known) has also undergone one comprehensive general rate case,³ which resulted in approximately \$27 million in rate reductions.

Late last year, we approved the merger of Bell Atlantic Corporation and GTE Corporation, the parent companies of, respectively, the entities now known as Verizon Virginia Inc. and Verizon South Inc.⁴ Due to conditions imposed by the Commission on the merger, Verizon South will experience certain reductions to its revenues as a result of the expansion of local calling areas for many of its customers and from adjustments to rates in its former Southwest operating territory to align those customers' rates with those paid by similarly situated customers in the rest of the newly merged company. These two changes will, in our analysis, lower the Company's revenues by approximately \$15.5 million on an annual basis. Additionally, the Company has agreed to advance the deployment of certain

² Application of Verizon South Inc., Annual Informational Filings, Case Nos. PUC960134, PUC970071, PUC970072, PUC980098, PUC990121, PUC000192, PUC000266 (Order Approving Joint Agreement and Requiring Refund, December 15, 2000).

³ Application of GTE South Incorporated, For revisions to its local exchange, access, and intraLATA long distance rates, Case No. PUC950019, 1997 S.C.C. Ann Rep. 216 (Order, August 7, 1997), aff'd sub. nom. GTE South Incorporated v. AT&T Communications of Virginia, Inc. et al., 259 Va. 338, 527 S.E.2d 437 (March 3, 2000).

⁴ Joint Petition of Bell Atlantic Corporation and GTE Corporation For Approval of Agreement and Plan of Merger, Case No. PUC990100 (Final Order, November 29, 1999)

enhanced network features in its service area. Specifically, it will make its Customer Local Area Signaling Services available to all customers within 24 months after the merger and, further, the Company agreed to specific annual minimum levels of plant investment in Virginia in years 2000-02.

Finally, earlier this month we approved a negotiated reduction in Verizon South's access revenues.⁵ As a result of this action, the Company will experience a cumulative revenue reduction over a five-year period of more than \$100 million. The initial rate reductions effective January 1, 2001, will reduce the Company's access charge revenues by approximately \$6 million in that year. Further rate reductions will be implemented for each of the next four years thereafter. At the end of the 5th year, access revenues will be approximately \$36 million lower than they are today.

We recite these facts to demonstrate both that the Company's rates have been re-established through a general rate proceeding to just and reasonable levels subsequent to its entry into its current Plan of Alternative Regulation and that its rates have been substantially reduced further by succeeding regulatory actions. We have analyzed the effect of these

⁵ Commonwealth of Virginia ex rel. State Corporation Commission, Ex parte, In re: Investigation of the appropriate level of intrastate access service prices of Verizon South Inc., Case No. PUC000283, D.C.C. No. 001210230 (Final Order, December 7, 2000).

reductions and are satisfied that given the reductions over the next five years, the rates and price increase provisions of the Plan should be appropriate for the foreseeable future.

We are not persuaded by AT&T's specific criticisms of the proposed plan, which in large measure restate its objections to the original price cap plans. There are factors in the current circumstances and in Verizon South's Plan that do not appear in the Verizon Virginia and Sprint plans and which are refinements to these original price cap plans. Foremost is the agreement by the Company that it will not be eligible for any rate adjustment unless it is meeting all service quality rules now or hereafter promulgated. AT&T asserts that the price change mechanism in the Plan does not allow customers to share in decreasing costs from all productivity gains. While true, the cumulative access charge reductions over the next several years serve to offset the potential enhancement to the Company's revenues from the "productivity" mechanism.

With respect to the "revenue-neutral" price change mechanism, we note that there have been only two instances when Verizon Virginia or the Sprint companies have successfully used this feature of their Plans. The inclusion of the specific language in Paragraph R of the Plan to forbid inclusion of access prices in any revenue-neutral change is a positive refinement as well. We find that the Plan meets all the

requirements set forth in § 56-235.5 of the Code of Virginia and its adoption is in the public interest.

Accordingly, IT IS THEREFORE ORDERED THAT:

(1) The Verizon South Inc. Plan for Alternative Regulation attached hereto is approved and shall be effective as of January 1, 2001.

(2) Verizon South shall notify the Commission, by letter addressed to the Director of the Division of Communications, of any election to adopt the Plan approved herein not later than five (5) days prior to its proposed implementation date.

(3) There being nothing further to come before the Commission in this case, this matter is dismissed.

VERIZON SOUTH INC. PLAN FOR ALTERNATIVE REGULATION

A. Applicability of Plan.

1. Upon election of the company, this plan will apply to Verizon South Inc. ("Verizon South") and will go into effect on January 1, 2001.
2. Nothing in this plan shall be deemed to affect the ability or authority of any entity other than Verizon South to offer any telecommunications service.

B. Changes to Plan.

1. Any change to this plan may occur only after an appropriate proceeding is initiated and held under the provisions of §56-235.5 D of the Code of Virginia.
2. Any such change approved by the Commission shall have prospective effect only.

C. Classification of Services.

1. Telecommunications services of Verizon South will be classified into four categories called Basic Local Exchange Telephone Services ("BLETS"), Discretionary services, Competitive services, and Bundled Services, as defined below. Verizon South's existing services are distributed among these categories in accordance with Appendix A hereto.
2. Service classifications are defined as follows:
 - a. "Competitive Services" are, pursuant to §56-235.5 F of the Code of Virginia, telecommunications services for which

competition or the potential for competition in the marketplace is or can be an effective regulator of the price of those services as determined by the Commission.

- b. "Discretionary Services" are telecommunications services that are optional, nonessential enhancements to BLETs, which may or may not be provided by suppliers other than Verizon South, but which do not conform to the definition of Competitive services.
- c. "Basic Local Exchange Telephone Services" ("BLETs") are essential, nonoptional telecommunications services for which competition or the potential for competition in the marketplace is not yet an effective regulator of the price of those services, and other services the Commission determines to be BLETs.
- d. "Bundled Services" are packages of services that include services from more than one of the categories defined in C2a, C2b, and C2c above and are offered at an aggregate price.

D. Classification of New Services and Reclassification of Existing Services.

- 1. Thirty days prior to offering a new service or reclassifying an existing service, Verizon South shall notify, in writing, the Staff, the Attorney General, and all certificated interexchange and local exchange carriers of the new or reclassified offering and shall provide a tariff and appropriate

documentation to the Staff. At a minimum, such documentation should identify and justify the proposed classification of the service in the tariff cover letter or attachments thereto, and in the case of a competitive classification include a list of current and/or potential alternative providers and services and explain how competition or the potential for competition is or can be an effective regulator of the price of the service. The Commission may suspend the proposed effective date if it finds that the documentation supporting the classification is insufficient, or as set out in subsection c. below.

- a. Simultaneous with such notification, the company shall designate the service category into which the service is classified.
- b. If the proposed service category is Competitive, notice must be given to all affected parties, and an opportunity for hearing must be provided in accordance with §56-235.5 E of the Code of Virginia.
- c. Any interested party shall be afforded an opportunity, by timely petition to the Commission, to propose that the service be classified in a different category; however, the filing of such petition shall not result in the postponement of any new service offering unless the Commission, for good cause shown, orders otherwise.
- d. Any such proceeding to determine the proper classification of a service offering shall be completed within 90 days

following the effective date of the service offering, except that if the proposed classification is Competitive, the proceeding must be completed within 120 days. The Commission, however, for good cause shown, may extend these time periods.

2. Any interested party may petition for the classification or reclassification of a Verizon South service. Any such proceeding must be completed within 90 days unless the reclassification is either to or from the Competitive category, in which case it must be completed within 120 days, unless the Commission should extend these time periods for good cause shown. If the proposed category is Competitive, subsection D.1.b above applies.

E. Tariff Requirements. Tariffs shall continue to be filed for all BLETs and Discretionary services, Bundled Services packages containing BLETs and/or Discretionary services, and for any Competitive service that is also offered within Verizon South's service territory, pursuant to a Virginia intrastate tariff, by another company that is certificated by this Commission. The prices of Competitive services shall not be regulated by the Commission, except as provided for in Subsection M (Competitive safeguards) of this Plan.

F. Price Changes for BLETs. Price changes for BLETs shall be governed by the following rules:

1. Price decreases. The Company may at any time reduce the price for any BLETS service by filing a revised tariff with the Commission. Such tariff shall take effect in accordance with §56-40 of the Code of Virginia.

2. Price increases.

a. No price increase (other than pursuant to the subsection H of this plan) will be allowed before January 1, 2004 for BLETS services.

b. In and after the year 2004, price increases for BLETS services will be allowed pursuant to the notification provisions of §56-237.1 and a showing by Verizon South that any individual price increase does not exceed in percentage terms $\frac{1}{2}$ the increase in the Gross Domestic Product Price Index (as defined in subsection K of this Plan) for the preceding year. After the initial price increase, any subsequent increase in prices for these services will be allowed pursuant to the notification provisions of §56-237.1 and shall not exceed in percentage terms $\frac{1}{2}$ the increase in the Gross Domestic Product Price Index since the last time the price of the service was increased. Any calculation of permissible price increases shall include only those months in which the Company has attained a satisfactory performance level in all of the retail service quality measurements adopted by the Commission in a

nonappealable Final Order. If a protest or objection to a BLETs price increase is filed by the lesser of 150 or 5.0% of the affected customers, the Commission shall, upon reasonable notice, conduct a public hearing concerning the lawfulness of the increase, pursuant to §56-235.5 of the Code of Virginia.

- c. No service shall be subject to more than one price increase in any 12-month period. If the Company fails to attain a satisfactory performance level, as reported on the filed quarterly report required by subsection N1, in all of the retail service quality measurements adopted by the Commission in a nonappealable Final Order, no BLETs price increases shall be implemented during the following quarter.

3. Rate regrouping of exchanges. Nothing in this plan shall be construed to prohibit rate regrouping of exchanges due to growth in access lines or expanded local calling.

G. Price Changes for Discretionary Services. Changes to prices for Discretionary services shall be governed by the following rules:

1. Price decreases. The Company may at any time reduce the price of any Discretionary service by filing a revised tariff with the Commission. Such tariff shall take effect in accordance with the requirements of §56-40 of the Code of Virginia.

2. Price increases.

- a. Price increases will be allowed after 30 days notice to the Commission, 30 days notice (by individual and solitary bill inserts or imprints) to customers, and a showing by Verizon South that the service whose price is being increased has not experienced a previous rate increase in the prior 12 months and that the increase does not exceed a percentage amount calculated by multiplying .0083 times the number of months (equates to 10% per 12-month period) since January 1, 2001, or .0083 times the number of months since the most recent increase after January 1, 2001. In no event may this increase exceed 25%. Any calculation of permissible price increases shall include only those months in which the Company has attained a satisfactory performance level in all of the retail service quality measurements adopted by the Commission in a nonappealable Final Order.
- b. If the Company fails to attain a satisfactory performance level, as reported on the filed quarterly report required by subsection N1, in all of the retail service quality measurements adopted by the Commission in a nonappealable Final Order, no Discretionary service price increases shall be implemented during the following quarter.

H. Revenue-Neutral Price Changes.

1. Nothing in this plan shall be construed to prohibit Verizon South from proposing changes in the price of any BLETs or Discretionary services that do not result in a net increase in operating revenues. The notification provisions of §56-237.1 of the Code of Virginia will be applied to such proposals, and if a protest or objection to the revenue-neutral restructuring is filed by the lesser of 150 or 5.0% of the affected customers, the Commission shall, upon reasonable notice, conduct a public hearing concerning the lawfulness of the restructuring pursuant to §56-235.5 of the Code of Virginia. The Commission shall approve such rate changes if it finds that they are in the public interest, or the Commission may refuse to approve the filing if it is not in the public interest or otherwise fails to comply with this plan.

2. The Commission will require Verizon South to show within the first two years following the implementation of the price changes that the changes are, in fact, revenue neutral. If they are not, the Commission may require a prospective adjustment in the affected prices to ensure revenue neutrality.

I. Individual-Case-Basis Pricing. Individual-Case-Basis (ICB) or custom-service-package contract pricing is allowed for BLETs and Discretionary services when Verizon South demonstrates that a competitive alternative exists for an individual customer, but where the service does not otherwise satisfy the requirements of subdivision C2a. of this Plan. The conditions of subsection M (Competitive safeguards) must be met. A copy of any ICB or custom-service-

package contract must be filed within thirty days of the contract effective date under proprietary protection with the Commission's Division of Communications with supporting data demonstrating that the rate is above the total incremental cost of the service.

J. Pricing for Bundled Services. Pricing and changes to prices for Bundled Services shall be governed by the following rules:

1. Price floor. The aggregate price for all of the services in the package shall be equal to or higher than the sum of the tariff rate for any BLETS service included in the package, plus the incremental cost of any Discretionary service(s), plus the price floor amount complying with subsection M2 for any Competitive service(s) included in the package.

2. Price ceiling. The aggregate price for all of the services in the package may not exceed the sum of the retail tariff rate determined for any BLETS or Discretionary service(s) included in the package, plus the rate appearing in the tariff or price list on file with the Commission for any Competitive service(s) included in the package.

3. Price decreases. Verizon South may reduce the price of any Bundled Service by filing a revised tariff with the Commission. Such tariff shall take effect in accordance with the requirements of § 56-40 of the Code of Virginia. Any such price reduction must comply with the requirements set out in subsection J1.

4. Price Increases.

- a. Price increases for Bundled Services will be allowed after at least 30 days notice to the Commission, at least 30 days notice (by individual and solitary bill inserts or imprints) to customers, and a showing by Verizon South that the price increase complies with the price ceiling as set out in subsection J2.
- b. No Bundled Service provided by Verizon South shall be subject to more than one price increase in any 12-month period.

K. Gross Domestic Product Price Index Standard. The Gross Domestic Product Price Index used to determine limits on price increases shall be the final estimate of the Chain-Weighted Gross Domestic Product - Price Index as prepared by the U.S. Department of Commerce and published in the Survey of Current Business, or its successor.

L. Financial Reporting. Verizon South shall file annually, unless otherwise indicated below, with the Commission its stockholder annual report (if available) and SEC Form 10-K; the stockholders' annual report and SEC Form 10-K of Verizon Communications Inc.; FCC/SCC Form M and the FCC Automated Reporting Management Information System Report 43-02 (to be filed only with the Division of Public Utility Accounting); a Virginia company, per books, rate-of-return statement that provides financial data on a total-Virginia, total-service basis, and on a Virginia-intrastate, total-service basis; a 13-month average

capital structure statement; and a 13-month average rate base statement. The rate-of-return, capital structure, and rate base statements shall be filed quarterly for the first two years of the plan, and annually thereafter. All of the above statements shall include the aggregate of all services, except for any service that is lawfully, preemptively deregulated by the FCC.

M. Competitive Safeguards. The following safeguards relating to fairness of competition will be imposed on Verizon South:

1. There will be no increases in the prices for BLETS, Discretionary services, and Bundled Services other than as outlined in subsections F, G, H, and J of this Plan.

2. Services and/or capabilities of a monopoly nature that are components of Competitive services must be offered on an unbundled basis in the tariffs at the time the Commission determines a service to be Competitive. When these services and/or capabilities are used by Competitive services, revenues shall be attributed to noncompetitive operations based on the tariff rates and quantities used.

Regarding new services, unbundling of all non-competitive components must be accomplished before Verizon South may offer a Competitive service related to the noncompetitive component(s). If Verizon South does not plan to offer a related service before the party requesting unbundling plans to offer its related service, the unbundling must be accomplished within a reasonable time after any reasonable request is made for

such unbundling, and with assurances that Verizon South can recover its related incremental costs.

If Verizon South offers a Competitive service using an unbundled noncompetitive component, it shall demonstrate that its price for the Competitive service equals or exceeds the incremental costs of the competitive components of the service plus the tariffed rates of any noncompetitive components.

3. Revenues from Competitive services in the aggregate must cover their incremental costs. Verizon South shall file data annually to demonstrate this. Also, the price of an individual Competitive service must cover its incremental costs. Verizon South shall maintain total incremental cost studies for each Competitive service offered demonstrating that a service's price equals or exceeds its incremental costs. These studies shall be filed with the Division of Communications within 30 days of a complaint alleging that an individual service's revenues fail to cover its total incremental costs.

N. Service Quality. Service quality reports shall be filed by Verizon South on a quarterly basis, or as directed by the Staff.

1. These reports shall conform to service rules adopted by the Commission by Final Order of June 10, 1993, in Case No. PUC930009, or any other service rules subsequently adopted by the Commission. These reports may be expanded to include results not contained in the present service reports.

2. Verizon South will also file reports showing results related to services provided to interexchange carriers as follows:

a. On-time performance;

- b. Outage duration; and
- c. Blocking below the tandem.

3. The Staff will analyze service results and take immediate action to resolve any service quality problems.

O. Availability of Services

1. Verizon South is required to file a report by the end of the first quarter of each year detailing its forecasted and actual capital expenditures and availability of advanced services to consumers in its service territory in Virginia.

This report at minimum shall include:

- a. budgeted capital expenditures and maintenance for the current and succeeding year;
- b. actual capital expenditures and maintenance for preceding year;
- c. identification and description of proposed capital investment projects exceeding \$100,000 for the current year;
- d. current availability of custom calling services by exchange;
- e. current availability of CLASS services by exchange;
- f. current availability of broadband and high speed access services (either directly or by its affiliates) by type, exchange, disaggregated between residential and business customers;
- g. additional information requested by the Staff.

P. Filing of Other Information.

1. Upon the request of the Staff, Verizon South will file such other information with respect to any services or practices of the company as may be required of public service companies under current Virginia law, or any amendments thereto.

2. If Verizon South fails to provide, timely and accurately, data required by the plan, including answers to any Staff request for data or information necessary for the execution of this plan, it shall be subject to a Rule to Show Cause hearing for such failure. The Commission will monitor closely all aspects of the Company performance under the Plan.

Q. Monitoring of Competitive Services. To assist the Commission in fulfilling the requirements of §56-235.5 G of the Code of Virginia to monitor the competitiveness of Competitive services, Verizon South must file, on a proprietary basis, a quarterly schedule reporting units and revenue for Competitive services (to be filed only with the Division of Economics and Finance). Also, Verizon South must file an annual price list for Competitive services, excluding Yellow Pages (to be filed only with the Divisions of Communications and Economics and Finance).

R. Access Charges. Interexchange Carriers' access charges are not included in the categories of services set out in this plan for pricing purposes, and therefore may not be included in any revenue neutral price changes proposed pursuant to Section H of the Plan. Pricing for such services will be

considered separately in Case No. PUC000003, In re: Investigation of the appropriate level of intrastate access service prices and/or other appropriate Commission proceeding. For all other purposes, access services are included in the categories as shown on Appendix A.