

STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6167

Investigation into an Alternative Regulation)
Plan for New England Telephone and)
Telegraph Company d/b/a Bell Atlantic-)
Vermont)

AND

Docket No. 6189

Petition of AT&T Communications of New)
England, Inc. for reduction to cost of intrastate)
access rates charged by New England)
Telephone and Telegraph Company d/b/a Bell)
Atlantic-Vermont)

Hearings at
Montpelier, Vermont
June 1 - June 3, 1999
June 8 - June 11, 1999

Order entered: 3/24/2000

ORDER

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David C. Coen, Board Member

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I. INTRODUCTION

In today's Order, we adopt an Incentive Regulation Plan for New England Telephone and Telegraph Company d/b/a Bell Atlantic-Vermont ("Bell Atlantic-Vermont" or the "Company").¹ The Plan provides Bell Atlantic² both the incentives and the regulatory flexibility to deploy new services and technologies and respond to changes in the marketplace rapidly. At the same time, we hereby set in place mechanisms to maintain important protections for Vermont consumers.³ Adoption of the Incentive Regulation Plan also continues the Public Service Board's ("Board") long term policies of easing competitive entry and establishing terms and conditions that enable competitors to easily introduce and modify services.⁴

The Plan adopted today is materially the same as the one described in the Proposed Order that we issued on February 8, 2000.⁵ The Proposed Order invited comments from the parties, including the potential for additional hearings if one or more parties sought to present additional evidence. No party requested further hearings. We have considered the comments of the parties in adopting today's final Order .

Today's Order also addresses Bell Atlantic's wholesale and retail rates. The Vermont Department of Public Service ("Department") asserts that Bell Atlantic is collecting more than \$34 million in excess revenues annually from Vermonters. As a remedy, the Department has

1. Bell Atlantic submitted a proposed alternative regulation plan which it referred to as a "Price Points

recommended rate changes in the first year of the Plan which it predicts will lead to revenue reductions of about \$23 million annually.⁶ In order to achieve its recommended \$23 million reduction in annual revenues, the Department recommends more than \$16 million in specific annual rate reductions and asserts that an additional \$6.5 million annual reduction will inevitably result as a secondary effect of those changes. Bell Atlantic, in response, acknowledges that it is over-earning (although it states that these over-earnings amount to only about \$1 million annually), and proposes a multi-year phased reduction to ultimately reduce rates by \$12 million per year. Bell Atlantic proposes specific rate changes, to be phased in over the next three years, designed to reduce its rates by that amount.

Our evaluation of the testimony and the evidence on contested financial matters is summarized in Attachment B of this Order, and detailed in the findings of fact, below. We conclude that (at its current rates) Bell Atlantic is earning approximately \$23 million annually in excess of just and reasonable rates. Accordingly, we conclude that as a condition of the plan, Bell Atlantic must reduce its retail rates. Specifically, we order approximately \$16.5 million in immediate rate reductions for Message Toll Service, Local Mileage Surcharge, Business Exchange Service, and intrastate switched carrier access charges. For the remaining \$6.5 million, we order no specific rate reductions; however, as both Bell Atlantic and the Department persuasively argued, we anticipate that the mandated reduction in access charges, combined with competition for toll Optional Calling Plans will lead Bell Atlantic to reduce its Optional Calling Plan rates by approximately this amount during the first year of the Incentive Regulation Plan.⁷ The rate reductions to switched access charges also will produce savings to

Plan, as Bell Atlantic phases out certain accounting mechanisms that we have recognized as valid in the Incentive Regulation Plan's initial years.

Our approval of the Incentive Regulation Plan is based upon our expectation that moving from traditional rate of return regulation to incentive regulation should yield significant benefits to customers in Vermont, to Vermont local exchange carriers (such as Bell Atlantic) and to other carriers. Incentive regulation encourages a firm to operate more efficiently by setting general limits on unilateral price changes that a utility can make. It reduces regulatory constraints on companies and allows emerging competition to force utilities to adopt efficient and non-predatory practices.⁸ Incentive regulation is also designed to be flexible and to allow incumbent local exchange carriers such as Bell Atlantic to benefit its customers as it responds to markets and competes effectively.

The Incentive Regulation Plan set out in today's Order meets these goals. The Plan contains the following basic elements:

- Traditional rate-of-return regulation is replaced by price regulation in which Bell Atlantic may not increase rates during the term of the Plan. Bell Atlantic is free to propose such rate reductions as it chooses, subject to price floors established in Dockets 5713 and 6077.
- At the outset of the Plan, Bell Atlantic must reduce its retail rates by \$16.5 million, by reducing end-to-end switched access charges to approximately \$.04, eliminating the exchange mileage surcharge, reducing business local exchange service rates by approximately \$5 million, and reducing message toll service rates by \$4.3 million.
- The Board expects that Bell Atlantic will make further price reductions

- Bell Atlantic will receive significant discretion to deploy new services without prior Board review, allowing the Company to more rapidly respond to market forces.

Collectively, these features of the Incentive Regulation Plan will benefit Bell Atlantic's Vermont ratepayers, Bell Atlantic's competitors, and the Company itself. Vermont ratepayers will see immediate rate reductions for toll rates and business dial tone rates, with the expectation of further toll rate reductions in the near future.⁹ As a result, Vermont basic rates will be more in line with those of other Bell Atlantic states.¹⁰

The competitive environment is enhanced through Bell Atlantic's increased flexibility to offer new services rapidly. At the same time, the Incentive Regulation Plan protects competitors, by requiring Bell Atlantic to adhere to Board-established price floors and other rules designed to facilitate competition, as well as by reducing intrastate switched access rates significantly. Vermont's access (wholesale) rates will now rank among the most attractive in Bell Atlantic service territory, a substantial improvement over their present status as second-highest.

If Bell Atlantic continues to provide high value service to Vermonters, then it will, for the term of the Incentive Regulation Plan, be free from direct review of its earnings; this will provide the Company with incentives to operate efficiently and the opportunity to benefit from that efficiency. The Board fully expects that this change will encourage Bell Atlantic to deploy new technology, including that necessary to offer broadband services, and to move aggressively to introduce new services that will enhance its earnings. Our relaxation of regulatory

II. BACKGROUND

A. Incentive Regulation in Vermont

The State of Vermont was an early proponent of alternative forms of regulation of local exchange carriers. As far back as 1985, public officials began to research and debate the merits of continuing traditional regulatory practices over the local exchange portion of the industry, given the rapid technological and competitive changes, as well as regulatory and judicial changes stemming from the federal level. This interest led to the 1987 promulgation of 30 V.S.A §§ 226a and 227a, which authorized incentive regulation based upon a contract negotiated between the Department and a local exchange carrier, as well as reduced regulation of competitive markets.

On October 27, 1987, in accordance with 30 V.S.A. § 226a, New England Telephone and Telegraph Company and the Department jointly filed a proposed Vermont Telecommunications Agreement ("VTA"), which after specific modifications directed by the Board, was approved in December of 1988.¹² The VTA provided the Company with marketing flexibility, freed the Company from rate of return regulation, while providing benefits to Vermont ratepayers, particularly the maintenance of stable rates for basic exchange telephone service.¹³ In addition, the VTA required the Company to invest approximately \$284 million in network modernization in Vermont. At the same time, the VTA contained a set of competitive safeguards designed to ensure the development of reasonable competition, including an aggregate rate differential between its average toll rates and its average wholesale premium access rates sold to its toll competitors.¹⁴

In 1993, the legislature enacted 30 V.S.A. § 226b, "Incentive Regulation of Basic Exchange Telecommunications Providers," authorizing alternative forms of regulation for local exchange carriers.¹⁵ This statutory change provided an additional mechanism for alternative forms of regulation in Vermont. Bell Atlantic has since filed two proposals for alternative regulation under §226b. First, in the Fall of 1993, Bell Atlantic proposed a Price Regulation Plan, which the Board approved, with several modifications. Bell Atlantic, however, declined to operate under the modified plan, so the Price Regulation Plan never took effect.¹⁶ More recently, Bell Atlantic filed a new Price Regulation Plan in 1997, which the Board considered in Docket 6000. After agreeing with the Department on the substance of a plan, but before the Board considered the merits of the proposal, Bell Atlantic withdrew that proposal. This unilateral decision deprived the Board of its opportunity to examine the incentive regulation proposal, which could have provided real benefits to Vermont consumers. In our Order in that docket granting the Company's Motion to Withdraw, we reiterated our continued interest in investigating an incentive regulation plan for the Company, and moving to secure many of the benefits that Bell Atlantic's plan could have provided.¹⁷ At that time, we encouraged Bell Atlantic to file such a plan within 60 days and suggested that, if the Company elected not to do so, we intended to initiate our own proceeding.

On June 2, 1998, rather than submitting a comprehensive incentive regulation plan as the Board had requested, the Company filed a series of tariff revisions that would have provided the Company with marketing flexibility (by modifying existing procedural requirements) and provided its customers with certain service quality commitments. By Order

authority to grant the specific tariff changes proposed by Bell Atlantic. Our decision was not based upon the conclusion that granting Bell Atlantic marketing flexibility would be bad public policy. To the contrary, we noted that, in conjunction with a properly structured alternative regulation plan,¹⁸ such marketing flexibility may be entirely appropriate in the competitive environment now evolving.

B. Procedural History

To further investigate the merits of incentive regulation, the Board opened Docket 6167 on November 18, 1998, the same day we dismissed Bell Atlantic's tariff filing proposal. In that Order, the Board did not propose a specific plan for alternative regulation of Bell Atlantic. Instead, we indicated that the plan submitted by Bell Atlantic in Docket 6000 was a reasonable starting point for our investigation.¹⁹ The Order also stated that Bell Atlantic and other parties were free to submit alternative proposals, which could be considered during the course of the Docket.

The Board held a prehearing conference on December 18, 1998.²⁰ A number of parties appeared at that conference, including: the Vermont Department of Public Service ("Department"), Bell Atlantic, AT&T Communications of New England, Inc. ("AT&T"), Sprint Communications Company, L.P. ("Sprint"), and Hyperion Telecommunications of Vermont, Inc. ("Hyperion").²¹

Also at the hearing, Bell Atlantic indicated its interest in providing the Board with a proposed alternative regulation plan by February. The Company also suggested that parties

The Board opened Docket 6189 to review a petition filed on December 22, 1998, by AT&T requesting that the Board reduce intrastate access rates currently charged by Bell Atlantic. On February 17, 1999, during a procedural hearing in Docket 6167, the Board raised the issue of whether the subject matter of the AT&T filing in Docket 6189 ought to be considered during hearings in Docket 6167. The Board concluded that, inasmuch as access rates are a subset of the overall revenue requirement being considered in 6167, it would inquire as to whether it might be appropriate to consolidate the dockets for the purpose of hearings. The parties agreed.²³ Docket 6167 was formally consolidated with Docket 6189 by Order of February 23, 1999.

Bell Atlantic subsequently filed its Price Points Plan on February 12, 1999. Hearings were held on June 1-3, and 8-11, 1999.

The Board issued a Proposed Order on February 8, 2000. No party requested further hearings, although Bell Atlantic submitted comments upon the Order and a calculation of the rate effects of the Board's Order. The Board also requested further comments upon Bell Atlantic's Compliance filing.

C. Statutory Framework

The present docket is governed by 30 V.S.A. § 226b, entitled "Incentive regulation of basic exchange telecommunications providers," which was enacted by the legislature in 1993 and amended in 1996. That section authorizes alternative forms of regulation and allows local exchange carriers (or the Board or Department) to propose alternatives to traditional rate of

authority to examine Bell Atlantic's rates, in a traditional manner, by investigating those rates under Sections 225, 226, and 227.²⁴

Subsection (c) of § 226b contains eleven criteria that an alternative regulation proposal must meet. The Board may approve such a proposal only if it finds, after notice and hearing, that such regulation, in its entirety:

- (1) promotes the general good of the state;
- (2) is consistent with State telecommunications purposes established under Section 202c of Title 30;
- (3) is consistent with the 10-Year State Telecommunications Plan, or there exists good cause to approve alternative forms of regulation notwithstanding this inconsistency;
- (4) is consistent with the public's interest relating to appropriate quality telecommunications services;
- (5) is consistent with the goal of protecting or promoting universal service to residential users of telecommunications;
- (6) provides reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies;
- (7) reasonably supports economic development in the affected service territory;
- (8) adequately protects consumer privacy interests;
- (9) supports reasonable competition;
- (10) includes adequate safeguards to insure that charges for non-competitive services do not subsidize competitive services; and
- (11) is just and reasonable and would not produce unjust discrimination between users of the public switched network in the pricing, quality or availability of the network functions or services offered.

instant proceeding does not apply due to the fact that the Board, and not the Company, has opened the investigation.²⁵

Subsection (f) empowers the Board to reject proposals for alternative regulation, or to issue an order of conditional approval, if it determines the proposal does not satisfy the requirements of § 226b.²⁶ If the Board issues an order of conditional approval, the parties may request further hearings on the modified plan; the Board must issue its final determination within 90 days of the original order. Any Board order approving or modifying an alternative regulation plan may not take effect sooner than 30 days from its issuance.²⁷

An order establishing an alternative form of regulation may include the following: exemption from or reduction of the requirements of 30 V.S.A. §§ 218a, 225, 226 and 227; terms and conditions for establishing new services, withdrawing services, price changes to services, and contracted services; and other rates, terms, and conditions that the Board finds to be consistent with the general considerations and standards under this section.²⁸

Subsection (i) allows the Board and Department to conduct investigations into the effectiveness of an approved alternative regulation plan already in effect. During the course of its predicted term, the statute also allows the Board, after notice and hearing, to terminate or modify an approved plan. 30 V.S.A. § 226b(i).

III. FINDINGS AND DISCUSSION

A. Overview of Price Points Plan

Roll Atlantic filed what it characterized as a Price Points Plan. The Roll Atlantic Plan

the Company, all consumers will benefit, with the rate cap producing a drop in the real price of services.

The Bell Atlantic Price Points Plan also provides the Company with new flexibility in the introduction of new services. Under the Price Points Plan, Bell Atlantic may offer new services, including modifications to existing services and special contracts, without prior review by the Board. These new services would be effective 30 days after filing (rather than 45 days as now required by Section 225) and could be reviewed only to ensure compliance with Board-mandated price floors. Except for price floor compliance, pricing of new services would fall entirely within the Company's discretion. The pricing and new service introduction flexibility would enable Bell Atlantic to offer services more rapidly, benefitting consumers and allowing the Company to respond readily to competitive market forces.

The Price Points Plan also includes a proposed Education Plan, whereby high schools throughout its service territory would benefit from high speed links enabling faster internet connection and distance learning. Bell Atlantic states that the costs of the Education Plan will not be included in the Company's cost-of-service that the Board evaluates to determine the Company's overall rates and thus will not be charged to ratepayers.²⁹ Finally, Bell Atlantic proposes a Service Quality Plan designed to ensure that service quality remains high and agrees to a process by which the Board will establish wholesale service quality performance measures.³⁰

in flexibility for the Company to meet competitive challenges in the Vermont marketplace."³¹ The Company and the Department also have jointly proposed that the Board adopt a stipulated Service Quality Plan³² as part of the overall Price Regulation Plan. The Company asserts that an 11.3 percent overall rate of return is appropriate.³³

2. Department of Public Service

The Department supports approval of a modified Bell Atlantic plan, including Bell Atlantic's requests for significant pricing flexibility³⁴ and for an exemption from a rate of return regulation for a period of five years.³⁵ The Department, however, asserts that it has identified between \$29 and 33 million in excess revenues. It argues that the Board must reduce Bell Atlantic rates by \$16 million if the Board "ever hopes to achieve its fairness and economic rationality objectives. . . ." ³⁶ Added to this is an estimated \$6.5 million in anticipated toll reductions that the Departments asserts will likely follow the reduction to the wholesale access rates due to competitive pressure.

3. AT&T

AT&T has three main arguments. First, it argues that the Board should order Bell Atlantic to reduce intrastate access rates to forward-looking, incremental cost.³⁷ Bell Atlantic should not be granted any regulatory flexibility unless and until wholesale performance standards and price floors are put into effect, although the resolution of these issues should not

delay the reduction of access rates.³⁸ Third, Bell Atlantic's Price Points Plan will inappropriately restrict future Board oversight authority.³⁹

4. Hyperion

Hyperion argues that unless conditioned as proposed by the Department, the Board cannot find that Bell Atlantic's Price Points Plan "in its entirety" should be approved, because it relies on competition to deliver benefits to Bell Atlantic customers, and that competition does not exist today.⁴⁰ Second, the Board must structure certain aspects of the Price Points Plan to ensure that the Company will share its gains with customers and not deter reasonable competition.⁴¹ The Board should approve the Bell Atlantic and Department's Service Quality stipulation, but should not implement the plan until the Board has established carrier to carrier standards.⁴²

5. Sprint

Sprint argues that the Board should reduce intrastate access charges to reflect only the forward looking economic costs associated with access service.⁴³ Reduction of access charges will stir competition in Vermont.⁴⁴ Imputation and separate affiliates are insufficient means of controlling anticompetitive behavior such as price squeezes.⁴⁵ Finally, once access charges are reduced, the Board should not impose restrictive flow-through requirements.⁴⁶

C. Revenue Requirement in the First Year of the Incentive Regulation Plan

1. General Findings

1. Bell Atlantic submitted an updated cost of service based upon a test year ending June 30, 1998. Exh. BAVT-3.

2. As filed, Bell Atlantic's collected revenues totaled \$186,671,988 in the historic test year. *Id.* Bell Atlantic's filing included regulatory, normalizing, and pro forma adjustments that increased the revenue requirement by \$2.968 million annually. *Id.*

3. The rate adjustments at the outset of the Incentive Regulation Plan will take effect during calendar year 2000. As such, the adjusted test year for ratemaking purposes is January 1, 2000, through December 31, 2000.

2. Transition Benefit Obligation/SFAS 106

a. Findings

4. Statement of Financial Accounting Standards ("SFAS") 106 required employers to go from a pay-as-you-go (cash) basis to an accrual basis of accounting for these post-retirement benefits. SFAS 106 applied to all forms of post-retirement benefits (except pensions), but its focus is on post-retirement health care benefits. Ostrander pf. at 7.

5. The Transition Benefit Obligation ("TBO") is the "catch-up" mechanism for restating prior periods as if on an accrual basis for unrecognized costs. *Id.* at 7.

6. To implement SFAS 106, Bell Atlantic began amortizing TBO over twenty years on its regulatory books, and has been using a twenty-year amortization period on its regulatory

Atlantic Corporation has approved a midstream reversal of course from a twenty-year amortization to a five-year amortization. *Id.* at 9.

10. Bell Atlantic has provided no evidence that it will be unable to recover these costs.⁴⁷ *Id.* at 9.

b. Discussion

The Department recommends that the Board disallow a Bell Atlantic proposed rate case adjustment related to SFAS 106. SFAS 106 became effective in 1990 and addressed "Employers Accounting for Post-retirement Benefits Other than Pension Benefits," requiring employers to go from a "pay-as-you-go" (cash) basis to an accrual basis of accounting for these benefits.⁴⁸ The TBO is the "catch-up" mechanism for restating prior periods as if on an accrual basis for unrecognized costs.⁴⁹

To implement SFAS 106, Bell Atlantic has been using a twenty-year amortization period on its regulatory books since 1993.⁵⁰ Indeed, the Board has approved the Company's implementation of SFAS 106, including the 20-year amortization of the TBO, in prior investigations.⁵¹ In the cost of service filed in this proceeding, however, Bell Atlantic changed the manner in which it implements SFAS 106, proposing to discontinue the twenty-year amortization and instead amortized the remaining TBO over the next five years. According to Bell Atlantic, increasing competition will likely result in loss of customers, decreased revenues, and decreased ability to recover those costs.⁵² The Company's adjustment effectively increases
test year costs by \$2.1 million

the Department, there is no reasonable justification for accelerating amortization of TBO to the five-year period proposed by Bell Atlantic and for changing a course already approved by the Board.⁵³

We conclude that Bell Atlantic's proposed adjustment should not be permitted at this time. As a matter of policy, a party seeking a change in existing amortizations of expenses that have been approved by the Board must demonstrate a compelling basis for that change.⁵⁴ Bell Atlantic has not met that burden. At the time FAS 106 became effective, Bell Atlantic had the option of proposing a shorter recovery period, as occurred for Bell Atlantic operating companies in Maryland and West Virginia,⁵⁵ or expensing the entire amount immediately. Bell Atlantic elected the existing twenty-year amortization, which the Board previously accepted.⁵⁶ The evidence in this proceeding does not demonstrate why the Board should alter that decision. In fact, collapsing the remaining amortization period to five years appears to be inconsistent with Generally Accepted Accounting Principles and SFAS 106, which primarily allowed an immediate write-off of the costs at their inception (around 1993) or over the service life of employees, twenty years.⁵⁷

Bell Atlantic's primary argument for altering course is that competitive pressures will impede the Company's ability to recover all of the TBO. However, the record does not persuade us that impending competition seriously threatens cost recovery of this or any other category of costs.⁵⁸ Although the Board fully expects increased competition in the Vermont telecommunications marketplace in the coming years, we have no basis to conclude that competition will prevent Bell Atlantic from having a fair opportunity to recover its costs and

earn a fair return on its investment.⁵⁹ Indeed, the record in this proceeding generally suggests that revenue growth and cost declines, coupled with wholesale service revenue growth (by the competitors of Bell Atlantic) provide a considerable offset to the threat of competition.⁶⁰ We conclude that there is a reasonable opportunity for the recovery of these costs in the current and foreseeable future.

Bell Atlantic's proposed change also has the effect of causing present ratepayers to pay for the TBO, rather than ratepayers over the next 13 years as contemplated by the original amortization schedule. Essentially, the Company requests the Board to require present ratepayers to pay higher rates because of future competition. We do not accept this premise and see no basis for imposing such higher rates on existing ratepayers. If, as the Company suggests, competition places significant pressures upon Bell Atlantic over time such that recovery of all just and reasonable costs may be imperiled, the Board can address the issue at the time it occurs.⁶¹

3. Wholesale Unbundled Network Element Costs

a. Findings

11. Wholesale unbundled network element costs are included in the Company's cost-of-service. Ostrander pf. at 12.

12. No adjustment was made by the Company to remove wholesale unbundled network element costs in this proceeding. Ostrander pf. at 12.

13. \$799,199 of intrastate test period wholesale expense is attributable to operational support systems. Ostrander pf. at 15.

14. The majority of the OSS costs have been incurred by the Company to date and are nonrecurring. Ostrander pf. at 16.

15. If the non-recurring costs are included in the test year costs, it will result in multiple recovery of these same costs. Ostrander pf. at 11.

b. Discussion

The Department proposes an adjustment to the cost of service to remove nonrecurring wholesale costs that Bell Atlantic has previously incurred and recovered from retail customers.⁶² The Department contends that if the non-recurring costs are included in the test year costs, it will likely result in multiple recovery of these same costs.⁶³ The Department was unable to specifically identify all of the non-recurring costs. Instead, the Department proposes an adjustment of \$1.264 million,⁶⁴ developed by annualizing wholesale unbundled network element revenues and using the annual wholesale revenues from the sale of unbundled network elements as a proxy for the unbundled network element costs in the test year.⁶⁵

The Company interprets the Department's challenge here as an attempt to separate all retail and wholesale costs and revenues.⁶⁶ As such, Bell Atlantic concludes that the Department "has selectively interpreted the Board's request for an updated cost of service for Vermont regulated services to include only 'retail' costs of service, excluding certain 'wholesale' operations."⁶⁷ Following the logic of this interpretation, the Company notes that the

revenues.⁶⁸ Bell Atlantic also claims that the Department went outside the test period to selectively capture or exclude items that serve to increase Bell Atlantic earnings.⁶⁹

We agree with the Department that *non-recurring* wholesale costs are *properly* excluded from the adjusted test-year cost-of-service. Vermont ratemaking is based upon a determination of test year revenues and expenses, which are then adjusted to reflect known and measurable changes. As the Vermont Supreme Court found, known and measurable changes "are changes that are measurable with a reasonable degree of accuracy and have a high probability of being in effect in the adjusted test year."⁷⁰ Costs that occur in the test year, but do not recur or will not occur during the adjusted test year are properly excluded as known and measurable changes from the adjusted test year. Thus, while it may be appropriate to permit recovery of certain wholesale related costs in retail rates, as the Department's witness notes,⁷¹ it would be inappropriate to include non-recurring costs whether wholesale or retail in character without a prior regulatory decision mandating separate recovery treatment.

The fact that wholesale unbundled network element costs are included in the Company's cost-of-service is not in dispute.⁷² Such costs include OSS, shared employee costs, and costs for branding and unbranding, among others.⁷³ However, the information provided to the Department was incomplete so that, other than OSS costs of \$799,199,⁷⁴ neither the Department nor the Company identified specific unbundled network element costs and whether those costs were recurring or not.⁷⁵

The evidence demonstrates that the \$799,199 of OSS costs constitute non-recurring costs whose recovery has already been provided in wholesale and retail rates during the test-

year period.⁷⁶ Accordingly, they should be removed from the test-year costs.⁷⁷ We also conclude that the full amount of non-recurring OSS costs should be removed. Bell Atlantic has failed to demonstrate that an adjustment based upon anticipated lost revenues from ensuing competition should be included in the calculation of costs.⁷⁸

Although we recognize that Bell Atlantic has not identified all wholesale unbundled network element-related costs for the test-year, we are not persuaded that the Department's broader *proxy* adjustment is reasonable. The Department's adjustment is based not on one-time costs in the test year, but rather on recurring revenues.⁷⁹ Indeed, the proxy adjustment relies on out-of-period revenues as the basis for the adjustment. It is not clear why these out-of-period adjustments to revenues should provide a reasonable proxy for estimating costs in the test-year period, let alone the wholesale unbundled network element and resale costs in the test-year, or, more to the point, the *non-recurring* wholesale unbundled network element and resale-related costs. Moreover, to the extent that the Department seeks to exclude more than non-recurring costs from rates, the Department has not demonstrated any basis for such an adjustment.⁸⁰

On a related issue, the Department argues that, aside from making the proxy adjustment increasing revenue, the Board should address in this docket other policy matters concerning wholesale costs and revenues. First, the Board should consider requiring Bell Atlantic to set up a formal chart of accounts for unbundled network element wholesale operations that separately and specifically records wholesale expenses and plant. Second, regardless of the decision on the tracking of wholesale costs and revenues, the Department

element cost study proceedings.⁸¹ In its Comments upon the Proposed Order, Bell Atlantic argues that the Board should defer requiring tracking of wholesale costs and revenues for purposes of administrative efficiency.⁸² According to Bell Atlantic, the FCC is considering, in an ongoing rulemaking proceeding, the issue of the appropriate mechanisms to track separately unbundled network element revenues and costs.⁸³ Bell Atlantic asserts that a Board-ordered accounting plan runs the risk of inconsistency with the federal scheme, without additional benefit.

We concur that tracking the costs and revenues of unbundled network element wholesale costs and revenues, as proposed by the Department, is reasonable. And, while it may be reasonable to adopt the same tracking system that the FCC ultimately adopts, at the present time, we do not know what that system will contain and whether it will be fully adequate to address the needs discussed above. We, therefore, request that Bell Atlantic file a proposal for tracking these costs and revenues within 60 days of the issuance of this Order.⁸⁴ In preparing its system of accounts, Bell Atlantic should consider the framework proposed by the Department, which on the whole appears reasonable.⁸⁵

4. Restructuring Costs and Savings

a. Findings

16. The intrastate share of test-year restructuring expenses was \$7.770 million. Exh. BAVT-4 (Attachment II, p. 5-1).

17. Bell Atlantic has incurred costs for process re-engineering costs since 1994. Under the Board Order in Docket 5702, the Company amortized these costs over five years. The costs and amortization amounts (in thousands) are as follows:

Year	Intrastate Costs	Amortization (5 years)
1994	\$17,181	\$3,436
1995	\$13,305	\$2,661
1996	\$12,911	\$2,582
1997	\$10,447	\$2,089
1998	\$7,373	\$1,475
1999	\$805	\$161

Exh. BAVT-3; exh. BAVT-4.

18. For the adjusted test year, calendar year 2000, the intrastate share of historic restructuring expenses amortized over five years is \$2.582 million in 1996, \$2.089 million for 1997, and \$1.475 million for 1998. These amortizations will expire at the end of 2000, 2001, and 2002, respectively, reducing expenses for future periods. Exh. BAVT-4 (Attachment II, pp. 5-1 through 5-3).

19. For calendar year 2000, the intrastate share of projected 1999 restructuring expenses amortized over five years is \$161,000. Exh. BAVT-4 (Attachment II, p. 6-2 to O'Quinn pf.).

20. Estimated savings from restructuring for the twelve months following the test year

share) and \$155,000 for non-management employees (\$113,000 intrastate). Tr. 6/3/99 at 11 (O'Quinn).

b. Discussion

In its cost of service filing, Bell Atlantic proposed an adjustment to test-year costs to reflect a five-year amortization of all restructuring costs incurred by the Company from July 1, 1994, to June 30, 1999; Bell Atlantic also adjusted the test year to include one year of incremental restructuring savings.⁸⁶ Under this adjustment, Bell Atlantic effectively reduces test year earnings by increasing expenses.⁸⁷

Bell Atlantic argues that the Board should permit the restructuring cost amortization adjustment because it has resulted in actual savings and efficiency gains. As one example, Bell Atlantic states that its cost per access line decreased by 22% on an inflation-adjusted basis from 1993 to the year ending June 1998.⁸⁸ Although expenses exceeded savings in 1994 and 1995, argues Bell Atlantic, the restructuring effort began to show net annual savings in 1996.⁸⁹ Bell Atlantic argues that the Department assertion that the restructuring costs greatly exceed savings even today is incorrect.⁹⁰

The Department recommends an adjustment to Bell Atlantic's treatment of these costs and savings of \$9.8 million.⁹¹ Essentially, the Department recommends that the Board

discontinue amortization of past amounts.⁹² This treatment is appropriate, the Department argues, because allowing recovery of non-recurring historic restructuring costs would violate state law and permit recovery of expenses that are financed out of the pension fund rather than the Company's general fund. In addition, the Department notes that Bell Atlantic did not amortize the restructure expenses on its financial books. The Department also asserts that the actual savings came in below estimates so that it is not clear that the ratepayers benefitted from the program. The Department's recommendation reduces expenses by \$9.8 million vis-a-vis Bell Atlantic's proposal, resulting in a net savings from test year income of \$0.6 million (going from a net expense of \$9.2 million to a net savings of \$0.6 million.).⁹³

Both the Department and the Company maintain that their respective adjustments are consistent with the Board's Order in Dockets 5700/5702.⁹⁴ The key distinction between the parties centers on the treatment of historic restructuring costs. For the reasons discussed below, we reject this position of the Department.

As a starting point, it is appropriate to review the Board's decision in Dockets 5700/5702. In that case, the Company had non-recurring test-year restructuring costs of \$2.938 million.⁹⁵ In the adjusted test year, Bell Atlantic put forth evidence demonstrating that it would incur non-recurring restructuring costs of \$11.153 million, largely attributable to pension enhancements that would encourage early retirement.⁹⁶ The Board concluded that the \$2.938 million should be removed from the cost of service as a known and measurable change from the

test year, because the cost was non-recurring. As to the additional restructuring expenses, the Board accepted them as a known and measurable change, but allowed the Company to amortize the expenses over five years, so that the adjusted test year included only one-fifth of the expected 1994 costs (approximately \$2.23 million).⁹⁷ The Board concluded that "it is appropriate to recognize in rates the longer term benefits provided for ratepayers by process re-engineering," finding that a five-year amortization achieved this result.⁹⁸ In particular, the Board found that although Bell Atlantic had proposed an adjustment to reflect the higher costs, "the future wage savings that it [Bell Atlantic] expects to reap through process re-engineering have not been reflected in this adjustment and will, therefore, accrue to the Company's and shareholders' benefit."⁹⁹

We note that our conclusion in Dockets 5700/5702 does not imply that companies should always amortize costs related to restructuring. For example, in that Docket, the Board started by eliminating the test year restructuring costs, which had been expensed rather than amortized. The expenses associated with the process re-engineering program that commenced in 1994 were large (in absolute dollars, as a percentage of Bell Atlantic's total cost of service, and by comparison to previous restructuring programs) and the significant ratepayer benefits expected to accrue would be delayed until a time during which Bell Atlantic would be operating under the Price Regulation Plan and thus not subject to rate review. Under these circumstances, the Board concluded that amortization of the large, atypical restructuring expenses was reasonable.

In principle, Bell Atlantic's amortization of the restructuring expenses from past years is

Nonetheless, the Department argues that allowing the amortization of past amounts violates Vermont law. We disagree. Bell Atlantic incurred the restructuring costs; no party challenged the reasonableness of the costs. Thus, in Dockets 5700/5702, the Board concluded that rates should allow cost recovery. The amortization simply forced Bell Atlantic to recover these costs in rates over five years instead of one. Reflection of the amortization does not, therefore, represent retroactive ratemaking, but merely the effect of having required the amortization in the first place (much like recovery of capital assets over time). Discontinuing the amortization, even during a time when Bell Atlantic has been earning quite well, would deprive the Company of a fair opportunity to recover all of the amounts that the Board had directed to recover over time. Moreover, the Company will only be permitted to recover the unamortized portion of the restructuring costs.

Although we recognize that the pension enhancements that form the bulk of the restructuring costs are not direct cash expenses, but rather are funded out of the Company's pension fund, the Department did not present sufficient evidence to demonstrate that we should reject rate recovery on this basis. Even if there is no present cash expense, by committing to expenditures from the pension fund, Bell Atlantic may accelerate the rate at which cash expenses could occur in the future to ensure that the pension fund is adequately funded. Allowing Bell Atlantic rate recovery now allows the Company to invest the additional money in the pension fund now, or set the money aside, and avoid such future payments from ratepayers.

Similarly although we are concerned that Bell Atlantic has not tracked the savings

same manner as its financial ones – by expensing the restructure costs.¹⁰¹ The Department opposed such treatment and the Board agreed, thus mandating the different financial treatment about which the Department now complains.

The Board does not, however, accept the Company's cost-of-service adjustment completely. Bell Atlantic based its calculations on an adjusted test year of July 1998 through June 1999.¹⁰² As we have stated previously, the Plan will not take effect until the year 2000, so a more reasonable adjusted test year for ratemaking purposes is calendar year 2000. Applying these principles, the actual restructuring costs should be removed from the test year (as Bell Atlantic has done) and replaced by the amortization amounts relevant to the rate year. Thus, only the one-fifth of the restructuring costs in 1996, 1997, 1998, 1999 should be included in rates. We estimate that this will cause a further reduction in Bell Atlantic's cost of service.¹⁰³ Intrastate amortization expenses should be increased to \$6.146 million in 2000 (reflecting amortization figures of \$2.582 million from 1996 incurred costs, \$2.089 million from 1997, and \$1.475 million from 1998). From this figure, further adjustment must be made to reflect the incremental annual savings of \$1.376 million from work force reductions.

The rate year cost-of-service, then, should reflect: (i) an adjustment for total intrastate restructuring costs incurred equaling \$7.770 million, which must be removed from the test-year cost-of-service; (ii) incremental savings from restructuring during the interim period equal to \$1.376 million; and (iii) an increase in expenses to reflect 1996-1999 amortization expenses and anticipated expenses equal to \$6.307 million. The adjustments effectively reduce test-year expenses by \$2.839 million.¹⁰⁴

costs associated with NET's restructuring efforts."¹⁰⁵ The costs per employee of the program Bell Atlantic implemented are even higher, amounting to over \$150,000 per employee. As in Dockets 5700/5702, no party presented evidence on the reasonableness of these per-employee costs or in their comparison to other early retirement programs by comparable companies. The Board questions whether these per-employee costs to encourage the departure of employees are reasonable, particularly at a time when the Company is seeking recovery of wage increases and concession programs that it states are necessary to retain and hire employees.¹⁰⁶ However, based upon the record before us, we make no adjustment to Bell Atlantic's restructure expense levels.

Finally, the record demonstrates that the significant costs Bell Atlantic incurred for restructuring are not continuing, even though the Company continues to recover the amortization of previous expenses. The five-year amortization of these expenses will phase out over the first half of the Plan, so that, all other things being equal, Bell Atlantic's expenses per the cost of service will decline by \$2.582 million in the year 2001, \$2.089 million in 2002, and \$1.475 million in 2003. These known and measurable changes to Bell Atlantic's expenses need to be reflected in rate reductions during the term of the Plan, as we discuss in Section III.E.4.

5. Bell Atlantic/NYNEX Merger Costs and Savings

a. Findings

24. The intrastate share of test-year merger expenses is \$2.909 million. Exh. BAVT-4 at 6-2. (Attachment II to O'Quinn nf)

27. Bell Atlantic-Vermont has not identified merger costs, including severance costs, in adequate detail to determine whether these costs were recurring or non-recurring, or whether they were actually related to the merger or some other event. Ostrander pf. at 32.

28. Using Bell Atlantic's adjustments, the merger results in net annual costs to ratepayers. Ostrander pf. at 28.

29. Bell Atlantic Corporation estimates cumulative merger savings (i.e., net of costs) of \$384 million in 1999 and \$1309 million in 2000, the adjusted test year. Ostrander pf. at 29-30.

30. In Docket 5900, the Board found that the Bell Atlantic-NYNEX merger would produce estimated savings of between \$600 and \$900 million by the third year of the merger. The Vermont share of these savings would be between \$4.3 and \$6.4 million. Docket 5900, Order of 2/26/97 at 17-18.

b. Discussion

In Docket 5900, the Board reviewed and approved the merger of NYNEX and Bell Atlantic, which then closed in August 1997. During the hearings on the proposed merger, the merging companies advised the Board that they anticipated total substantial annual savings by the third year of the merger.¹⁰⁷

As expected, the merger has produced net savings and is expected to produce additional savings in the future.¹⁰⁸ To reflect the merger costs and savings, Bell Atlantic has proposed adjustments that remove the incremental "merger transition costs" incurred during the test period.¹⁰⁹ These are replaced by interim period savings (at least through June 30, 1999) of

The Department maintains that Bell Atlantic's treatment of merger costs and savings in this docket has turned the merger, an event which it represented in Docket 5900 would yield savings for Vermont ratepayers, and which results in net savings on Bell Atlantic Corporation's corporate books in 1998 and 1999 alone, into a net loss on Bell Atlantic's intrastate books.¹¹² The Department asserts that with Bell Atlantic's adjustments, the merger results in net annual costs of \$.3 million to be paid by ratepayers.¹¹³ The Department maintains that Bell Atlantic achieves this result by using an adjusted test period of July 1998 to June 1999, a period that does not incorporate the period in which new rates will be in effect.¹¹⁴ The Department recommends an adjustment of \$1.8 million, turning Bell Atlantic's attempt to assign to ratepayers with net costs of \$.3 million into net merger savings of \$1.5 million.¹¹⁵

The Company argues that the Department has proposed an adjustment which disallows costs associated with the merger while retaining the saving.¹¹⁶ The Company argues that this inconsistent treatment artificially and unfairly reduces Bell Atlantic's costs of service.¹¹⁷

Bell Atlantic bears the burden of demonstrating the reasonableness of its filing. On this issue, the Board finds the Company's explanations unconvincing. As with restructuring costs and savings, Bell Atlantic is unable to identify merger costs or savings in detail or by account number on the company books.¹¹⁸ Rather than track costs and savings, Bell Atlantic estimates merger costs and savings at the level of the Vermont intrastate jurisdiction through adjustments of high level, *i.e.*, Bell Atlantic Corporation, estimates.¹¹⁹ But Bell Atlantic cannot demonstrate whether these costs are recurring or were non-recurring; whether these costs were

actually related to the merger or some other event; if these costs are prudently incurred costs that will ultimately inure to the benefit of ratepayers; or whether these costs include a significant amount of corporate overhead with no little or no direct relationship to Vermont.¹²⁰ Nor has Bell Atlantic provided information necessary to match merger costs and merger savings.¹²¹ The information provided by the Company suggests that Bell Atlantic allocates Vermont a higher proportion of costs than savings, although the Company did not justify this disparity.¹²²

Therefore, we accept the Department's proposed adjustments, although we note that they are quite conservative. For example, the Department significantly reduced its estimates for merger savings from those contained in Company reports and did not attempt to capture the full savings that will occur during the adjusted test year. As to the exclusion of costs proposed by the Department, the evidence in the record shows that the expenses included in Bell Atlantic's filing will not occur during the period that rates will take effect, calendar year 2000. Rather, Bell Atlantic's expenses are non-recurring events. During the period when new rates will actually be in effect, merger costs shrink to a level far lower, and merger savings grow to a level far greater, than those levels in Bell Atlantic's adjusted test year.¹²³ To include these costs in rates would have the effect of allowing these historic costs to be recovered in each year that the Incentive Regulation Plan is in effect. Bell Atlantic should therefore further reduce expenses by \$1.492 million.

In addition to the adjusted test year savings and costs, Bell Atlantic's filing includes an amortization of non-recurring test-year severance expenses for SFAS No. 112.¹²⁴ SFAS No.

1993.¹²⁵ As part of the merger, Bell Atlantic incurred a one-time severance expense of \$1.6 million associated with SFAS 112 in the third quarter of 1997.¹²⁶ In the current case, the Company proposes a five-year amortization of test-year expenses connected with the merger and related post-employment benefits. According to Bell Atlantic, such treatment is "based on prior Board orders."¹²⁷ Nonetheless, Bell Atlantic did not actually amortize these costs on either its regulatory or financial books, but made this adjustment solely for purposes of this rate case.

We do not concur. The costs in question occurred in the test year and will not recur during the adjusted test year. As such, removal of the entire expense is appropriate as a known and measurable adjustment to the test year. Our decision in Dockets 5700/5702 and here requiring amortization of restructuring expense does not lead to a different outcome. Rather, due to the extraordinary nature of the restructuring expenses under the Company's process re-engineering program, we concluded that amortization was appropriate, reflecting the fact that Bell Atlantic incurred large, atypical up front costs with the savings appearing later. Bell Atlantic has not demonstrated that the costs associated with merger-related severance expenses should be accorded the same treatment. Moreover, in the absence of a prior Board Order directing the Company to amortize particular expenses, it is not clear why the Board should allow the Company to now amortize a non-recurring test-year cost.¹²⁸ We, therefore, reject the Company's proposal to include an amortized share of these costs as an adjustment to the test year.

The Department also notes that there are anticipated savings associated with the

savings presented in Docket 6050 will not benefit ratepayers.¹²⁹ The Department, therefore, argues that it would be appropriate to create a placeholder for the merger savings, although it does not propose one. We decline to adopt the Department's recommendation. At this time, the effects of the Bell Atlantic/GTE merger, if it ultimately occurs, are too uncertain to allow the Board to recognize them as future rate adjustments. We do, however, expect that Bell Atlantic will experience significant additional savings once the merger occurs. This expectation guides, in part, our conclusion that monitoring of Bell Atlantic's performance during the term of the plan (with the possibility to make modifications) is appropriate, as explained in Section III.E.6. below.

6. Yellow Pages

a. Findings

31. Bell Atlantic's regulated Vermont operations receive contribution from Bell Atlantic's Directory Company based upon a January 1, 1991, Directory License Agreement. Ostrander pf. at 34.

32. Bell Atlantic's \$7 million Yellow Pages contribution is the same amount the Board included in Dockets 5700/5702 five years ago. See Order of 10/5/94 at 91.

33. The Department derived an \$8.8 million contribution from Yellow Pages by starting with the contribution approved in Dockets 5700/5702, \$7 million, and applying an annual growth rate of four to five percent. Ostrander pf. at 35.

34. Although revenue growth exceeded cost changes for the Yellow Pages subsidiary on

Bell Atlantic's cost of service includes a \$7 million contribution from Bell Atlantic Corporation's Yellow Pages subsidiary. This amount is the same contribution that the Board included in Bell Atlantic's cost of service for Dockets 5700/5702 five years ago.¹³⁰

The Department recommends adjusting the Yellow Pages \$1.8 million more than the \$7 million Yellow Pages contribution Bell Atlantic included in its cost of service analysis.¹³¹ The Department derived an \$8.8 million contribution from Yellow Pages by starting with the contribution approved in Dockets 5700/5702, \$7 million, and applying an annual growth rate of four to five percent.¹³² The Department asserts that the stagnancy of the Yellow Pages contribution to Bell Atlantic over a five-year period is troubling, particularly when the Board considers that, according to Bell Atlantic Corporation's annual report and SEC filings, the Directory Company's revenues have grown significantly and expenses have declined.¹³³ The Department asserts that since Bell Atlantic Corporation's net revenues from directory publishing, and hence its contribution toward regulated telecommunications services, are growing, so too should the contribution to Bell Atlantic's Vermont operations.

The Company counters that the Department is proposing to increase Bell Atlantic's revenue by \$1.8 million by attributing non-existent Yellow Pages income to Bell Atlantic.¹³⁴ They assert that the Department's calculation is purely theoretical and based on the performance in other states. Bell Atlantic asserts that the Department's proposal ignores the testimony that revenue growth essentially matched cost growth, making net income flat for a number of years.¹³⁵

We conclude that the Department's proposed adjustment to increase Yellow Pages

Department is correct that over the past five years, net earnings from directory publishing for Bell Atlantic Corporation have increased.¹³⁶ However, the evidence also suggests that while Bell Atlantic Corporation generally has benefitted from the growth in Yellow Pages earnings, there has been no corresponding benefit to Vermont that would justify the adjustments proposed here by the Department.¹³⁷ Rather, net earnings within Vermont have remained constant.

Although we do not accept the Department's proposed adjustment, the Board still has several concerns with the allocation of revenues from the directory publishing subsidiary that have not been adequately addressed by the Company. First, the Board expressed concern over the Directory License Agreement in 1994 in its Order in Dockets 5700/5702:

We note that the first term of the Directory License Agreement expires on December 31, 1995. We hereby put NET on notice that prior to renewal of that agreement we intend to undertake a more comprehensive review of the ratepayer effects of NET's treatment of Yellow Pages revenues.¹³⁸

Notwithstanding this clear statement, Bell Atlantic renewed the agreement without seeking Board review -- the renewed Directory License Agreement expired January 1, 1999.¹³⁹ Nor has the Company presented evidence to demonstrate the reasonableness of the process by which Bell Atlantic compensates regulated ratepayers for the benefits those ratepayers provide to the directory publishing subsidiary, as suggested in the 1994 Order. In fact, the evidence presented suggests that the directory publishing subsidiary retains earnings based upon a higher rate of return than the Board allows the regulated company.¹⁴⁰ Finally, we note that despite requests from the Board the Company did not even provide a copy of the Directory License

Agreement.¹⁴¹ The Board makes no adjustments to the cost of service based upon these concerns at the present time, but may explore them in the future.

7. Revenue Annualization

a. Findings

35. The revenue annualization adjustments proposed by the Department are based on projections of a trend and not on known and measurable effects of any particular event. Tr. 6/3/99 at 48-49 (Ostrander).

36. Following implementation of IntraLATA Presubscription in November 1997, Bell Atlantic's toll revenues decreased, but access revenues increased. Exh. BAVT-4.

37. Bell Atlantic's cost-of-service included an adjustment to toll revenues to annualize the reduced tolls revenues that occurred following IntraLATA Presubscription. This reduction was \$1.773 million annually. Exh. BAVT-4 (p. 4-3).

38. Revenues from switched access for the last six months of the test year (following extended area service implementation) exceeded access revenues for the first half of the test year by approximately \$1.75 million annually. Bell Atlantic did not normalize access revenues. Exh. BAVT-3 (I-1); exh. BAVT-4.

b. Discussion

The Department recommends an adjustment of \$3 million in order to reflect revenue growth resulting from growth in access lines in vertical services and in toll access minutes of

none of which were expressly authorized by the Board in Dockets 5700/5702.¹⁴⁴ The Department asserts that it would be unreasonable to consider Bell Atlantic's proposed adjustments, which tend to reduce the Company's revenues, without also considering adjustments for known and measurable changes tending in the other direction.¹⁴⁵

The Company counters that the revenue annualization adjustments proposed by the Department violate general ratemaking principles because they are based only on projections of a trend and not on known and measurable effects of any particular event.¹⁴⁶ Indeed, the Company notes further that the position of the Department here is inconsistent with its position in prior investigations.¹⁴⁷ By contrast, the normalization and pro-forma adjustments Bell Atlantic made were based on test-period events and test-period volumes annualized consistently with past Board Orders.¹⁴⁸

In this proceeding, the Board is reviewing a proposed alternative form of regulation; the Board has not opened a formal examination into Bell Atlantic's rates under 30 V.S.A. § 227. The examination of Bell Atlantic's cost of service occurs in the context of that alternative regulation plan, and is aimed at ensuring that rates at the outset of the plan are reasonable and thereby consistent with the general good of the state.¹⁴⁹ Section 226b does not limit the Board to traditional ratemaking principles in the context of the current multi-year incentive rate proceeding. Nevertheless, absent good cause, departure from past traditional principles may

144. In addition, Bell Atlantic made an out-of-period adjustment for wage increases in April 1999. Though this adjustment is unusual, the Department did not recommend reversing it.

not be warranted. We conclude that the recommendations of the Department here move beyond the application of traditional principles and we are not persuaded that there is sufficient cause in the instant case.

The matching of costs and revenues is a touchstone of traditional ratemaking.¹⁵⁰ As a result, when establishing rates, the Board generally uses test year figures for the number of customers (access lines), usage, and the sales of ancillary services, disregarding normal growth. This practice ensures that expenses that are dependent upon customer numbers and usage are consistent with the customer volumes.

The Department has presented no basis for changing our traditional ratemaking practice. While usage has clearly grown, the Department has not presented sufficient evidence to demonstrate that continued use of test year volumes will lead to rates that are not just and reasonable. Moreover, it is not clear that an adjustment, such as that proposed here by the Department can be made without a corresponding adjustment to costs and investments that correspond to the adjustments for revenue projections advanced here by the Department. No record of a corresponding adjustment has been made nor reason for departing from the principle of matching costs and revenue. The Department also has not identified a particular event or events that would trigger the proposed adjustment.¹⁵¹

The record is clear that the Company made a downward adjustment in toll revenues to account for the introduction of IntraLATA Presubscription in November 1997.¹⁵² The evidence presented demonstrates that following IntraLATA Presubscription, Bell Atlantic's toll revenues dropped. Annualization of the final month of the test year is a reasonable means to value the difference in toll revenues from the pre-IntraLATA Presubscription period to the adjusted test year. However, the same evidence also demonstrates that following IntraLATA Presubscription, access revenues increased; while Bell Atlantic lost the toll revenue when a customer switched to a different toll carrier, the Company gained access revenues from the customer's new toll carrier. Bell Atlantic did not adjust access revenues to account for the effects of IntraLATA Presubscription.¹⁵³ Although seasonal variability in the data makes it difficult to precisely adjust access revenues without prior year monthly information, the record demonstrates that access revenues for the last six months of the test year were approximately \$1.75 above the first six months.¹⁵⁴ This increase in access revenues substantially offsets the reductions in toll revenues that can be attributed to the introduction of intraLATA presubscription in November of 1997. We conclude, therefore, that the Company should eliminate its proposed adjustments to test year revenues of \$1.773 million.

40. This decline resulted in part from Bell Atlantic Corporation's November 1997 sale of its interest in Bellcore. *Id.* at 42-44.

41. Bellcore, which was owned in equal parts by the seven original Regional Bell Holding Companies (RBHCs), historically imposed a significant amount of R&D costs on Bell Atlantic. Ostrander *pf.* at 42.

42. Subsequent to the end of the test year, Bell Atlantic's intrastate R&D costs continued to fall at an even more rapid pace, thereby justifying a far larger adjustment. Ostrander *pf.* at 44.

b. Discussion

The Department recommends reducing test year R&D costs based on the decline in the balance of Bell Atlantic's R&D account from year end June 30, 1997, to year end June 1998.¹⁵⁵ In that period, the intrastate portion of Bell Atlantic's R&D expenses fell by \$263,524.¹⁵⁶ Subsequently, Bell Atlantic's intrastate R&D costs continued to fall at an even more rapid pace, thereby justifying a far larger adjustment.¹⁵⁷ The proposed reduction is intended to partially reflect the decline in Bell Atlantic's R&D costs that resulted from Bell Atlantic Corporation's November 1997 sale of its interest in Bellcore.¹⁵⁸ Bellcore, which was owned in equal parts by the seven original Regional Bell Holding Companies (RBHCs), historically imposed a significant amount of R&D costs on Bell Atlantic. Since the sale of Bellcore in 1997, R&D costs have declined significantly and, the Department asserts that there is no indication that these costs will return to previous levels.¹⁵⁹

The Company responds that the R&D adjustments made by the Department selectively identified and included revenue and expense accounts that have tended in a direction helpful to the Department's case since the test period.¹⁶⁰

The parties do not disagree on the underlying facts. Bell Atlantic's R&D expense dropped from the end of June 1997 through the end of June 1998 and has continued to drop since that time.¹⁶¹ It appears that much, if not all, of this reduction is attributable to the RBHC's sale of Bellcore, to which the Company previously paid significant R&D amounts. The Company acknowledges that the R&D savings exhibited during this period will occur during the adjusted test year.¹⁶² As a result, the Department's proposed adjustment represents a known and measurable change from the test year and is accepted.

9. Year-end Rate Base

a. Findings

43. Bell Atlantic used an average test-year rate base in calculating the cost-of-service. This approach was consistent with the methodology applied by the Board in Dockets 5700/5702. Exh. BAVT-3 at 5 (Attachment 1 to O'Quinn pf.).

44. Revenue growth appears to be outpacing growth in investment, particularly after adjustments for accumulated depreciation. At least for the last five-year period (from 1993 through 1998), there has been a consistent pattern of decline in net telephone plant in service investment with the most significant decline occurring between 1997 and 1998 (a reduction of approximately \$13 million from \$226 million to \$213 million) Ostrander nf at 49

Bell Atlantic used an average rate base during the test year. The Department argues for use of an end-of-test-year rate base. The Department recommends reducing Bell Atlantic's proposed rate base by \$7.3 million.¹⁶³ The Department argues that using end-of-test-year rate base (June 30, 1998) is more reasonable because it produces a closer match with Bell Atlantic's rate case adjustments. Although it acknowledges that the Board standard applied in Dockets 5700/5702 is an average-year rate base, the Department claims that circumstances have changed and that justifies a change in the rules.¹⁶⁴

The Company counters that in the October 5, 1994 Order in Dockets 5700/5702, the Board made clear that the average-year rate base was the norm, and that its approval of an end-of-year rate base in a previous docket was based on exceptional circumstances that were no longer present.¹⁶⁵

For providers of telecommunications services, the Board has not established a firm principle favoring either the average-year rate base standard or end-of-year rate base standard. For example, in Dockets 5700/5702 an average-year standard was applied.¹⁶⁶ By contrast, in the last litigated rate proceeding prior to Dockets 5700/5702, the Board employed a year-end rate base.¹⁶⁷

These different approaches to rate base reflect the Board's attempt to ensure that the rate base methodology will lead to results that produce just and reasonable rates. As the Board explained in 1994, the Board selected a methodology that:

will more fairly match the Company's costs and revenues to the investments that give rise to them, and will provide an adequate opportunity for NET to earn its

The Board declined to strictly follow the matching principle in 1985, however, concluding that the establishment of just and reasonable rates required an exercise of judgment by the Board in balancing the interests of the ratepayer and the Company.¹⁶⁹ At that time, Bell Atlantic's investment levels were growing and were expected to continue growth. Yet average revenues per line were moving in opposite directions. Strict adherence to matching principles, the Board noted, would produce a mismatch and not provide an opportunity to realize a reasonable or "adequate" return.¹⁷⁰

Our goal is to establish just and reasonable rates for Bell Atlantic, so that the Company has an opportunity to earn a fair return on its investment. As we explained above in our decision to allow the restructuring expense, in general, this calls for a matching of the Company's costs and revenues during a particular period. Here, however, the particular investment and revenue patterns for Bell Atlantic demonstrate that use of average-year rate base will not accurately reflect the cost and revenue patterns that will occur in the adjusted test year of 2000.

The evidence demonstrates that at the present time, revenue growth is significantly outpacing growth in investment, particularly after adjustments for accumulated depreciation. For the last five years (from 1993 through 1998), Bell Atlantic has shown a consistent pattern of decline in net telephone plant in service investment. The most significant decline occurred at the end of that period, between 1997 and 1998, with net telephone plant dropping approximately \$13 million (from \$226 million to \$213 million).¹⁷¹ As Bell Atlantic has not increased its investment there is no basis to conclude that this trend will not continue. At the

during the adjusted test year than would be the thirteen-month average rate base Bell Atlantic advocates and that we adopted in Dockets 5700/5702. Failure to reflect the consistent pattern of declining rate base would not accurately reflect the cost characteristics of the Company and cause ratepayers to pay rates higher than necessary to adequately compensate Bell Atlantic. We stress, however, that our decision relies upon the readily apparent investment trends; absent the clear and steady decline in net plant in service over time, the Board might have adopted a different approach.

10. Reciprocal Compensation

a. Findings

46. Reciprocal compensation is a method for interconnecting carriers to compensate each other for the exchange of traffic between networks. Brevitz pf. at 42.

47. The Company's cost of service includes a pro forma adjustment to Bell Atlantic intrastate costs based on payments (specifically "reciprocal compensation" payment) to a competitive local exchange carrier for Bell Atlantic customer local calls terminated on the competitive local exchange carrier's network. O'Quinn reb. pf. at 14; Brevitz pf. at 4; Brevitz sur. pf. at 42.

48. The adjustment proposed here by the Company was made in anticipation of an FCC order similar to that directing Southwestern Bell to treat costs associated with internet calls as *intrastate* costs, even while they may be regarded as interstate services by the FCC. Tr. 6/2/99 at 204 (O'Quinn).

b. Discussion

Reciprocal compensation is a method for interconnecting carriers to compensate each other for the exchange of traffic between networks.¹⁷³ The Company proposes a pro forma adjustment to Bell Atlantic intrastate costs based on payments (specifically "reciprocal compensation" payment) to a competitive local exchange carrier for Bell Atlantic customer local calls terminated on the competitive local exchange carrier's network. Specifically, the Company proposes an *adjustment* based on its estimates of internet calling originating on the Bell Atlantic network that was terminated in the network of another facilities-based competitive local exchange carrier.¹⁷⁴ Bell Atlantic estimated the internet portion of the traffic by taking the invoices from one carrier for the months of July, August, September and October 1998, averaged them, and multiplied by 12 months.¹⁷⁵

The Department argues that the Company should not be permitted cost recovery of the adjustment proposed by the Company for reciprocal compensation payments.¹⁷⁶ According to the Department, Bell Atlantic agreed to a reciprocal compensation scheme over a "Board-sanctioned" alternative known as "Bill and Keep"; had the Company elected a Bill and Keep arrangement, no reciprocal compensation payments would have occurred.¹⁷⁷ The Department argues that the current reciprocal compensation scheme adopted between Bell Atlantic and other competitive local exchange carriers is destructive to the co-carrier structure of a traffic handling scheme that requires the cooperation of carriers.¹⁷⁸

The costs that the Department challenges here are not Bell Atlantic's costs for

compensation payments should be disallowed because the Company could have (and should have) selected a Bill and Keep compensation scheme that would have avoided those payments.¹⁷⁹ The Department also observes that Bell Atlantic's selection of reciprocal compensation also imposed significant unnecessary costs associated with measuring and billing exchange of local traffic on a per-minute basis.¹⁸⁰

The questions raised by the Department do raise some concerns with the compensation scheme adopted by the Company; however, the record in this case is not adequate for us to conclude that the Company acted in an imprudent manner by agreeing to reciprocal compensation payments. We note that, although the Board has adopted a presumption in favor of a Bill and Keep method for mutual compensation of traffic termination, the Board has explicitly permitted parties to an interconnection agreement to adopt reciprocal compensation mechanisms (as permitted by the federal Telecommunications Act of 1996). Bell Atlantic's reciprocal compensation scheme, embodied in interconnection agreements that the Board approved, is not unreasonable.

Nonetheless, there are some remaining concerns with the Company's adjustment. Bell Atlantic's adjustment to reflect increased reciprocal compensation payments includes payments for internet-bound traffic. The FCC has previously ruled that such traffic is interstate, in which case it should not be included in the Company's intrastate expenses. However, the FCC also has directed Southwestern Bell to treat costs associated with internet calls as intrastate costs, even though they may be regarded as interstate services by the FCC.¹⁸¹ It is reasonable to expect that the FCC would make a similar judgment with respect to Bell Atlantic's reciprocal

Thus, we conclude that it would be unfair to the Company to preclude recovery of these costs given current FCC policy regarding the intrastate nature of these costs. If, however, there is a court decision, or regulatory order that changes this cost recovery policy, then the termination costs of internet traffic will flow to the interstate jurisdiction. Should this event occur, Bell Atlantic will reflect the change as an exogenous event and reduce intrastate rates accordingly.¹⁸³

11. IntraLATA Presubscription

a. Findings

52. Bell Atlantic incurred non-recurring costs associated with intraLATA presubscription ("IntraLATA Presubscription") that it did not remove from the cost of service in the test year. Ostrander sur. pf. at 12.

53. The IntraLATA Presubscription test year costs include expenses in the amount of \$51,671 (representing total expenses of \$78,515 net of offsetting test period revenue of \$26,844), and capital costs of \$77,059, for a total of \$128,730.¹⁸⁴ Pursuant to a Board Order, capital costs were to be recovered over only two years (Docket 5713, Order of 8/20/97). Capital costs will be recovered before new rates go into effect. *Id.*

b. Discussion

The Department asserts that Bell Atlantic incurred non-recurring costs associated with intraLATA presubscription ("IntraLATA Presubscription") that it did not remove from the cost

capital costs of \$77,059, for a total of \$128,730.¹⁸⁶ The Department argues that since these costs have been incurred and are behind Bell Atlantic, they should not be included in the adjusted test year, since otherwise Bell Atlantic may recover these costs twice.¹⁸⁷ In fact, in Docket 5713, Phase II, the Board established a mechanism specifically designed for recovery of these costs through a surcharge on access rates. Docket 5713, Order of 8/20/97.¹⁸⁸ Bell Atlantic agrees that the Department's IntraLATA Presubscription adjustment "may have" merit, although the Company maintains that it lost money implementing IntraLATA Presubscription.¹⁸⁹

The record demonstrates that the test year costs associated with the implementation of IntraLATA Presubscription should be excluded from the adjusted test year cost of service. The test year expenses are non-recurring and represent known and measurable changes that need to be reflected in rates. Capital costs, which would normally be included in rate base, should also be excluded here; as the Department notes, the Board established a mechanism specifically designed for recovery of these costs through a surcharge on access rates.¹⁹⁰ To permit inclusion of these costs associated with intraLATA presubscription here would allow Bell Atlantic to recover the expenses and capital costs more than once. We, therefore, accept the Department's recommendation and require that the test year cost-of-service should be reduced by \$128,730 to reflect the effects of non-recurring IntraLATA Presubscription costs that the Company will not continue to incur in the future and for which a separate recovery mechanism has already been established.

The evidence also raises questions as to whether the above adjustment captures all non-recurring IntraLATA Presubscription implementation costs in the test year. The IntraLATA Presubscription implementation costs for the test year identified by Bell Atlantic are far smaller than the costs to which Bell Atlantic testified in Docket 5713.¹⁹¹ In fact, Bell Atlantic claims that, in the test year, it incurred only about twenty percent of the costs that it projected in Docket 5713. Based upon statements in Docket 5713 and the fact that IntraLATA Presubscription implementation took place in November 1997, most if not all of Bell Atlantic's IntraLATA Presubscription implementation costs should have been incurred in the test period (if not previously).¹⁹² Bell Atlantic failed to produce any evidence to reconcile this inconsistency. On the record before us, however, we cannot conclude that further adjustments are appropriate.

12. Vermont Cost Allocations

a. Findings

54. The various differences between company financial books and the rate case filing are usually the "rate case adjustments" sponsored by the Company. Ostrander sur. pf. at 14.

55. Bell Atlantic's cost-of-service differs from its actual books by approximately \$1.6 million, after taking account of the rate case adjustment. This difference was not identified in the cost of service filing. Ostrander sur. pf. at 14-15.

56. The adjustments never were actually booked to the financials and were made purely for rate case purposes. Ostrander sur. pf. at 16

financial books and the rate case filing are usually the "rate case adjustments" sponsored by the Company. The Department states that after taking account of the rate case adjustments, there still remains a difference of approximately \$1.6 million between the Bell Atlantic actual books and the cost-of-service filed by the Company.¹⁹³ According to the Department, Bell Atlantic did not explain or identify this rate case adjustment.¹⁹⁴ The Company responded that the differences between the "MR" books and the rate case cost of service filing reflect the correction of certain misallocations that occurred within Bell Atlantic.¹⁹⁵

We conclude that the Company here has not met its burden of proof on this issue. Although Bell Atlantic has suggested that the differences in accounts pointed out by the Department represent solely the correction of a mis-assignment of costs, the Company has not presented any evidence to substantiate that claim, despite adequate opportunity to do so (including specific questions from the Board).¹⁹⁶ Instead, the evidence in the record supports the conclusion that Bell Atlantic never actually booked these adjustments to the financial statements and made the adjustments solely for purposes of setting intrastate rates.¹⁹⁷ We conclude, therefore, that the cost-of-service should be reduced by \$1.585 million as proposed by the Department.

13. Local Number Portability

a. Findings

57 The Company incurred cost to implement local number portability of \$366 200 in

b. Discussion

The Department argues that the Board should reduce Bell Atlantic's test year costs by an amount equal to the costs associated with implementing Local Number Portability incurred in the test year.¹⁹⁸ According to the Department, the FCC has established a separate mechanism for recovery of Local Number Portability-related costs. The Department argues that for Bell to recover those costs, which are non-recurring, in its going-forward intrastate rates would allow Bell substantial over-recovery.¹⁹⁹ The Department's testimony on this Department initiated adjustment to the Company's cost-of-service was uncontested.

We concur with the Department. The FCC has ruled that Local Number Portability-related implementation costs incurred by incumbent local exchange carriers are not subject to jurisdictional separations but instead are assigned solely to the interstate jurisdiction.²⁰⁰ The FCC also has established a mechanism specifically designed to recover Local Number Portability-related implementation costs.²⁰¹ Allowing compensation in intrastate rates would provide the Company with double recovery.

Bell Atlantic incurred Local Number Portability costs of \$366,200 in the test year, of which \$270,600 are intrastate.²⁰² Accordingly, the Company should reduce its test-year cost of service by \$270,600.

14. Cost of Capital

The Cost of Capital is determined by (i) establishing an appropriate capital structure

dispute include determinations of debt, equity and capital structure itself. In the present case, capital structure and the cost of equity are the principal areas of dispute.

The principles applied in the context of establishing an appropriate cost of capital have been established.²⁰³ As the Department summarizes the principle, "a utility is allowed an opportunity to earn a return similar to enterprises of equal risk."²⁰⁴

Bell Atlantic's proposed cost of service is based upon an overall rate of return of 11.3%. The Company argues that this return is justified in light of the market conditions and risks the Company faces, particularly from the emergence of competition. In contrast, the Department recommends an overall rate of return of 9.3 percent.²⁰⁵ While the Department acknowledges an increasing level of competition in this state, they assert that the level of competition is exaggerated by the Company and that there is little evidence of corresponding investment risk as wholesale markets replace the retail market share and as retail markets expand. The Company relies on a recommended 14.5% return on equity while the Department relies on an assumed 11.5% return on equity.

The differences between the Company and the Department also relate to capital structure. Bell Atlantic's cost of service used a capital structure based on 58% equity and 42% debt to calculate its weighted average cost of capital. The Department recommends a capital structure consisting of 52 percent common equity capital, 45.5 percent long-term debt and 2.50 percent short-term debt.

59. In seeking to estimate the cost of equity capital of a firm, it is necessary to gauge investor expectations with regard to the relative risk and return of that firm, as well as that for the particular risk-class of investments in which that firm is classified. Hill pf. at 4.

60. Investors are interested in future expected competition when they assess Bell Atlantic's investment risk because expected future competition is a primary determinant of volatility in the expected returns on their investment. Vander Weide reb. pf. at 16.

61. There are as many as 200 certificated providers of toll service in Vermont today. Tr. 6/10/99 at 143 (Brevitz).

62. Since intraLATA presubscription in November 1997, some 40% of Bell Atlantic's business access lines and 30% of its residence access lines have been presubscribed to toll carriers other than Bell Atlantic. Tr. 6/9/99 at 213 (McCarren).

63. As of February 1999, Bell Atlantic has negotiated, executed and filed with the Board 10 wireline interconnection agreements (of which eight have been approved and two are pending), seven wireless interconnection agreements (of which six have been approved and one is pending), and 13 resale agreements (of which 12 have been approved and one is pending). McCarren pf. at 6.

64. Several competitors have filed to provide local exchange service in Vermont, including AT&T, Hyperion, Sprint, and MCI Metro. Vander Weide reb. pf. at 10.

65. Competitive local exchange carriers also now have the capability to provide facilities-based competition in Vermont. Tr. 6/10/99 at 210 (McCarren).

66. Bell Atlantic estimates its market share of local service at 99 percent. Tr. 6/9/99 at

Atlantic-Vermont) are expected to remain dominant in the market for local exchange telephone services. Hill pf. at 9.

70. The local exchange telephone operations remain relatively low-risk operations. Hill pf. at 13.

71. As evidenced by a fifteen-year period since the 1984 break up of the Bell system, this capital structure is commensurate with Bell Atlantic's operational risk, which has not been dramatically affected by the advent of competition. Hill pf. at 17.

72. From 1984 to 1998, Bell Atlantic achieved steady and stable increases in operating revenues and operating expenses, both of which have trended upward at approximately the same rate. Hill pf. at 17; exh. DPS-16 (SGH-1, Sch. 3 at 1).

73. From 1991 through 1998, the positive differential between revenues and expenses is widening over time. Hill pf. at 17; exh. DPS-16 (SGH-1, Sch 3 at 2).

74. Bell Atlantic's operating profitability (revenues less expenses) is *increasing* in a time when competition is reportedly making substantial inroads into the Company's markets and creating increased operational risk. Hill pf. at 17-18.

ii. Discussion

Central to the arguments made by the Company is its assertion that competition is increasing investor risk and earnings requirements. The issue is central to both the proxy group inputs used to estimate the cost of equity and in the selection of the appropriate capital structure. As the Company's witness argues

volatility in the expected returns on their investment.²⁰⁷ When risk increases, investors demand higher returns on their investment.²⁰⁸ The Department, however, challenges the view that competition is significantly increasing risk and investor requirements.²⁰⁹ They argue that Bell Atlantic is merely facing a "quasi-competitive/utility" and that they are only due a return reflecting the level of risk and investor requirements more typical of a traditional utility investment.²¹⁰

As evidence to support their position, the Company provides considerable background on the intentions of competitors and legislators (in passing the Telecommunications Act of 1996) regarding the intent to introduce and spread local competition at the national level.²¹¹ At the state level, the Company asserts that "there can be no question that the market for intrastate toll services in Vermont is highly competitive." They note that the Vermont Public Service Board determined as early as 1986 in Docket 4946 that the legal barriers to competitive provision of in-state toll services should be removed.²¹² The Department estimates that there are as many as 200 certificated providers of toll service in Vermont today.²¹³ Since intraLATA presubscription in November 1997, some 40% of Bell Atlantic's business access lines and 30% of its residence access lines have presubscribed to toll carriers other than Bell Atlantic.²¹⁴

207. Vander Weide reb. pf. at 16.

208. *Id.* at 18.

209. Department Brief at 59.

210. Hill pf. at 7. This characterization of the Bell Atlantic environment in Vermont was pointedly challenged by Dr. Vander Weide. Vander Weide pf. at 3.

Bell Atlantic also observes that its competitors agree that the toll market is competitive. "[C]ompetitive toll service providers have been active and successful in soliciting new toll customers as well as existing Bell Atlantic toll customers. . . . In the relatively short time since the implementation of intraLATA presubscription, competition has been working in the intraLATA toll market."²¹⁵ "[T]he long distance industry's high and increasing churn rates provide further evidence of an actively competitive market."²¹⁶

The Company argues further that competition exists in the local exchange market. As of February 1999, Bell Atlantic observes that it has negotiated, executed and filed with the Board 10 wireline interconnection agreements (of which eight have been approved and two are pending), seven wireless interconnection agreements (of which six have been approved and one is pending), and 13 resale agreements (of which 12 have been approved and one is pending).²¹⁷ Competitive local exchange carriers also now have the capability to provide facilities-based competition in Vermont. Hyperion, in particular, is an active competitor in the business market.²¹⁸ They argue that a host of other competitors may soon enter the local market, enabled by the Telecommunications Act and technological changes, such as cable telephony²¹⁹ and fixed wireless services,²²⁰ that make it feasible to provide local service by means other than the traditional public switched network.²²¹

214. (...continued)
instate and interstate toll carriers.

215. *Sanders*, at 56.

Furthermore, Bell Atlantic argues, investors perceive Bell Atlantic as constrained in its ability to meet the increased level of competition. Bell Atlantic faces a number of disadvantages in its efforts to compete in a fully competitive local exchange market. As an incumbent local exchange carrier, Bell Atlantic has the obligation to provide telecommunications services to all customers, even those whose rates fail to cover the cost of providing service. Investors are concerned that the universal service support mechanisms that will be put in place may not be sufficient to balance the incumbent local exchange carrier's obligation to continue to provide service in high-cost areas, while competitors are free to "skim the cream" by serving only the most profitable markets.²²²

In addition, local exchange carriers such as Bell Atlantic are required by the Act to provide competitors access to unbundled network elements and interconnection services, while competitors have no similar obligation. Thus, unlike their competitors, local exchange carriers cannot obtain a competitive advantage from investments in new technologies to the extent they are required to share these benefits with all competitors.²²³

The Department appears to acknowledge some of the inroads of competition, but rather centers its concerns on the asserted relationship between the competition and the risk that a local exchange company such as Bell Atlantic faces in Vermont. The Department also questions the level of competition in the key toll and local markets. They claim data provided from the Company show that Bell Atlantic retains a dominant market position.²²⁴ Local service is not competitive, with Bell Atlantic estimating its market share at 99 percent.²²⁵ Similarly toll access is not highly competitive.²²⁶

rates, a capital structure with an equity component similar to that of unregulated, competitive industrial firms is not appropriate.²²⁸

We generally concur with the Department. While competition has clearly entered the Vermont telecommunications markets, particularly in toll, there is no indication that the advent of competition has significantly affected Bell Atlantic's market risk. As evidenced by a fifteen-year period since the 1984 break up of the Bell system, a period marked by increasing competition, competition has not dramatically affected Bell Atlantic's operational risk.²²⁹ In fact, during the period from 1984 to 1998, Bell Atlantic achieved steady and stable increases in operating revenues²³⁰ and operating expenses,²³¹ both of which have trended upward at approximately the same rate.²³² More recently, during 1991 through 1998, while more volatility is experienced than in the 1980s, the differential between revenues and expenses is widening over time.²³³

Thus, the impact of competition on investor risk is not, as yet, evident in the financial reports of the Company. Moreover, Bell Atlantic's operating profitability (revenues less expenses) is *increasing* in a time when competition, according to the Company, is making substantial inroads into the Company's markets and creating increased operational risk.²³⁴ We, therefore, conclude that the risk to Bell Atlantic's interexchange and local service is small in comparison with competitive markets.

Furthermore, to the extent that risks from competition have increased, they do not appear to have affected the Company's financial risks. The pace of competitive entry has undoubtedly been one factor. In addition, while the promise of competition may be increasing

over time, competitive entry also provides the opportunity for changing revenue sources rather than decreasing them. Lost retail revenues may well be replaced by the new revenue sources at the wholesale level. For example, Bell Atlantic has shown that intraLATA Presubscription produced a significant drop in toll revenue. This decrease, however, was largely offset by increased switched access revenues.

b. Flotation Expenses

i. Findings

75. The Department of Public Service made no explicit adjustment to account for flotation costs. Hill pf. at 48; Vander Weide reb. pf. at 46.

76. All firms which sell debt and equity securities in the capital markets incur flotation costs. These include underwriters' commissions, legal fees, and printing expenses, accounting fees, and underpricing required to sell large issues, among others. Vander Weide reb. pf. at 46; exh. BAVT- 16 (JVW-2 at 2).

77. Flotation costs and other transaction costs offset one another, so that no specific adjustment to equity capital cost is needed. Hill pf. at 49-50.

78. There are legitimate out-of-pocket costs incurred by a firm with the public issuance of equity capital. Flotation costs, however, are de minimus when compared to underwriters' fees. Hill pf. at 19.

79. Investor expectations regarding stock sales at market prices in excess of book value are captured in the Discounted Cash Flow model growth rate. Hill nf. at 49

for flotation costs. The Department argues that it is inappropriate to take further account for the adjustments, citing four reasons.

First, the Department argues that Bell Atlantic's stock is selling for 500% above its book value. As such, all shareholders benefit (by realizing an increase in the per share book value of their investment) every time a new share is issued.²³⁶ To this, Bell Atlantic responds that flotation costs are just another cost component of the Company's overall cost-of-service. When conducting a cost-of-service analysis, according to Bell Atlantic, it should be included along with the other costs.

Second, Mr. Hill argues that the majority of issuance expenses are underwriters' fees, or "discounts" and are not out-of-pocket expenses for the issuing company. As a result, underwriters' fees are not an expense incurred by the issuing utility, so that Bell Atlantic should not recover such "costs" in rates.²³⁷ To this, Dr. Vander Weide notes that the issuance expense incurred in a public offering reduces the amount of capital available for investment by the company (relative to that paid in by investors).²³⁸

Third, the Department argues that the specific discounted cash flow ("DCF") analysis used, already makes an upward adjustment to account for investor expectations regarding stock sales at market prices in excess of book value. Further adjustment for issuance expenses is therefore unnecessary.²³⁹ Dr. Vander Weide argues that the adjustment made here is distinguishable from one made for flotation costs.²⁴⁰

Fourth, Mr. Hill cites a study by NRRI that notes that a specific adjustment for issuance expenses is unnecessary. Certain investor expenses, such as brokerage fees, tend to increase

Department, such transaction costs offset the flotation costs.²⁴¹ Dr. Vander Weide responds that the research cited by Mr. Hill is unpersuasive and that the relative magnitude of brokerage fees in relation to flotation expenses is insignificant.

The Board concludes that it is not appropriate to include flotation costs in the cost of capital. Although, in principle, flotation costs may represent a cost, Bell Atlantic did not present any evidence that the Company will actually incur such costs during the adjusted test year. Thus, inclusion of flotation costs is not warranted.²⁴²

Moreover, it is not clear that the flotation costs, if any, represent an out-of-pocket expense or an expense for which the Company is not already compensated in its return. Flotation costs represent agents' fees paid by the investors to the underwriters. Since those costs are borne by the investors, any addition to the return requirement imparted by the existence of those costs is accounted for in the price those investors are willing to provide. Inclusion of flotation costs in the cost of capital would thus effectively double-count that return.²⁴³

c. Capital Structure

Findings

80. In the current proceeding, it is appropriate to determine a reasonable overall return to apply to an historical-cost rate base. The appropriate capital structure to consider is a book-value-based capitalization. Hill sur. pf. at 13.

81. While some market share erosion in outbound intra-ATA long distance has

82. Bell Atlantic's operational risk has increased over the past years and should be reflected in the capital structure applied in determining the overall cost of capital. Hill sur. pf. at 3.

83. As of June 30, 1998, the booked capital structure consisted of 57.78 percent common equity, 40.18 percent long-term debt and 2.03 percent short-term debt. Hill pf. at 12; exh. BAVT-3 at 4 (Attachment I to O'Quinn pf.); exh. BAVT-4 at 3 (Attachment II to O'Quinn pf.).

84. The June 30, 1998, booked capital structure is similar to the book capital structure of Bell Atlantic over the past five quarters. Hill pf. at 12.

85. The level of short-term debt is equivalent to the percentage of that form of capital actually used by Bell Atlantic over the past five quarters. Hill pf. at 16; exh. DPS-16 (SGH-2, Schedule 2 at 1). The level of short-term debt has been increasing over the past three years. Hill pf. at 13.

86. While telephone operations continue to be the core business for Bell Atlantic (approximately 75% of assets), investments in competitive markets and overseas (investments in other sovereign nations) subjects the parent holding company to greater levels of operations risk than faced by the regulated local exchange telephone operations in Vermont. Hill pf. at 15.

87. The Department's proposed capital structure, together with the return of equity originally proposed by the Department's witness, results in interest coverage ratios below that recommended for a local exchange carrier with an AA rating. Vander Weide reh. nf. at 30.

2.03 percent short-term debt.²⁴⁴ The Company maintains that it is consistent with the capital structure the Board approved in Dockets 5700/5702.²⁴⁵

The Department notes that while book capital structure provides some information, book value is not the sole consideration in establishing required revenues.²⁴⁶ The Department recommends a capital structure consisting of 52 percent common equity capital, 45.5 percent long-term debt and 2.50 percent short-term debt.²⁴⁷ The level of short-term debt is equivalent to the percentage of that form of capital actually used by Bell Atlantic over the past five quarters. The level of equity capital is based on the Board's capital structure ruling in Dockets 5700/5702 adjusted for Company-supplied information regarding revenues, expenses and competition.²⁴⁸ The level of long-term debt is residually calculated.

The Company argues that the Department's proposed capital structure containing only 52 percent equity would severely and adversely affect the interest rate Bell Atlantic would have to pay on its short- and long-term debt. Mr. Hill, the Department's witness, asserts that his recommendation would produce an interest coverage ratio of 3.94 times.²⁴⁹ That, asserts the Company witness, is well below the interest coverage, more than 4.5 times, that the bond rating agency Standard & Poor (S&P) recommends for a local exchange carrier with an AA rating.²⁵⁰ According to Bell Atlantic, a 3.94 times interest coverage ratio for telecommunications companies is consistent with a low A or a high BBB bond rating, leading to a cost of long-term

244. Hill pf. at 12. For reasons unexplained, Bell Atlantic's filed capital structure does not correspond precisely to its book capital structure for June 30, 1998. Hill pf. at 12-13.

245. Bell Atlantic Brief at 24. The Company argues that in calculating the capital structure at the time

debt in the range of 7.28 percent to 7.74 percent, rather than 7.01 percent. The costs of short-term debt, and of equity, would likewise be substantially higher. Since lower-rated companies have a more difficult time attracting capital, the plant would likely be less modern, the operating expenses higher, and the quality of service lower.²⁵¹

The Department asserts that Bell Atlantic's filed capital structure is not commensurate with the operational risk of a local exchange telephone operation.²⁵² Therefore, Bell Atlantic's cost of capital should be based on a capital structure that is more highly leveraged and that better balances the interests of ratepayers and the Company's investors. The Department observes that regulated utilities have much more debt and much less equity than Bell Atlantic's filed capital structure.²⁵³ Indeed, they argue that the filed capital structure is similar to that of fully competitive markets.²⁵⁴ The current average equity capital component for electric and combination electric and gas utility companies is 43 percent, and for gas distribution and integrated gas companies, 46 percent.²⁵⁵ Both gas and electric utilities are facing increasing levels of competition, but the average capital structures of these companies are far less equity-rich than Bell Atlantic's filed capital structure.²⁵⁶

The fundamental issue here is whether the regulated telecommunications business of Bell Atlantic in Vermont is more appropriately treated, for ratemaking purposes, as a traditional regulated monopoly with relatively low risk revenue sources, or as a competitive business with the business risks that typify a business operating in effective competitive markets. As discussed below, we conclude that while inroads are being made in the market for telecommunications services they may be viewed as relatively low risk revenues sources

additional risks and uncertainties associated with the telecommunications markets in Vermont that warrant a higher proportion of equity over the course of the term of the plan. For purposes of determining the cost of capital, we conclude that the equity component should include a proportion of equity that is roughly 54 percent, which is approximately the mid-point between the booked proportion and that which was approved in our last fully litigated rate proceeding.

d. Cost of Debt and Equity

i. Findings

89. The cost of short-term debt equals 5.34% and the cost of long-term debt is 7.00%. Exh. DPS -16 (SGH-1 Schedule 12); Hill pf. at 4.

90. The cost of equity capital for establishing a revenue requirement is an expectational or ex ante concept. Hill pf. at 4.

91. The level of capital costs in the U.S. economy is relatively low by historical standards and, more important, is expected to remain at those relatively low levels in the future. Hill pf. at 4-8.

92. The Department's cost of equity recommendation is based on the four methods of equity cost evaluation, discounted cash flow ("DCF"), modified earning to price ratio ("MEPR"), market-to-book ratio ("MTB"), and the capital asset pricing model ("CAPM").²⁵⁷ Hill pf. at 3 and 47; *see also* Exh. DPS-16 (SGH-1, Sch. 4-11) and Vander Weide reb. pf. at 6.

93. The Department's witness chooses to use an annual DCF model to estimate Bell

94. The Department's expert estimated the equity capital cost of the local exchange telephone operations of Bell Atlantic-Vermont to be in the range of 10.75% to 11.5%. Hill pf. at 3.

95. Regional Bell Holding Companies ("RBHCs") still offer useful information in estimating the equity capital cost of a telephone utility operation. Since local service and network access operations remain a fundamental portion of the business of an RBHC, they should service as useful proxy groups in determining the cost of equity capital. Hill pf. at 21.

96. While less risky than telecommunications companies generally, gas utilities face many of the same kinds of competitive risks faced in the local exchange telephone industry. Hill pf. at 5.

97. Rapid technological change is increasing the risks of local exchange service to Bell Atlantic for local exchange services. Vander Weide reb. pf. at 14-15.

98. Competition has not progressed as far in the natural gas industry as it has in telecommunications. Natural gas distribution companies are not subject to the risk of rapid technological change to the same extent as the telecommunications companies. Vander Weide reb. pf. at 30.

99. The modified earnings-price ratio analysis is used as a corroborative model. Hill pf. at 34.

100. The use of a market-to-book ratio in the Department's analysis is used to explain how current market data, properly interpreted, supports the reasonableness of the equity cost estimate developed using the DCF and three other models. Hill pf. at 12 and 34. The capital

102. A summary of the estimates of the cost of equity capital is as follows:

<u>Method</u>	<u>Regional Holding Companies</u>	<u>Gas Distributors</u>
DCF	11.62%	10.63%
MEPR	15.47%/17.27%	9.53%/10/26%
MTB	11.74%/10.64%	10.60%/10.12%
CAPM	10.42%/12.02%	8.79%/9.95%

Hill pf. at 47.

103. An appropriate equity capital cost of local exchange telephone operations of Bell Atlantic-Vermont is in the range of 10.75% to 11.5%. Hill pf. at 3.

ii. Discussion

Bell Atlantic's proposed cost of capital includes a required rate of return on equity of 14.50%. The Company maintains that its return on equity should recognize the increasing business risk that the Company asserts it is experiencing overall and in Vermont. Specifically, the opening of the local exchange market to facilities-based and resale competitors, including cable, PBX and wireless providers, and continued competitive losses within the intrastate toll market, increase the business and financial risks the Company faces.²⁵⁸ The return on equity of 14.50% was developed using the discounted cash flow model.²⁵⁹ In contrast, the Department proposes a return on equity of 10.75% to 11.5%.²⁶⁰

The key difference between the Company's and the Department's estimates relates to

from proxies with lower investment risk than Bell Atlantic.²⁶¹ The Company asserts that the appropriate risk proxy group for the purpose of estimating Bell Atlantic's cost of equity is a group of companies from the S&P Industrials that have slightly less risk than the average company in the S&P Industrials.²⁶² The Company's witness argues that RBHCs are unreliable because the RBHCs are going through significant transition and transformation.²⁶³ Finally, Bell Atlantic argues that the Department also misapplies the model by assuming annual rather than quarterly dividends, when in fact stock dividends are paid quarterly.²⁶⁴

Mr. Hill's cost of equity recommendation is based on the four methods of equity cost evaluation he performed: discounted cash flow; modified earning to price ratio; market-to-book ratio; and the capital asset pricing model.²⁶⁵ And again, just as in the methodology the Board approved in Dockets 5700/5702, Order of 10/5/94 at 80-81, for purposes of comparison, Mr. Hill used two similar sample groups, the RBHCs,²⁶⁶ which Mr. Hill used as the limit on the upper end of end of the range of reasonable returns on equity,²⁶⁷ and a group of natural gas local distribution companies ("LDCs"), which Mr. Hill used as a limit on the lower end of the range

261. Vander Weide, reb. pf. at 4-5.

262. *Id.* at 31-32.

263. Vander Weide reb. pf. at 4. Mr. Hill's proxy group of RBHCs has been reduced from seven to five

of reasonable returns in recognition of the similar though lower risks of the operations of those companies.²⁶⁸

Because of their diversification into riskier ventures, RBHCs have a higher risk profile which demands a higher rate of return on equity than do the local exchange operations of a local exchange carrier such as Bell Atlantic.²⁶⁹ Therefore, Mr. Hill used the lower end of the RBHC group as the upper end of the range of reasonable return for Bell Atlantic.²⁷⁰

For the RBHCs, the DCF method yielded a return on equity of 11.62 percent and the average of the corroborative methods (other than MEPR as explained above) was 11.21 percent.²⁷¹ Mr. Hill discarded the other results of the other methodologies, which, with an average result less than the DCF result, would have reduced Bell Atlantic's cost of equity below the DCF result.²⁷² Rounding up the DCF result to 11.75 percent, and forming a fifty-point range around it, Mr. Hill found a range for RBHC cost of equity of 11.5 to 12 percent.²⁷³ For the group of natural gas LDCs, Mr. Hill found a range for cost of equity is 10 to 10.75 percent.²⁷⁴ The range for Bell Atlantic, then, is 10.75, the upper end of the LDC range, to 11.5, the lower end of the RBHC range.²⁷⁵ The Department argues that by relying for comparison on S&P 500 firms rather than on telephone companies and other regulated utilities

268. Hill pf. at 23. Dr. Vander Weide used natural gas distributors as similar-risk proxies for a company's local exchange telephone operations. *C&P Telephone of West Virginia*, W.V. P.S.C. Case No. 84-747-T-42T. Hill sur. pf. at 16.

269. Hill pf. at 23.

with similar operating risks, Bell Atlantic abandoned traditional ratemaking principles and Board precedent.

In general, we accept the use of the proxy groups recommended by the Department as reasonable proxy groups for the Bell Atlantic-Vermont operations. Use of fully competitive proxy groups, such as the S&P 500, is inappropriate for determining the cost of equity capital through the models used by the Company. The greater risk posed by the diversified holdings of RBHCs, as opposed to the relative safety of their local exchange operations, is well documented, thus warranting use of the low end of the group. Bell Atlantic Corporation itself, in its SEC Form S-4 related to its merger with NYNEX, represented to the investment community that the holding company as a whole is a more risky venture than its local exchange telephone operations.²⁷⁶ Merrill, Lynch, pre-merger Bell Atlantic's financial advisor for that deal, set a discount rate for the local telephone operations of Bell Atlantic Corporation and NYNEX of 8 to 10 percent, and set discount rates for the holding companies' other businesses, such as long distance and cellular, at 10 to 14 percent. Bond rating agencies have confirmed that the local exchange operations of an RBHC present a far lower risk profile than that of the RBHC with its diversified holding of risky enterprises.²⁷⁷ As the Department notes, the level of capital costs in the U.S. economy is relatively low by historical standards and, more important, is expected to remain at those relatively low levels in the future.²⁷⁸ Such considerations have informed the Board's cost-of-capital determination in the past.²⁷⁹ Together with the evidence that we have received on the models, we conclude that a reasonable return on equity should equal 11.5 percent.

TYPE OF CAPITAL	PERCENT OF TOTAL	COST RATE	WEIGHTED AVERAGE COST RATE
Common Equity	54.0%	11.5%	6.21%
Long-term Debt	43.5%	7.0%	3.05%
Short-term Debt	2.5%	5.34%	0.13%
TOTALS	100%		9.39%

15. Summary of Cost of Service Adjustments

Based on the information provided by the parties, we find that the Company is overearning by \$23.051 million or approximately 13%.²⁸⁰ The revenue requirement adopted here establishes just and reasonable rates at the outset of the Incentive Regulation Plan. It is important to recognize, however, that our analysis attempts to apply consistent ratemaking principles to certain regulatory assets that will be declining over the term of the Plan.

Moreover, we do not base the starting rate levels on any assumptions concerning future revenue growth.²⁸¹ We note, however, that the continued amortization of the restructuring costs during the Plan means that, without further reduction over the term of the Plan, the Company would be expected to overearn by similar amounts. This issue stands separate from any analysis of productivity gains, reductions in operating costs, new revenue sources or other considerations that might play into an analysis of total factor productivity discussed in the

D. Rate Adjustments at Beginning of Plan

Our conclusion that Bell Atlantic's rates at the outset of the alternative regulation plan exceed a just and reasonable level by approximately \$23 million requires us to consider whether, by how much, and when we should direct Bell Atlantic to reduce its retail (and wholesale) rates. The parties have presented several alternatives.

Bell Atlantic proposes rate reductions of \$5.184 million in the first year of the Plan, with additional rate reductions of approximately \$7 million that would occur over the next three years.²⁸² The proposal included rate reductions for intrastate switched access charges, business exchange service, and toll optional calling plans (including the introduction of new plans), and elimination of local service mileage surcharges.²⁸³

Specifically, Bell Atlantic proposed to reduce access by one cent at the outset of the plan, another 1.5 cents at the beginning of the second year, and an additional 1 cent at the beginning of the third year.²⁸⁴ As a result, states the Company, "two years after the plan becomes effective, Bell Atlantic will have reduced intrastate end-to-end switched access rates from approximately 10.9 cents to approximately 5.9 cents — a 45% reduction."²⁸⁵ For business exchange service, Bell Atlantic proposed a rate reduction of \$2 from the monthly charge in the higher rate groups (Rate Groups 6 and 7) in year two of the Plan, with an additional reduction of \$1 in year 4.²⁸⁶ Elimination of the mileage surcharge would reduce Company revenue by

\$904,718. Finally, the introduction of new toll optional calling plans would lead to reductions in years one and two of the Plan.²⁸⁷

The Department recommends rate reductions totaling approximately \$23 million, which consists of \$16 million of specific rate reductions and an expectation that these rate design changes will lead Bell Atlantic to reduce its intrastate rates by a further \$6.5 million.²⁸⁸ The Department argues that because switched access is a bottleneck wholesale service, access rates "should be driven down as close to economic cost as possible while still providing a reasonable contribution to joint and common costs."²⁸⁹ According to the Department, its recommendation would set Bell Atlantic intrastate switched toll access rates at just more than \$.04 per minute, resulting in an initial revenue reduction to the Company of \$6.5 million.²⁹⁰

The Department also recommends that the Board direct Bell Atlantic to reduce charges for Business Exchange Service by \$10 monthly per line, which leads to a revenue reduction of \$6,536,760. Finally, the Department proposes rate reductions of \$3 million of Message Toll Service charges.

AT&T urges the Board to order Bell Atlantic "to set its access rates at levels based on the Total Element Long-Run Incremental Cost ("TELRIC") of providing access services."²⁹¹ AT&T states that setting access rates according to Bell Atlantic's view of unbundled network

287. These rate reductions equal approximately \$2.85 million in year one and \$1.7 million in year two. Exhs. DPS-21 and 22 (DB-5).

288. Brevitz pf. at 48; Department Brief at 1, 95; Department Reply Brief at 29. The Department's

element costs would result in a combined, end-to-end rate of \$0.0379.²⁹² AT&T made no recommendations on other rate reductions.

Sprint also urges the Board to reduce access charges to economic cost and to permit the competitive long distance market to dictate the manner in which access savings are flowed through to end-users.²⁹³ Sprint, however, "commits to flow-through 100 percent of any access reduction received in this docket," and has offered to work with the Board and Department to verify that it has "reduced [its] rates and [is] providing benefits derived from the reduction in access charges to Vermont consumers."²⁹⁴ Sprint did not make recommendations for other changes to Bell Atlantic's rates.

Hyperion specifically supports the rate allocations proposed by the Department.²⁹⁵ Hyperion argues that the Board ought to allocate access rate reductions to customers less likely to benefit from competition.²⁹⁶ Doing so, says Hyperion, will help to meet Section 226b's competitive criteria by preventing Bell Atlantic from earning higher margins from captive customers to make up for margins lost in competitive markets.²⁹⁷

After considering the evidence and the arguments of the parties, the Board concludes that an overall rate reduction of \$16.5 million is appropriate. This figure is less than the amount by which we conclude that Bell Atlantic is overearning. For the difference (\$6.5 million annually), we conclude that no specific rate reduction is necessary at the present time. Instead, competitive pressures are likely to force a reduction in the price of Optional Calling Plans, or the introduction of new Optional Calling Plans, by Bell Atlantic within the next year of approximately the \$6.5 million difference.²⁹⁸ However, as we explain below concerning

For the \$16.5 million of specified rate reductions, Bell Atlantic shall reduce its rates in the following manner:

- Access Charges. As parties have argued, the first priority should be to reduce access charges and the business exchange rate. Accordingly, carrier switched access charges should be reduced to approximately 4 cents per minute, which has the effect of reducing revenue by \$5.98 million annually.²⁹⁹ This should be achieved by reducing rate elements to the same level as interstate switched access and then eliminating the Carrier Common Line charge.
- Optional Calling Plans. We order no specific rate reductions associated with Optional Calling Plans. We expect, however, as the Department and Bell Atlantic have both argued, that market forces will force Bell Atlantic to reduce the rates of existing Optional Calling Plans and introduce new ones over the next few years, so that the full revenue reduction found by the Board will be achieved.
- Business Exchange Service. Basic business dial tone rates are the highest among New England states. We also find no cost basis for the existing difference between rates in the various rate groups. Therefore, Bell Atlantic should reduce the dial tone rate in Rate Groups 6 and 7 to the rate for Rate Groups 4 and 5. The equalized rate should then be further reduced so that business customers in all rate groups pay a dial tone rate of \$33 per month. This rate change will reduce Bell Atlantic's intrastate revenues by approximately \$4.91 million.³⁰⁰
- Exchange Mileage Surcharges. Bell Atlantic should eliminate the Exchange Mileage Surcharge, through which customers outside of the base rate area in each exchange pay higher rates. The effect of this change is to reduce revenues by \$904,718 annually.
- Message Toll Service. The difference between the revenue reductions set out above and the \$16.5 million by which we conclude Bell Atlantic must reduce its retail revenue requirement should be used to reduce Message Toll Service rates.³⁰¹ Toll reductions should be used first to collapse rate bands then to lower the overall

comment upon Bell Atlantic's use of December, 1999 volumes and asked the Company to submit a recalculation based upon test year figures. Bell Atlantic argued that use of December, 1999 volumes was appropriate considering the timing of the rate changes.³⁰² By contrast, the Department commented that the Company should have used test year figures, citing past precedent.

We conclude that the Department is correct. The revenue requirement set out above is based upon test year costs and revenues adjusted for known and measurable changes. We have also based the calculation on test year customer levels and usage volumes (although as described in Part III.B.7., toll and switched access revenues are based upon June, 1998 volumes, annualized). In fact, we specifically reject an adjustment proposed by the Department to use more recent volumes. For consistency, and to properly apply the matching principles discussed previously, it is necessary to use the same basis for calculating the revenue effect of the rate reductions.

On March 21, 2000, Bell Atlantic submitted a revised Compliance filing in which the Company set out the revenue effect of each of the rate reductions set out in this Order, including the residual amount to be applied to Message Toll Service, and specific rate adjustments. The Department filed a letter accepting Bell Atlantic's Compliance filing. AT&T objected, stating that the Compliance filing was not consistent with the Proposed Order or the Board's intent to lower access charge rate elements to interstate levels. After consideration of the filing and the parties' comments, we accept the Compliance filing and approve the rate adjustment embodied therein. Bell Atlantic's Compliance filing is consistent with the intent of

1. Access Charges

Access charges are payments made by interexchange companies ("Interexchange carriers"), such as Sprint, AT&T and MCI WorldCom, to local exchange carriers, such as Bell Atlantic, for access to its local network.³⁰⁴ Bell Atlantic's access charges currently exceed Bell Atlantic access charges in all of the states in which it provides service.³⁰⁵ In Vermont, Interexchange carriers pay Bell Atlantic approximately 10.6 cents per minute, end-to-end (originating and terminating), to deliver each toll call.³⁰⁶

In this docket, AT&T, Sprint, the Department and even Bell Atlantic agree that Bell Atlantic's access charges are too high and should be lowered. The parties, however, found little further agreement beyond this fundamental point. Parties failed to agree on the amounts by which Bell Atlantic's access charges should be lowered, the timing of those reductions and a rate design for remaining access charges. The parties also disagreed on whether there should be an administratively-imposed "flow-through" of savings that would become available if Bell Atlantic were to lower its access charges.

For reasons set out below, the Board concludes that Bell Atlantic's access charges should be lowered to a level that will realize an average revenue per-minute (ARPM) of approximately four cents per minute, and that rate elements comprising the access charges reflect greater alignment with their interstate counterpart. However, as several of the parties recommend, we conclude that the Carrier Common Line Charge should be eliminated as proposed by the Department. The Board further concludes that these reductions should be made at the outset of the Plan. The reductions to access charges will significantly reduce the wholesale prices now

paid by interexchange carriers. To pass these savings on to ratepayers, we are requiring the companies serving Vermont's intraLATA market to flow-through the access charge reductions to their retail rates within 90 days of the this Order.

a. Switched Access Revenues

i. Findings

104. Switched access comprises three elements: local transport; local switching; and Carrier Common Line charge. Salvatore pf. at 7-8.

105. Access charges also include fees for transporting the call to the interexchange carrier network and for call completion using the local transport elements. The local transport rate elements, then, include the local transport facility and the local transport termination charges. Both the transport facility and the local transport termination charges are charged on a per-access minute of use basis. Salvatore pf. at 8.

106. Bell Atlantic's current tariffed access rates are as follows:

	Originating	Terminating	Total	<u>Average</u>
CCLC	\$0.006900	\$0.023648	\$0.030548	\$0.015274
Local Switching				
•Local End Office Switching-LS2	\$0.008400	\$0.008400	\$0.016800	\$0.08400
•Line Termination Common Line	\$0.006200	\$0.006200	\$0.012400	\$0.06200

107. The end office local switching element is charged, for both terminating and originating calls, on a per-minute of use basis. Salvatore pf. at 8.

108. The Carrier Common Line element represents the "loop," the term used to connote the connection between the company switch and the end-user. The corresponding Carrier Common Line Charge is a per-access-minute-of-use charge for all originating and terminating minutes over the loop. Salvatore pf. at 7-8.

109. Bell Atlantic access charges substantially exceed the costs of providing access and currently exceed Bell Atlantic access charges in all of the states in which it provides service. Exh. AT&T-1 (Salvatore pf., exh. A); tr. 6/2/99 at 26-27 (Silvia).

110. As with other services, efficiency is reduced when carrier access is priced above incremental cost. Taylor reb. pf. at 16.

111. As of June 1998, the clear majority of residential and business access lines were presubscribed to Bell Atlantic. Sands pf. at 7, fn. 4.

112. Based upon October 1998 data, and on an annualized basis, Bell Atlantic revenues derived from Bell Atlantic access charges totaled \$13,241,448.³⁰⁸ Exh. Sprint-1 (Attachment DGB-3); tr. 6/10/99 at 211 (Brevitz).

113. Bell Atlantic's intrastate access revenue growth, year-to-year, since 1995, is larger than the annual revenue reductions proposed by Bell Atlantic under the Price Points Plan. Brevitz pf. at 23.

114. Bell Atlantic intrastate toll revenue is a combination of the access and the usage. If Bell Atlantic loses usage on a retail basis but increases the access on the wholesale basis there is

116. The revenue reductions associated with proposed access charge reductions have been calculated by Bell Atlantic using constant demand, without growth. Similarly, the Department did not take into account natural growth in calculating the revenue effects of proposed access charge reductions. Brevitz pf. at 22; tr. 6/10/99 at 211 (Brevitz).

117. Bell Atlantic is currently experiencing growth in usage of services and demand for access lines. Tr. 6/10/99 at 210 (Brevitz).

118. Bell Atlantic's minutes of access can be expected to continue to grow due to growth in the market. Tr. 6/10/99 at 160, 211-212 (Brevitz).

119. Bell Atlantic's Price Points Plan contains no specific proposal to restructure the rates corresponding to specific access charge elements. Exh. BAVT-14; exh. BAVT-15; tr. 6/2/99 at 39 (Silvia).

120. The end-to-end unbundled network element rates proposed by Bell Atlantic and AT&T are 3.7876 cents per minute and 1.3612 cents per minute, respectively. The interim end-to-end unbundled network element rates are 1.7268 cents per minute. Neither the interim rates nor the unbundled network element rate proposals of Bell Atlantic or AT&T include a component corresponding to the loop or Carrier Common Line Charge element of current access charges. Exh. AT&T-2 (Exh. D).

ii. Discussion

Bell Atlantic proposes to lower its rates, over the first three years of the plan, from approximately 10.6 cents to approximately 5.9 cents. At the end of its phase-in period, Bell

1.73 cents per minute of use on a combined end-to-end basis.³¹⁰ The Department's proposal would lower Bell Atlantic's access charges in two stages. First, the Department proposes to set Bell Atlantic's switched access rates, including the CCL, at interstate levels, resulting in an average rate of 5.737 cents per minute, an effective revenue reduction of \$4.5 million or approximately \$5.9 million after accounting for anticipated adjustments from Dockets 5670, 5702, and 5940).³¹¹ Second, the Department asks the Board to eliminate the Carrier Common Line Charge rate element, creating an additional revenue reduction equal to \$2.184 million.³¹² The first part of the Department proposal, it says, has an overall revenue effect roughly equal to the reductions proposed by Bell Atlantic over the course of the plan.³¹³ The Department proposal as a whole reduces access rates by \$6.502 million, or roughly \$8.1 million after adjustments anticipated from Dockets 5670, 5702 and 5940.³¹⁴

The Board concurs with the parties that a major reduction in switched access rates is appropriate. These rates significantly exceed their underlying costs, by whatever forward-looking methodology is used.³¹⁵

The Board concludes that Bell Atlantic's switched access charges should be lowered to a level that would realize an average revenue per-minute of four cents per minute using the methodology proposed by the Department. This large access rate reduction strikes a balance

310. AT&T argues that the access rates should be based on the Total Element Long-Run Incremental Cost of providing access services. AT&T Brief at 1. AT&T proposed an end-to-end access rate of roughly 1.3612 cents per minute, at the low end. Salvatore sur. pf. at 4; exh. AT&T-2 (exh. D to Salvatore pf.). This figure is based upon AT&T's view of Bell Atlantic's unbundled network element costs. Setting access rates according to Bell Atlantic's view of unbundled network element costs, as proposed in Docket 5710, would

between the slower access charge reduction proposed by Bell Atlantic and the drastic reductions proposed by AT&T, MCI, and Sprint. Bell Atlantic's reductions would have left access charges well above their economic cost, leading to higher retail toll rates for consumers. As to the more precipitous reduction to the levels sought by the interexchange carriers, we find the evidence on the economic cost of access inconclusive.³¹⁶ The reduction to approximately four cents for end-to-end switched access will, however, move the access rates closer to their underlying economic cost, which testimony in this proceeding places between 1.36 and 3.79 cents per minute based upon the cost of the corresponding unbundled network elements.³¹⁷

We also find that the methodology presented by the Department represents a reasonable rate design. Our acceptance of the elimination of the Carrier Common Line charge does not, however, reflect an agreement with the rationale put forward by the Department and interexchange carriers for elimination of that charge. The Department suggested that the Carrier Common Line charge had no cost basis. The interexchange carriers argue that local loop costs are incremental to local service, not to access and thus, the Carrier Common Line Charge represents local and not toll use (requiring it to be collected from local users).³¹⁸ We do not accept the premise that toll is incremental to basic service or that the provision of toll service imposes no costs on the local network. Evidence presented in this proceeding also demonstrates that components of the local loop that are increasingly traffic-sensitive, meaning that toll service affects the costs.³¹⁹ Nonetheless, the results of the Department's proposal –

switched access rates of approximately four cents per minute – are reasonable and we accept the methodology for deriving them.³²⁰

Bell Atlantic shall reduce its access charges to mirror the rate levels, although not necessarily all rate elements of the FCC's interstate access rates for Bell Atlantic.³²¹ As a second step, Bell Atlantic shall eliminate the Carrier Common Line charge. Together, these rate changes will reduce access rates to roughly four cents per minute. This reduction has an immediate revenue effect of approximately \$5.98 million.

b. Flow-through of Access Charge Reductions

i. Findings

121. Lower Bell Atlantic access rates result in lower costs of access to intrastate toll providers, and lower intrastate toll provider costs make it possible for toll providers to reduce rates. Tr. 6/10/99 at 48 (McCarren).

122. Bell Atlantic can be expected to lower toll rates in response to competitors who lower their rates. Tr. 6/10/99 at 48 (McCarren); tr. 6/10/99 at 108 (Frost); tr. 6/10/99 at 142 (Brevitz).

123. The reductions to switched access may result in corresponding decreases in toll prices offered by Bell Atlantic's competitors and by Bell Atlantic itself during the term of the Plan. McCarren pf. at 3.

124. Consumers will benefit if Bell Atlantic has flexibility in the toll market to respond

127. Competitive toll service providers are reducing prices as a means to win customers from Bell Atlantic, providing value to customers through other means or both. There are many ways that competitors may respond to changing conditions in the market. Sands pf. at 10.

ii. Discussion

The reduction in switched access rates will greatly reduce the wholesale cost of access. Interexchange carriers will thus see a drop of more than 50 percent in the largest component of their cost of offering toll service. Unless interexchange carriers reduce their retail toll rates, however, retail ratepayers do not benefit from the access rate reductions, as we recently acknowledged in Docket 5903:

The Board does not generally review the rates of competitive toll providers. . . . Yet as the Board has seen, changes in interexchange carrier cost structures do not necessarily translate to retail rates. For example, following the decrease in access charges in Dockets 5700/5702, competitors did not lower their intraLATA toll rates.³²²

To assure that retail ratepayers derive a benefit from the reduced access charges, the Department proposes that the Board require interexchange carriers to reduce their retail toll rates to flow-through the entire effect of the access rate reduction (although the Department does not recommend that the Board direct Bell Atlantic to reduce all of its toll rates, as well). The interexchange carriers generally oppose a requirement to flow-through access reductions, although at least one carrier has committed to working to achieve the same result.³²³ Bell Atlantic maintains that flow-through is unnecessary because "as a result of the competitiveness

Atlantic must be discounted because Bell Atlantic itself will benefit from reduced competitive pressure if its competitors do not reduce their prices to reflect a flow-through.

The Board's goal in decreasing access charges is twofold: to facilitate competition by reducing the price of access closer to its economic costs and to reduce the price of toll for retail consumers. Unless the rate reductions set out herein are flowed through to customers, the profitability of interexchange carriers will be enhanced, but ratepayers will not see the full benefit of the rate reductions we adopt here, thus failing to achieve one of our two goals. Therefore, we will require the three largest competitive interexchange carriers offering intrastate services, which consist of AT&T, Sprint, and MCI WorldCom, to decrease their intrastate toll rates by the amount necessary to return the benefits of Bell Atlantic's access charge reduction to that provider's customers (application of the flow-through requirement to Bell Atlantic is discussed below).³²⁵

Interexchange carriers subject to this requirement shall reduce their retail rates within 90 days of the date Bell Atlantic reduces its intrastate access charges as mandated herein.³²⁶ Interexchange carriers must flow-through access charge reductions on an aggregate dollar-for-dollar basis so that the average toll rate per minute declines by the same amount as the average access charge rate per minute reduction from this docket and Dockets 5940/5702.³²⁷ The flow-through must affect all customer classes; residential customers must receive a share of the access charge proportionate to their minutes of use. Within these guidelines, interexchange carriers retain discretion to select the rates that they will reduce.

Following the toll reductions, interexchange carriers subject to the flow-through requirement shall submit a report to the Board demonstrating that they have achieved the flow-through as mandated. If the data do not demonstrate the required reduction, the company that has failed to make the required reductions shall immediately file a written report explaining why the necessary reductions did not occur.³²⁸ These carriers also must retain data (including minutes of use) pertinent to each carrier's obligation to flow-through the access rate reductions for a period of two years. The carriers also must submit a second report one year after the initial report, demonstrating that the carrier continues to meet the requirements of this Order.

We do not, however, extend the flow-through requirement to Bell Atlantic. Although ratepayers do not benefit from the access charge reductions unless carriers extend the rate reductions to customers, the record of this proceeding demonstrates that reductions in toll charges by interexchange carriers will force Bell Atlantic to make similar reductions to its own toll rates, particularly the Optional Calling Plans. Both Bell Atlantic and the Department assert that due to competition in the toll market, our adoption of the access charge reductions ordered above will lead to reductions in Optional Calling Plans of approximately \$6.5 million.³²⁹ Thus, it is unnecessary to direct Bell Atlantic to flow-through the rate reductions immediately; we anticipate reductions in the average revenue per-minute calling from these optional calling plans to fall by an amount equal to the reductions in switched access rates.³³⁰ The Board also seeks to provide Bell Atlantic with the flexibility to determine when and how to reduce its Optional Calling Plan rates, particularly in light of the broader rate changes directed herein.

Although the Board relies upon market forces to force Optional Calling Plan rate

If Bell Atlantic has not reduced its Optional Calling Plan rates by that time, the Board is prepared to institute proceedings designed to ensure that the relevant benefits accrue to Vermonters within eighteen months of the commencement of this Plan. We also direct Bell Atlantic to report semi-annually on its Optional Calling Plan rate reductions (on an average rate per minute and total revenue basis) to allow parties and the Board to assess the Company's efforts.

2. Business Dial Tone

a. Findings

128. The disparity between Bell Atlantic's rates for measured business lines and its rates for residential dial tone, services that are essentially equivalent, does not reflect the difference in cost, if any, of the two services.³³¹ Tr. 6/9/99 at 222 (McCarren).

129. The business market is an area targeted by Bell Atlantic's competitors. Tr. 6/10/99 at 210 (McCarren).

130. The primary telecommunications services not currently subject to competition would be local telephone service, both business and residential. Brevitz sur. pf. at 28.

131. A number of alternative technologies exist to provide business exchange services, including systems utilizing the network, like Centrex, and customer equipment, like PBX.

b. Discussion

Bell Atlantic proposes to reduce measured business lines in the second year of the plan by \$2 per line per month. In the fourth year of the plan, Bell Atlantic proposes another reduction equal to \$1 per line per month. The Department suggests that these reductions are too little and too late and requests that the Board reduce the business exchange rates by \$10 at the onset of the Plan.³³² The reductions proposed by the Department would apply to all rate groups.³³³

The evidence in this proceeding clearly suggests that a reduction in the business exchange rate is appropriate. The differential between residential and business rates are out of line with underlying costs by a wide margin.³³⁴ Reductions of the business exchange rate will have the effect of improving Bell Atlantic's competitive position for business service by lowering its business line rates while remaining above TELRIC costs. It will also substantially narrow the business/residence rate differential³³⁵ and serve to support economic development consistent with Section 226b(c)(7).³³⁶ Finally, we note that both the Department and the Company agree that a reduction in measured business line (i.e., 1MB) service is in order.³³⁷

The remaining issues are the magnitude of the rate reduction and the particular service elements to which it applies. At the present time both residential and business customers are classified, by exchange, into what are termed "Rate Groups." The classification is based upon the number of customers within the local calling area for a particular customer. Bell Atlantic's tariff contains seven Rate Groups although due to line growth and expansion of calling areas

no exchanges are in Rate Groups 1, 2, or 3.³³⁸ Business Exchange rates vary by Rate Group, so that customers in Rate Groups 4 and 5 pay a basic exchange rate of \$33.89 per month, while those in Rate Groups 6 and 7 have a rate of \$41.26.³³⁹

Rather than decreasing all rates by \$10 per month per line, the Board concludes that it is more appropriate to equalize the rates (at the \$33.89 per month level applicable now in Rate Groups 4 and 5) and then reduce the rates for all business customers to \$33 per month. This produces a revenue reduction of approximately \$4.91 million for business exchange rates.³⁴⁰ The reduction of all business exchange rates to \$33 per month will provide benefits to all customers. The vast majority of Bell Atlantic customers are in exchanges that are now in Rate Groups 6 and 7. These customers will see monthly rate reductions of almost \$9. A principle benefit of the modified rate design is that it also eliminates the existing historic inequity. To the extent that a basis may have existed decades ago for the disparity, the evidence presented to the Board does not now demonstrate that basis. Furthermore, no party presented any evidence that would justify maintaining separate rates.

In its original Compliance filing on February 28, 2000, Bell Atlantic adjusted not only the dial tone line rate, but also the local measured service usage package available to customers. Under existing tariffs, customers in higher rate groups pay a higher charge for the usage package, but also receive more minutes of use. Bell Atlantic's filing proposed to provide all customers with the usage package now provided in Rate Groups 4 and 5. The Department commented that Bell Atlantic should instead offer the larger usage package now available to Rate Group 6 and 7 customers even though this may lead to a net increase in price for some

the federal Universal Service program. The tariff applies a higher credit to Rate Groups 6 and 7 than applies to Rate Groups 4 and 5, due to the higher rates in the former group at the time Bell Atlantic adopted the tariff.³⁴¹ With the change in business exchange service rates ordered herein, Bell Atlantic will need to recalculate the credit for business customers, so that the same credit applies to all rate groups.³⁴² The net effect of the Universal Service Credit and this Order will be to reduce effective business exchange service rates to approximately \$27 monthly; for customers in the higher Rate Groups, monthly service charges will be more than 30 percent lower than those in effect at the end of 1999.

3. Mileage Surcharges

a. Findings

134. Bell Atlantic's existing rates include charges for local exchange service mileage of \$0.65 to \$5.15 that apply to both residence and business customers. Customers living outside of the core area incur these charges, which vary with the distance of the customer's premises from the exchange base rate area. Bell Atlantic PSB Vt. No. 20, Part A, Section 5.2.1 and Part M, Section 1.5.4; Brevitz pf. at 38.

135. The charge for distance mileage is processed manually and is the source of frustration and dissatisfaction to consumers. McCarren pf. at 3-4; tr. 6/9/99 at 178-179 (McCarren).

136. Mileage charges are administered incorrectly under the current processes and procedures. Bell Atlantic does not know the extent of the inaccuracy. Tr. 6/9/99 at 179-180

b. Discussion

Existing Bell Atlantic tariffs include a charge for Local Exchange Service Mileage that apply when a customer's location is outside the base rate area, but within the exchange boundary. These charges, which produce about \$900 thousand in annual revenues, are the only portions of Bell Atlantic's basic exchange rates that are distance-sensitive, even though the cost to Bell Atlantic to provide the service varies with distance.³⁴³ However, mileage charges also are a source of customer frustration, confusion, and dissatisfaction.³⁴⁴ Bell Atlantic asserts that administration of the mileage charges has been also problematic, such that not all customers to whom the tariff applies are actually being charged for mileage. For these reasons, Bell Atlantic recommends that the Board approve elimination of the mileage charges.³⁴⁵

In contrast, the Department argues that the Board should reject Bell Atlantic's proposal to eliminate local exchange mileage charges. They argue that to eliminate these charges would contribute to "sprawl" and is inconsistent with the Draft *Vermont Telecommunications Plan* (Final Draft, May 1999) at 2-21.³⁴⁶ The Department also argues that this undermines an important principle of cost causation in ratemaking.

The Board concludes that reduction in the mileage charges as part of the revenue reductions at the outset of the plan is reasonable and appropriate. The Board continues to support the principle of cost causation as a touch stone of ratemaking. To that end, the Board is now investigating whether to deaverage wholesale rates for unbundled network elements.³⁴⁷ If the Board directs Bell Atlantic to deaverage wholesale it is possible that some measure of rate

wire center, it does not provide a reasonable framework from which to base such rate deaveraging. The evidence does not demonstrate that the mileage surcharges accurately reflect the underlying costs of service. Base rate areas and mileage charges were established some time ago and, in all likelihood, fail to recognize present population distributions and costs. For example, outside of the base rate area, the mileage surcharges fail to reflect population densities, but are based solely on loop length. Thus, it now seems speculative, at best, to conclude that current distance mileage charges or a reasonable facsimile will form the basis of potential future deaveraging proposals. We conclude, therefore, that mileage charges should be eliminated.

We are not persuaded that the Department's concern regarding the threat of "sprawl" associated with removing these charges presents a serious threat. Sprawl is a legitimate concern. However, it is difficult to imagine that the monthly mileage charges in question weigh significantly into the locational decisions of prospective homeowners or tenants. Nor are we persuaded that Bell Atlantic's inability to administer the mileage charges appropriately is a compelling rationale for their termination; if the Board concluded that the charges were in the public interest, Bell Atlantic would simply be required to improve its management of this tariff.

4. Toll Reductions

a. Findings

139. Message Toll Service toll rates are paid by a substantial portion of the residential toll ratenavers and a significant nonortion of business toll calling occurs at the dav rate under

141. Since the early 1980s, the Message Toll Service schedules have stayed relatively static. Tr. 6/10/99 at 185 (Brevitz).

142. Absent regulatory mandate, Message Toll Service, measured business, and the Carrier Common Line Charge portion of access will not move. Tr. 6/10/99 at 185-86 (Brevitz); tr. 6/11/99 at 48 (Silvia).

b. Discussion

As this Order makes clear, a primary objective of the rate reductions ordered in this Docket is to align rates closer to economic cost.³⁴⁸ Evidence presented in this proceeding and elsewhere demonstrates that toll rates, particularly Message Toll Service (Bell Atlantic's standard toll calling rates), business exchange service rates, and access charges are presently well in excess of their economic costs, while other major elements of Bell Atlantic's rate structure are closer to economic cost. The reductions to access charges and business exchange service ordered elsewhere in Section III.D. make major strides to achieving the Board's objectives. And, as we explained, the access charge reductions will impel Bell Atlantic to reduce its Optional Calling Plan rates. The remaining rate component greatly above cost is Message Toll Service.

Bell Atlantic does not propose specific reductions to Message Toll Service, but instead offers reductions to access rates and toll reductions through the introduction of new toll Optional Calling Plans and enhancements to existing optional calling plans. They argue that the competitive toll market should force reductions in toll rates by passing through reductions in

argues that market forces that may force rate reductions for Optional Calling Plans (as we find above) are inadequate to force reductions for what they assert is the non-competitive end of the toll market in Vermont, Bell Atlantic's Message Toll Service. Indeed, the Department notes that Bell Atlantic currently has the highest Message Toll Service rates in the Bell Atlantic region.³⁵¹

We concur with the Department that the remaining portion of the mandated revenue requirement reduction should be applied to Message Toll Service. Such rate reductions will bring these rates closer to their economic cost.³⁵² And, although competition is strong for Optional Calling Plans, we are unlikely to see significant reductions in Message Toll Service rates due to competition. Moreover, toll rate reductions will stimulate more efficient use of the network.

The Board agrees with the basic thrust of the Department's proposal to collapse mileage bands, but concludes that it does not go far enough. The current rate design is complex and an effort should be made to simplify the design. Efficiency and fairness also seem to favor reductions to the distance sensitive differentials embedded in the current mileage band structure, particularly since distance-sensitivity is a relatively small portion of the total cost of a toll call. In our Proposed Order, therefore, we concluded that it was appropriate to collapse the current rate design into two mileage bands. Under that proposal, the lower rate band would encompass what is now classified as mileage bands 1 through 3. The upper rate band would include current mileage bands 4 through 7. We also invited comments from the parties on whether we should collapse the Message Toll Service into a single rate band

\$0.20 per minute, evening rate of \$0.14 per minute, and night rate of \$0.10 per minute. For the vast majority of customers using Message Toll Service, this represents a significant rate reduction. It will also significantly simplify the rate structure. Accordingly, we accept the modified rate design.

Bell Atlantic's regular financial filings demonstrate that overall, revenues from toll and access are declining (in large part owing to regulatory interventions such as the extended area service proceeding and the current review of rates), even as usage rises.³⁵³ The rate reductions set out here will put Vermont significantly closer to cost-based rates and a step closer to what might be considered a statewide local service market in which measured service and unbundled network element-based access rates emerge as the only traffic sensitive charges.³⁵⁴

5. Local Measured Service

In a May 14, 1999, letter to the parties, the Board had solicited opinions from the parties on a potential need to modify the local measured service rate design. The Board asked whether Vermont should be considering modifying the rate design for measured service in light of changing patterns of usage (we questioned whether the "peak" period was still the peak).

Although the Department agreed that it may be appropriate to revisit the measured service rate design, no party suggested specific realignment or rate reductions for measured service rates.³⁵⁵ While trends suggested that the issue should be periodically revisited, we conclude that no action is warranted at this time.

Plan (including the term of a plan and alternative forms and approaches to incentive regulation) and alterations proposed by other parties.

1. Incentive Rate Plan Proposals and Alternatives

Bell Atlantic characterizes the alternative regulation plan it put forward as a "Price Points Plan." The Price Points Plan has several basic aspects. First, prices of existing products and services may not rise during the term of the plan, except in response to exogenous changes.³⁵⁶ According to the Company, capping prices of existing products and services at current levels provides consumers a real price decrease (i.e., inflation adjusted) equal to the rate of inflation, thus passing through productivity gains to consumers.³⁵⁷ Second, the Price Points Plan establishes explicit price reductions for certain products and services that will occur at specific times during the term of the plan.³⁵⁸ Bell Atlantic asserts that the proposed reductions in the prices of products and services and the likely decrease in toll prices that result from the

356. Exh. BAVT-14 at 1-2. Specifically, the Price Points Plan states the following:
Existing regulated intrastate telecommunications products and services are any and all products and services that have approved intrastate tariffs on the effective date of the Plan. Existing special contracts are governed by their own terms and those terms are not modified by this Plan.

1. The Company will not propose any price increases for existing regulated intrastate telecommunications products or services during the life of the Plan except if:
 - a. There is an exogenous event that produces a change [as described below].
 - b. The Company proposes and the Board approves a revenue-neutral

proposed reductions in access charges will produce even greater real price reductions.³⁵⁹ Under the Price Points Plan, Bell Atlantic absorbs the business risks associated with the price restrictions and reductions. The Company would also bear the risk of market losses resulting from, for example, the effects of competition.³⁶⁰

The Department supports key provisions of the Price Points Plan, but also recommends significant modifications. The Department supports a five-year plan, but proposes that the Price Points Plan be modified to become a straight "price cap" plan. According to the parties, the essential structural difference between the Price Points Plan and the Department's proposal centers on the timing of the proposed rate reductions that are built into the plan and the flexibility to reduce prices downward.³⁶¹ The Department proposes price reductions at the beginning of the plan rather than over the term of the plan as Bell Atlantic proposes. As compared with the Price Points Plan, the Department asserts that a straight cap plan provides more flexibility to the Company. Rates for existing services are *capped*, and the Company has downward pricing flexibility under the specified plan mechanics.³⁶²

The Department suggested, although it did not recommend, two other alternatives to the Price Points Plan. One of these is an indexed "price cap" formula plan, such as the Board approved in Dockets 5700/5702 and now applies to Bell Atlantic's interstate rates.³⁶³ Under such a plan, price changes over the term of the plan are dictated through an inflation/productivity offset formula. Inflation is expressly recognized and is netted against a measure of expected productivity. The formula then produces an input for price changes over the term of the plan which is applied to rates in service baskets under specified rules on a

"excess earnings" under rate base/rate of return regulation, based on periodic or annual reviews of earnings.³⁶⁴

The various forms of alternative regulation represent different methods to better approximate competitive market forces and to encourage companies to respond to those forces, where they exist. The risks associated with deployment of new technology and services and the onset of competition are shifted to the Company; successful endeavors are rewarded by increased earnings (which the Company retains), while failures must be borne by shareholders. As a company operating under alternative regulation has the ability to retain more earnings if its efforts are successful, the company is also encouraged to operate more efficiently.³⁶⁵ Although an alternative regulation plan should provide a company with incentives to operate as it would in a fully competitive environment, it is not intended to simply reward a company with higher earnings, but rather to allow the company an opportunity to obtain such earnings through positive actions. Thus, just and reasonable starting rates are inherent in an incentive regulation plan; otherwise a company commencing with earnings above or below just and reasonable rate levels would unfairly benefit or be harmed throughout the term of the plan, without taking the risk that incentive regulation presumes.

Upon closer examination, the differences between the basic structure of the Price Points Plan and the various alternatives are subtle, often more semantic than real. For example, only two significant structural differences appear in the proposals put forth by Bell Atlantic and the Department: the specified rate reductions proposed by Bell Atlantic and the rates at the outset of the plan (although neither the Department nor Bell Atlantic disagree that rates at the outset

existing services, reflection of anticipated productivity gains during the plan, and the degree to which the Company may retain excess earnings.

Examining the manner in which the Price Points Plan addresses each of these factors, we conclude that the basic structure is reasonable and we approve it. Turning first to the pricing flexibility for existing services, the incentive regulation plan prevents Bell Atlantic from increasing the prices on such services during its term, except due to exogenous events.³⁶⁷ Thus, existing ratepayers receive stable rates, founded on initial rates that are just and reasonable. Factoring in the likely effect of inflation, Bell Atlantic customers will experience a decrease in real prices during the term. This rate stability places business and unanticipated inflation risks on Bell Atlantic while shielding its ratepayers from the same risks.³⁶⁸

The Price Points Plan imposes no limits on Bell Atlantic's earnings. It is contemplated that the Company would be free to earn without restriction, thus allowing Bell Atlantic to benefit from the risks it takes. The reasonableness of unlimited earnings is tied to the manner in which the plan reflects productivity and normal earnings growth.

Historically, the telecommunications industry has experienced greater productivity growth than the economy as a whole.³⁶⁹ Price index plans typically incorporate this difference in a productivity factor, which is offset against inflation and serves to limit rate increases or mandate rate decreases during the term of the plan. Here, neither the Company nor the Department's proposal includes explicit treatment for either an inflation or a productivity offset, so that the implicit productivity factor in the proposed Price Points Plan is essentially equal to inflation.³⁷⁰ Both the Department and Bell Atlantic argue that this is reasonable: the former

because of the administrative costs associated with traditional price caps plans and the likelihood of competitive pressures to force further rate reductions;³⁷¹ the latter because of its view that the inflation-based productivity factor, coupled with specified rate reductions, is reasonable.³⁷²

The productivity factor that the Department implicitly accepts and to which Bell Atlantic points, however, does not appear to capture many of the changes now occurring in the telecommunications environment. For example, Bell Atlantic has experienced sustained growth in the number of access lines and a significant increase in minutes of use,³⁷³ both of which lead to increased revenues. Recent financial statements show intrastate revenue is growing, intrastate expense is declining, and intrastate net income is, therefore, growing.³⁷⁴ During the period from 1991 through 1998, there is a widening differential between revenues and expenses during a period in which competition, according to the Company, is allegedly making substantial inroads into the Company's markets.³⁷⁵ Bell Atlantic's net investment is declining and its return on investment is growing.³⁷⁶ Thus, the Company is likely to experience cost reductions and revenue growth that may greatly outpace the growth in those factors across the industry over a

broad expanse of time.³⁷⁷ Furthermore, significant growth in demand can be expected to follow the rate reductions proposed for this term of the plan ("elasticity effects").³⁷⁸

These factors are specific to the Bell Atlantic service territory, tied to recent trends, and provide a compelling basis for concluding those trends should continue over the period of the plan. These factors thus suggest a strong likelihood that absent further rate reductions during the term of the Incentive Regulation Plan, Bell Atlantic's earnings will experience large growth without the Company needing to take the risks contemplated by alternative regulation plans.³⁷⁹

The alternative regulation plans presented by the Department and the Company do not specifically address these trends that appear to be inherent in the new telecommunications environment. Instead, both parties rely upon the increasingly competitive marketplace to place sufficient pressure upon the Company to lower rates and thus, pass through to ratepayers the cost savings and increasing earnings described above.

Although we are not convinced that competition is sufficiently robust to exert this pressure, outside of the intraLATA toll market, we accept the basic structure of Bell Atlantic's proposal. It will prevent rate increases for existing services to the benefit of ratepayers. Bell Atlantic, rather than ratepayers, will bear the risk associated with the flexibility to offer new

377. Bell Atlantic's access line growth was 3.6 percent and 3.2 percent for 1997 and 1998 respectively, without considering revenue growth in vertical services and toll access, would more than support the Department's adjustment. Exh. PSB-3 at 1; exh. BAVT-17 (DPS 7-6); Ostrander pf. at 41; Ostrander sur. pf. at 9. Based on Bell Atlantic's forecasts (which in recent times have underestimated growth), access line growth in 1999 and 2000 is expected to remain strong and to exceed 1998 growth. See, exh. PSB-3; exh.

services, which includes modifications of existing services (presumably at lower price or with enhanced value to consumers). In addition, we rely upon Bell Atlantic's commitments to invest at a faster pace and lower prices during the term if the earnings become "unreasonable."³⁸⁰ This commitment does not constitute an earnings cap, but it is consistent with the Board's expectations in approving the Incentive Regulation Plan. The Incentive Regulation Plan also promotes regulatory certainty for Bell Atlantic, which may foster competition because the focus of all competitors can be on customers rather than on the regulatory process.³⁸¹

Nonetheless, our approval comes with several conditions. First, as we have discussed above, our review of the financial performance of the Company suggests that the Company will continue to enjoy substantial overearnings absent an immediate rate reduction. Therefore, we direct immediate rate reductions at the outset of the Incentive Regulation Plan. Second, in addition to the rate reductions that the Company makes under its new flexibility, Bell Atlantic also must reduce rates to reflect the decline in regulatory assets that are reflected in rates, have been amortized over recent years and for which the amortization expense will expire over the term of the Plan.³⁸² Third, as we discuss in Section III.E.6, below, if the competitive marketplace does not provide an adequate stimulus to impel Bell Atlantic to pass through the benefits of increased revenues to ratepayers during the term, the Board may be forced to reexamine the reasonableness of the Plan at midterm and make appropriate adjustment. We strongly support the concept of incentive regulation and will be quite reluctant to use such authority. However, the evidence presented on recent revenue trends, if extended over the term of the Plan suggests that unless Bell Atlantic makes significant additional rate reductions or

which includes all products or services not now offered under tariff in Vermont, special contracts for individuals or groups of customers, or any combination of new and/or existing products or services.³⁸³ Specifically, Bell Atlantic proposes the following with respect to new services:

- "Pricing terms and conditions of new products or services will be at the sole discretion of Bell Atlantic, subject only to meeting any relevant price floor obligation established by the Board."³⁸⁴
- New products or services are not subject to the pricing restrictions, nor subject to price changes brought about by exogenous events.³⁸⁵
- New services will not be subject to suspension³⁸⁶ and will take effect thirty days after filing (except for rate decreases, to which the existing five-day period under Section 225(a) will apply);³⁸⁷
- Bell Atlantic will file a privacy impact statement with any tariff filing for new services or products.
- Sections 218(a), 225, 226, 227 and 229 of Title 30 do not apply to new services or promotional offerings during the term of the Price Points Plan.³⁸⁸
- As discussed above, price increases for existing products and services (including existing special contracts) are not allowed, except for a revenue-

383. The Price Points Plan states:

New products and services include: unrelated interstate telecommunication products...

neutral restructuring or exogenous event.³⁸⁹ Existing services can be withdrawn or modified only to current Board requirements.³⁹⁰

- Once a new product or service is in effect, Bell Atlantic may change their terms and conditions, including prices, in the same manner, except for price reductions.
- Any price reduction for a new product or service shall be effective five business days after filing with the Board and the Department.
- Special contracts will be governed by their terms and will not be modified by the Price Points Plan.³⁹¹

The Company asserts that it should be provided with the flexibility and incentive to deploy new products and services, to bring them to market quickly and to price them to market conditions (consistent with meeting any price floor requirements).³⁹² According to Bell Atlantic, this flexibility and the level of certainty and predictability in the regulatory treatment of new services, is critical to Bell Atlantic in today's markets.³⁹³

Bell Atlantic's proposal raises a number of issues. The Department notes that the Company proposal would also permit perfect price discrimination.³⁹⁴ The Department argues that Bell Atlantic's proposal is based on a view that the Vermont telecommunications market is competitive today and that regulatory parity with competitors is now warranted. The Department argues that allowing the incumbent the broad discretion Bell Atlantic proposes is premature.³⁹⁵ Thus, the Department argues that tying arrangements should not be permitted and that the Company should not be allowed to discriminate.³⁹⁶ The Department also asserts that new services should bear a reasonable share of responsibility for recovery of costs

associated with exogenous events.³⁹⁷ We address each of these issues and others raised by Bell Atlantic's proposal in the following sections.

a. Competitive Price Floor Provisions

Bell Atlantic commits to comply with Board rules concerning price floors.³⁹⁸ The Company does not, however, propose to file the price floor analysis with its tariff offerings, but only on request. Instead, Bell Atlantic proposes self-policing of price floor rules; at the time of filing a new service, the Company will certify compliance with the price floor, but would not file a price floor analysis at that time.³⁹⁹ In addition, Bell Atlantic proposes no specific remedy for failure to comply with price floor requirements. Rather, Bell Atlantic would limit the Board's authority to determining that a price floor violation exists; if the Board makes such a finding, the Company could choose a remedy among the alternatives available.⁴⁰⁰

The Department asserts that Bell Atlantic has strong incentives to violate price floors, and relying on certification alone does not adequately protect consumers.⁴⁰¹ They assert that price reductions lead to increased volumes, and, given the economies of scale in providing telecommunications services, to increased revenue and profit.⁴⁰² Also, because of the significant costs associated with attracting customers, as a short-term strategy Bell Atlantic may price below the floor in order to maximize market share and profit in the long-term.⁴⁰³ Thus, the Department argues that the Board should require the Company to *file* a price floor analysis with each new service and each change in the rate of a new service. Despite its position that Bell Atlantic has an incentive to violate price floors, the Department did not propose any

We concur that as a condition of receiving flexibility to price new products and services, Bell Atlantic must comply with price floor rules.⁴⁰⁴ As we found in Dockets 5700/5702, price floors based upon imputation are necessary to prevent anti-competitive behavior by service providers that also supply the monopoly (or largely monopoly) inputs to those services.⁴⁰⁵ Reducing the price floor restriction to its simplest form, this Board requirement only specifies that the services are profitably priced. In theory, Bell Atlantic should have no incentive to price below the price floor, since such pricing would reduce the profits that the Company would gain by selling the unbundled network elements. However, recent proceedings suggest that despite the apparent lack of incentive, Bell Atlantic may actually price special contracts below the price floor.⁴⁰⁶ As several parties have suggested, Bell Atlantic may choose to price below the price floor for a variety of reasons, such as to increase the opportunities to sell additional services to those customers.⁴⁰⁷

We also conclude that Bell Atlantic must file the price floor analysis with each new service filing. The Company must perform a price floor analysis in order to certify price floor compliance; filing the analysis will place no additional burden on the Company.⁴⁰⁸ At the same time, filing the analysis at the time of tariff filing provides both the Board and Department with information to readily assess Bell Atlantic's compliance.⁴⁰⁹

The remaining issue pertains to the consequence of price floor violations. Bell Atlantic proposes that the Board will simply determine that Bell Atlantic failed to price in excess of the floor, leaving the Company to propose a remedy on a case-by-case basis. This proposal is inadequate. Instead of ad hoc remediation in fairness to the affected consumer (or consumers

provides certainty for the customers and a deterrent to Bell Atlantic engaging in anti-competitive pricing.

For customers purchasing services under tariff, Bell Atlantic will be required to adjust its prices to exceed the price floor. Special contract customers present a different problem. These customers engaged in arms-length negotiations with Bell Atlantic resulting in a contract that the customer found reasonable. In many cases, the customer will have chosen Bell Atlantic over other providers. Voiding the contract, even on a prospective basis, may harm these customers, particularly if they incurred costs associated with obtaining the contract. We conclude, therefore, that special contracts should remain in force for a reasonable period of time after the Board finds a price floor violation for that contract. In most cases, that period will be one year, although we will consider a longer period if the customer incurred significant costs.⁴¹⁰

Price floor violations cause greater harm to the competitive process. Although Bell Atlantic is already harmed because it may derive less contribution than had it instead sold the monopoly inputs at wholesale, competitors that lose a prospective customer due to that underpricing can be even more adversely affected. Because our goal is to facilitate the competitive process, the best approach is to establish sufficient deterrent to encourage Bell Atlantic to not engage in the anti-competitive behavior in the first instance. We conclude, therefore, that if Bell Atlantic is found to have priced below its floor, it must reduce other rates by an amount equal to the difference between the revenue generated at the price floor and the revenue produced at the contract or tariff price. Bell Atlantic must use this rate reduction to reduce rates for the less competitive services: residential exchange service⁴¹¹

Turning first to the timing of tariff filings, Bell Atlantic proposes that tariffs will be effective thirty days after filing and may not be suspended. This represents a change from the filing requirements in 30 V.S.A. § 225, which requires tariffs to be filed at least forty-five days in advance of their proposed effective date.

Bell Atlantic's proposal to reduce the time between filing and effectiveness of new products and services will enable the Company to react more rapidly to competition and provide consumers with such services more rapidly, to their benefit. Allowing Bell Atlantic to make new services effective within thirty days would also provide the Company with an advantage over its competitors, who must still adhere to the forty-five-day period. As we found in 1994, "[i]t would be inappropriate for [Bell Atlantic] to be able to raise rates on 30 days' notice when its competitors are required to provide 45 days' notice." The Incentive Regulation Plan will retain the notice requirement at forty-five days.⁴¹²

The second issue is the permissibility of the bundling of competitive services with uncompetitive ones. Under the Bell Atlantic proposal, Bell Atlantic would be permitted to package a service that is not yet competitive with a service in which some competitive rivalry exists.⁴¹³

In competitive markets, bundling of services (with discounts to customers purchasing bundled services) is commonplace. In the current Vermont marketplace, with many services having no or little competition, bundling of more competitive services at a discount provides a potential unfair advantage to Bell Atlantic. For example, only Bell Atlantic presently offers residential basic service within its service territory; competitors could not match a discount for

The Board expects that as competition evolves, Bell Atlantic and its competitors will increasingly seek to offer a range of services in bundles. For consumers, such bundles offer real benefits in the form of discounts. In addition, competitors threatened by bundled service offerings from Bell Atlantic have the ability to offer similar bundles through resale. Bell Atlantic must make the bundled services available for resale at an avoided cost discount. In addition, competitors can purchase unbundled network elements, allowing them to offer a bundle of basic and toll service and thus effectively compete. Although we recognize that few companies have chosen to enter the Vermont market and compete for basic service, we see no reason to deprive Vermont consumers of discounts from Bell Atlantic simply because of competitors' inaction. Thus, the Department's concerns can be met while still allowing Bell Atlantic to bundle competitive and non-competitive services at a discount, subject to the obligation to make the combination available for resale.

The Department's concern with Bell Atlantic's ability to engage in price discrimination is intertwined with the question of the degree to which the Board will relax or eliminate certain regulatory requirements during the term of the Incentive Regulation Plan. The specific sections at issue are the procedural requirements concerning tariff filings and investigation of Bell Atlantic's services in Sections 225, 226, and 227, the requirement to obtain prior approval of special contracts in Section 229, and the substantive requirements in Section 218, requiring rates to be just and reasonable and non-discriminatory. Moreover, despite the broad language in Bell Atlantic's proposed waiver, the Company actually seeks a more narrow waiver, so that these sections will continue to apply to existing services.

filings of tariffs, the Board's authority to require appropriate notice of tariff filings, and the Board's authority to investigate particular tariff filings to determine that they are consistent with the Incentive Regulation Plan.

We also waive prior review of agreements, contracts, or arrangements under Section 229.⁴¹⁵ Bell Atlantic must still comply with the price floor requirements and other requirements set out in this Order and in Docket 6077, as well as obligations under Docket 5713. Bell Atlantic must still file these agreements, with the price floor analysis, prior to their commencement date. In addition, we limit the term of special contracts and other Section 229 arrangements. Special contracts and other Section 229 arrangements must be limited to a term no greater than the later of three years from the date of commencement or until the end of the Incentive Regulation Plan.⁴¹⁶

Bell Atlantic's proposed plan asks that we waive the applicability of 30 V.S.A. § 218. That section allows the Board to make changes to rates and other terms and conditions of service if the rates "are found unjust, unreasonable, insufficient or unjustly discriminatory." We find that this public interest will be served if, in the context of the Order's many provisions, we agree to waive Section 218 with certain exceptions. This section will not apply to Bell Atlantic's earnings during the term of the Incentive Regulation Plan, except as discussed in Section III.E.6., below. Bell Atlantic must continue to comply with all price floor requirements established by the Board and any requirements imposed by Docket 5713. Moreover, we note utility law in Vermont had, throughout the 20th century, concerns over discrimination in prices

among customers.⁴¹⁷ We conclude that, as the Department argues, complete waiver of the non-discrimination standard in Section 218 would permit the Company to engage in perfect price discrimination.⁴¹⁸ Section 218 was enacted because of a legislative concern that companies like Bell Atlantic could establish non-cost-based preferential rates for certain classes of customers, such as legislators, regulators, or employees of companies with inter-locking boards of directors. Thus, although we conclude that the Company should be afforded considerable flexibility to compete fairly in the developing marketplace, we decline to waive completely Section 218's prohibition against unjust discrimination. Because Bell Atlantic will have appropriate incentives to fairly price their services in a manner that is responsive to the marketplace, so long as the Company meets its pricing floor, we will presume the rates proposed are not unjustly discriminatory without further regulatory intervention and supervision. However, we will monitor the manner in which Bell Atlantic uses its pricing flexibility during the term of the Incentive Regulation Plan and reserve the right to apply the prohibition against unjust discrimination if necessary.⁴¹⁹ Finally, we point out that the flexibility we extend to the Company here goes only so far that new services do not (1) conflict with federal law, (2) reflect preferential rates to self provisioning of service, or provisioning to affiliates (using appropriate price floor analysis), or (3) conflict with the conclusions reached by the Board in Docket 6077 or 5713.⁴²⁰

c. Special Contracts

The Company proposes that existing special contracts be subject to the provisions of

treated like new services and would be afforded the pricing flexibility and regulatory relief that are associated with the introduction of new services. We concur, subject to the conditions set out in the previous section.

d. Promotional Offerings

Bell Atlantic's proposal will allow the Company to introduce promotional offerings. Specifically, the Price Points Plan states the following:

The Company may offer products and services on a promotional basis. These offerings may be limited as to duration, dates, and times of the offerings, customers eligible to receive the offerings, and/or locations where offerings are made. Pricing terms and conditions of promotional offerings will be at the sole discretion of Bell Atlantic subject only to meeting any relevant price floor obligation established by the Board.⁴²¹

The only restriction that Bell Atlantic proposes is that the Company must make available promotional offerings for resale by competitors if they exceed 90 days.⁴²² No party contests Bell Atlantic's proposal. We note only that there appears to be no clear definition of a promotional offering in the Price Points Plan. As such, the Company may be afforded the unintended opportunity to treat all new services as promotional offerings or to permit extended temporary rate reductions. We conclude, therefore, that promotional offerings should be limited in time to 180 days, with Bell Atlantic making available for resale any promotional offering exceeding 90 days.

3. Treatment of Exogenous Costs

The Price Points Plan permits Bell Atlantic to adjust rates to reflect exogenous *events*, which are events beyond the control of the Company and that have an economic impact upon the Company in excess of \$250,000.⁴²³ The plan defines an exogenous event as:

one that is beyond the control of Bell Atlantic and that produces a positive or negative economic change in revenues and/or costs of regulated intrastate operations in excess of \$250,000. An exogenous event should include, but not be limited to the following events:

- i. Changes in tax laws;
- ii. Changes in Generally Accepted Accounting Principles that apply specifically to telecommunications or changes in the Federal Communications Commission ("FCC") Uniform Systems of Accounts;
- iii. Any FCC rules changes pertaining to jurisdictional separations;
- iv. Regulatory, judicial, or legislative changes affecting the telecommunications industry, including rules and orders that are necessary to implement such changes.⁴²⁴

This definition excludes general economic and business trends, as well as costs increases or decreases due to inflation and revenue losses resulting from competition.⁴²⁵ According to Bell Atlantic, it intended the broad exogenous provision to create a great deal of flexibility for unforeseeable events.⁴²⁶ Either the Department or the Company may propose a change in prices to offset the economic change resulting from an exogenous event. The party proposing the change bears the burden of proof with respect to the change.⁴²⁷

The Department argues that the exogenous cost provisions are overly broad and should be narrowed significantly, if not eliminated;⁴²⁸ the broad exogenous provision potentially

reduces the incentive in incentive regulation.⁴²⁹ The Department recommends the following modifications, similar to the definition the Department supported in Dockets 5700/5702:⁴³⁰

- (1) Exogenous matters can affect revenues and thus the definition should focus on events;⁴³¹
- (2) The plan should state explicitly that losses due to competition, a downturn of the economy, and/or inflation are not exogenous;⁴³²
- (3) The definition of an exogenous event should be limited to events that directly affect cash flow, and should include neither mere book entries (paper entries) which have no cash flow implications nor events that have merely an "economic" but not a cash flow impact;⁴³³
- (4) The Board should consider whether an event proposed by Bell Atlantic as exogenous is outside Bell Atlantic's or its affiliates' control and whether the change was initiated or supported by Bell Atlantic or its affiliates;⁴³⁴
- (5) Exogenous events resulting from affiliate transactions (*e.g.*, a new Directory License Agreement) should be disallowed, or at the minimum, there should be a greater burden regarding the reasonableness of these events and the threshold should be raised to \$1 million;⁴³⁵
- (6) "Federally mandated cost separations and accounting changes" should be removed from the definition. Many accounting changes do not affect cash flow and therefore should not qualify, and federally mandated cost separations should not automatically qualify, but rather should be judged on a case-by-case basis and subject to the Board's discretion;⁴³⁶
- (7) Changes in unbundled network element costs/rates and in universal service funding should not necessarily be treated as exogenous events, but should be treated in separate investigations because of broader impacts on competition and other important rate issues.

range of events could have quite significant impacts on the Company's financial performance, potentially to the detriment of service delivery. Conversely, other events, such as increases to federal Universal Service supports may be intended to benefit ratepayers; absent exogenous treatment, the ratepayers may not see this benefit. Although we expect Bell Atlantic to bear an increased share of these risks and rewards under incentive regulation, some allowance for events that operate to the Company's detriment and are outside of the Company's control is reasonable.

We find Bell Atlantic's proposal overly broad, however, and direct several modifications to narrow what constitutes an exogenous event. First, we limit the potential exogenous events to those specifically enumerated and delete the generalized language suggesting that unlisted events could qualify.⁴³⁷ Second, as recommended by the Department, changes that qualify for exogenous treatment should encompass events, not simply cost or revenue shifts. These events must be specific discernable changes; broad indefinite changes in the industry (e.g., competition) or the economy (e.g., inflation) will not qualify. The Incentive Regulation Plan will state this explicitly. Third, to qualify, an exogenous event must be truly outside the control of Bell Atlantic. Thus, we agree with the Department's third and fourth recommendations that increases in costs associated with affiliate arrangements should not qualify for exogenous treatment.

Fourth, the \$250,000 threshold proposed by the Company is inappropriately low and ill-defined.⁴³⁸ Relative to the Company's test year revenues it represents only roughly 1/10th of one percent and only one percent of its earnings requirement under the Company's own cost-of-

modified the Plan to allow the Board to initiate such changes; in Board-initiated investigations of exogenous events, no party will bear the burden of proof.

We do not accept several of the Department's recommendations. Limiting exogenous events to those affecting cash flow excludes a range of events, including changes in federal separations rules, that may have direct impacts upon Bell Atlantic's intrastate operations. Separations changes do not alter the profitability of Bell Atlantic's overall Vermont operations, but they could have a major impact upon the regulated intrastate operations. For example, the FCC could reduce Bell Atlantic's intrastate costs by shifting more costs to the interstate jurisdiction. Absent exogenous treatment of that separations change, Vermont ratepayers might not have a clear entitlement to the corresponding intrastate cost reduction. Recognizing this exogenous event as a relevant cost shift would reduce existing rates. The Department's proposal also would not require Bell Atlantic to flow through any changes in Universal Service funding under Section 254 of the Act; these changes should be automatic, since they are outside the Company's control.

The Department also recommended excluding changes in unbundled network element costs/rates and in universal service funding from the definition altogether in favor of case-by-case determinations. This modification is unnecessary. Before Bell Atlantic may adjust rates based upon an exogenous event, the Company must obtain approval of the Board. The Price Points Plan does not set out a specific standard that will guide the Board in determining whether to allow an adjustment based upon the exogenous event. We will thus make a case-by-case determination as to the reasonableness of allowing rate adjustments and the allocation

that the plan assures just and reasonable rates.⁴⁴⁰ We concur. In reviewing any request for exogenous treatment, the Board's intent will be to maintain the same balance of risks and rewards as existed prior to the exogenous event.

In Section III.C.10., the Board allowed the Company to include in its cost-of-service costs associated with reciprocal compensation payments for calls to internet service providers. FCC rulings have suggested that these calls are more properly allocated to the interstate jurisdiction. Moreover, in other jurisdictions, Bell Atlantic has challenged the payment of reciprocal compensation to competitors for calls terminating at internet service providers. The Company has suggested that it may challenge similar payments here. If the FCC ultimately reclassifies the traffic as interstate or the Board relieves Bell Atlantic of the obligation to pay reciprocal compensation for such calls, Bell Atlantic shall reflect the change as an exogenous event and reduce rates accordingly.⁴⁴¹

The Price Points Plan, as proposed, states that exogenous costs will be passed through on a cost-causative basis, with no mandatory assignment of exogenous costs to new services.⁴⁴² The Department argues that the Board should assign costs to new services nonetheless, although the Company would retain the flexibility to pass those changes through in the form of higher or lower rates. The Department also asserts that only the jurisdictional intrastate and service-specific impact of the exogenous event should be flowed through to the related service. For example, if a significant exogenous event affects an expense related to local, toll and access, then local service should bear only a *pro rata* amount of the exogenous cost increase, and it should bear only the separated intrastate portion of that amount.⁴⁴³

and non-regulated services. Where causation is not discernable, the Board will assign a reasonable share to new services (to the extent feasible, the Board will attempt to assign these costs on a pro rata basis). Once the allocation has occurred, Bell Atlantic will then have a certain degree of discretion as to whether it must pass through the revenues and/or costs. For new services (or unregulated services), Bell Atlantic will have complete discretion to determine how and if to reflect the exogenous effects. For existing services, Bell Atlantic must pass through any effects that reduce rates; the Company will retain the discretion not to increase rates for such services.

4. Privacy

Bell Atlantic's proposed Price Points Plan includes consumer privacy protections.

Section II. B. 4. of the proposed Price Points Plan states:

At the time a tariff is filed for a new product or service, the Company will file a statement of foreseeable impacts on customer privacy expectations. In the event that the statement identifies any potential privacy impact, the statement will describe any options the Company proposes to make available to customers to address privacy concerns. After review of this statement, the Board may open a proceeding to address the privacy issues and, on its conclusion, issue appropriate orders affecting the service. The service will remain in effect pending the Board's decision.⁴⁴⁵

As this Board has previously found, advances in telecommunications and changes in the telecommunications marketplace have significant potential impacts upon customer privacy.⁴⁴⁶

It is appropriate that Bell Atlantic's incentive regulation plan includes provisions governing

the implementation of a technology change that may affect customer privacy as required by Docket 5903.⁴⁴⁸ The Board concludes that these standards and the other consumer protection standards adopted in Docket 5903 should continue to apply to Bell Atlantic during the term of the Incentive Regulation Plan, which appears to be consistent with the intent of Bell Atlantic and the Department, although not explicitly stated in the Price Points Plan.⁴⁴⁹ The revised privacy terms of the Incentive Regulation Plan are as follows:

At the time a tariff is filed for a new product or service, or at least 30 days prior to the time the Company introduces or modifies a service or implements a technology change that may affect the privacy interests of consumers, the Company will file a statement of foreseeable impacts on customer privacy expectations. In the event that the statement identifies any potential privacy impact, the statement will describe any options the Company proposes to make available to customers to address privacy concerns. After review of this statement, the Board may open a proceeding to address the privacy issues and, on its conclusion, issue appropriate orders affecting the service. The service will remain in effect pending the Board's decision.

5. Effects of Accounting Adjustments During the Term of the Plan

Bell Atlantic has proposed several specific price adjustments during the term of its Price Points Plan. These include reductions to toll optional calling plans, business exchange service and switched access charges.⁴⁵⁰ The rate design changes we ordered in Section III.D. render several of the Company's proposal moot (specifically the access charge and business exchange service reductions). We anticipate that Bell Atlantic will engage in other rate reductions or offer additional new services over the term of the Incentive Regulation Plan that will provide

In addition to incorporating the specific rate reductions that Bell Atlantic proposes, one category of cost declines, however, is exceptional and warrants pre-defined rate reductions over the term of the Incentive Regulation Plan regardless of Company performance. As we discuss in Section III.C.4., Bell Atlantic has been required to amortize certain restructuring costs over more than five years, rather than recovering those costs in the year they were incurred. The actual restructuring costs subject to this rate treatment have declined and are included in the base-year rates only as a matter of regulatory accounting in the context of setting base year rates.⁴⁵¹ During the term of the Plan, these amortization expenses will decline and ultimately be phased out (having been incurred in each of the years from 1994 through 1999).⁴⁵²

To reflect the reduction in these expenses that exist in Bell Atlantic's present rates solely because of our accounting treatment, it is necessary for Bell Atlantic to reduce its rates to reflect the termination of the amortization during years 2, 3, 4 and 5 of the Plan.⁴⁵³ These will correspond to specific rate reductions equal to \$2.582 million in 2001, \$2.089 million in 2002, \$1.475 million in 2003, and \$0.161 million in 2004.

We also conclude that the reductions should occur in service categories for which the Company faces less competition and therefore is unlikely to reduce the rates without regulatory intervention. In 2001, we conclude that further reductions equal to \$2.582 million should occur to the Message Toll Service rates. As the testimony in the proceeding has demonstrated, toll Message Toll Service rates have, historically, seen little change over time. This is a category of service that is predominantly associated with residential, low volume consumers. The anticipated rate changes should focus on both the stated need for further reductions in Message

Finally, we conclude that further reductions in toll access charges will be warranted over time. At this time, we tentatively conclude that the reductions of \$1.475 million in 2003 and \$161,000 in 2004 should be passed through as reductions in intrastate toll access charges in each of those years. This rate reduction will reduce or eliminate the differential between wholesale unbundled network element rates for elements that make up switched access and the access charges. However, there is a considerable period of time between now and the time for these rate reductions. Moreover, Bell Atlantic's unbundled network element rates are still under review; it is possible, if not likely, that revisions to the Company's cost studies as a result of Docket 5713 will alter the current unbundled network element charges.⁴⁵⁴ Furthermore, changes due to competition may make it more appropriate to reduce other rates, instead of switched access charges. Thus, rather than now ordering the rate reductions in years 2003 and 2004, we invite the Department and the Company to propose alternative rate reductions at least 60 days prior to the reductions actually taking effect in January of 2003 and 2004.⁴⁵⁵

6. Modifications to Plan During the Term

We expect that the Incentive Regulation Plan will continue to function unchanged for its full five-year term. This commitment also provides a high likelihood that Bell Atlantic will benefit from any risks that it takes in regard to new investments or higher-value offerings. However, Bell Atlantic witness McCarren asked us to rely upon (and take assurance from) the fact that Section 226b(i) of Title 30 allows the Department and the Board to:

Conduct investigations into the effectiveness of the alternative forms of

The Board does not anticipate the need to invoke the last sentence of this subsection. However, since Bell Atlantic has asked us to rely upon this "safety-valve" in granting it significant forbearance and since our approval of the Incentive Regulation Plan is founded upon certain assumptions as to Bell Atlantic's performance (such as those set out below and in Section III.E.1.), it may be useful to indicate some of the factors that could lead us to consider modifying the Plan during its term.⁴⁵⁷

The Incentive Regulation Plan we approve is largely a fixed price arrangement in a declining cost industry. Although Bell Atlantic and the Department point to the expectation that rate levels will decrease during the term of the Plan, with minor exceptions, there are no specific requirements to achieve that result. Overall, the Board sees this concept as consistent with the general good. By its design, the Incentive Regulation Plan set out in this Order is intended to break the linkage between price regulation and earnings regulation, thus promoting stronger incentives for the Company to introduce and market its services effectively, and to cut costs. It is our expectation that the Company will take advantage of this flexibility to aggressively deploy new services. In addition, market forces should encourage Bell Atlantic to lower rates to compete with new entrants. These responses to the earnings freedom and pricing flexibility granted in the Incentive Regulation Plan will benefit both Bell Atlantic and Vermont consumers.

Nevertheless, consumer benefit is the overarching goal of 30 V.S.A. § 226b and the evidence does not offer a total guarantee that consumers will benefit under the plan relative to traditional cost-based regulation. Bell Atlantic's revenues are increasing and its costs are

incentives provided in the Incentive Regulation Plan. Neither the Department's nor the Company's proposals appear to fully address this potential.⁴⁵⁹

Thus, while we rely upon Bell Atlantic's commitment, we plan to closely monitor Bell Atlantic's performance to ensure that consumers benefit. Two factors will represent a major part of our assessment. The first factor is the relationship of Bell Atlantic's Vermont rates to those of other states in Bell Atlantic Corporation's service territory. At present, Bell Atlantic's Vermont rates in many categories, such as toll and basic exchange service, are among the highest in the Bell Atlantic states.⁴⁶⁰ In terms of overall value, Bell Atlantic's Vermont customers have historically paid more per line and more per minute of use than Bell Atlantic's customers in other states. To some degree, this rate differential may reflect empirically greater cost of providing service in Vermont. Some of these cost differences may continue to be significant. Other factors, like those leading to the earnings growth and cost reductions that we discuss in the Order are not unique to Vermont; other states in Bell Atlantic Corporation's service territory are experiencing similar trends. Overall, we expect that Bell Atlantic's operation under the Incentive Regulation Plan will allow it the flexibility to begin to bring its Vermont charges closer to other states, essentially improving the "ratio of value" to consumers.⁴⁶¹ If this ratio of value between Vermont and other northeastern states worsens over the course of the Incentive Regulation Plan, we will be concerned.⁴⁶²

If this were to occur, we would need to consider a second factor: the Company's earnings. We do not here place a cap on earnings. Instead, we expect that operation under incentive regulation will permit Bell Atlantic to achieve higher earnings than it would under

as an incentive to produce increased value for consumers.⁴⁶³ If the relative value of Bell Atlantic's service to Vermont (as described in the preceding paragraph) deteriorates *at the same time that the Company's Vermont earnings are higher than in other states that it serves*, we will be more likely to exercise our authority under Section 226b(i). Other factors will clearly weigh in our consideration, such as the service quality performance and whether the pricing flexibility granted under this Incentive Regulation Plan has been used in anti-competitive manners. And, as we discussed above in Section III.E.2., the Board intends to monitor Bell Atlantic's use of the pricing flexibility we grant in this Incentive Regulation Plan. If the Company uses the flexibility in anti-competitive manners or engages in patterns of unjustified price discrimination, the Board will consider modification of the Plan.⁴⁶⁴

Section 226b(i) does not limit the time at which the Board may make modifications to an alternative regulation plan. Absent exigent circumstances, any meaningful assessment of the Company's performance must allow a reasonable time for the incentives inherent in the Plan to take effect. Thus, while we plan to monitor the performance throughout the Plan (as envisioned by Section 226b(d)), we would expect to focus our examination on the mid-point of the Plan.

We stress that we do not anticipate the need for any adjustments to the Incentive Regulation Plan. The above discussion of possible factors that could lead to such adjustments is intended to provide assistance to Bell Atlantic and the parties as to the Board's expectations of the effects of the Plan, to provide some certainty to the affected public, and to guide Bell Atlantic in its efforts to use the flexibility we grant in order to provide value to Vermont's ratenavers

7. Duration of Plan

Bell Atlantic proposed a five-year term for the Price Points Plan.⁴⁶⁵ The Department "does not object" to Bell Atlantic's proposal of a plan term of five years.⁴⁶⁶

We conclude generally that a five-year term is reasonable. This period is of sufficient duration to provide Bell Atlantic with the appropriate economic incentives and rate stability needed to compete in the marketplace and to allow the Company to make and follow through with medium and long-term strategic business plans.⁴⁶⁷

Bell Atlantic also commits to begin discussions on a successor alternative regulation plan at least six months in advance of the end of the Plan. To ensure continuity, Bell Atlantic proposes that, at the Company's request, the Incentive Regulation Plan will be automatically extended pending completion of a successor plan. The Price Points Plan states:

The [Department] and the Company will confer and consult regarding an extension of the Plan or a successor plan at least six months prior to the conclusion of the Plan. Subsequent to conferring and consulting with the DPS, but not less than three months prior to the conclusion of this Plan, the Company will convey to the Board and Department the Company's intention regarding a successor plan, if any. At the request of the Company, the Plan shall remain in effect until the Board has approved a successor plan.⁴⁶⁸

Planning for the successor to the Incentive Regulation Plan is reasonable, although we question whether six months provides sufficient time for negotiations, submission of such a plan, and Board approval. Although we do not order it, we strongly encourage Bell Atlantic to commence a dialogue with the Department earlier.⁴⁶⁹

We have more concern over Bell Atlantic's ability to unilaterally extend the Incentive

term, an unlimited extension is not appropriate. If Bell Atlantic determines that an extension of the Incentive Regulation Plan is necessary to allow completion of a successor arrangement, the Company shall request an extension of the Plan, which the Board will then review.⁴⁷⁰

F. Infrastructure Improvement

Subsection (c) (6) of § 226b states that the Board must find that an incentive regulation plan, "provides reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies."⁴⁷¹ Bell Atlantic's plan contains no proposal for a particular investment plan, either involving specific levels of investment or investment in certain areas or in certain types of technology. Instead, Bell Atlantic states that the Price Points Plan "provides proper incentives for investing in the Vermont infrastructure by allowing Bell Atlantic to manage the risks and benefits of investing in cost-saving and new technologies at the same time that it must meet high service quality standards."⁴⁷² Bell Atlantic insists that it will be able to achieve reasonable earnings only if it is able to reduce its costs and offer products and services that keep pace with changing customer expectations at prices they find attractive.

Bell Atlantic adds that nothing in its plan interferes with or alters the requirement to maintain historic investment levels, one of the conditions of the Board's approval of the merger between Bell Atlantic and NYNEX in Docket No. 5900.⁴⁷³ The Price Points Plan, says Bell

Atlantic, is also consistent with state telecommunications policies reflected in 30 V.S.A. § 202c.⁴⁷⁴

The Department concurs with Bell Atlantic that the Board should impose no investment requirement on Bell Atlantic.⁴⁷⁵ The Department asks the Board to read the § 226b(c) (6) standard as not being "result driven." According to the Department, this requirement does not authorize the Board to require any particular investments, or even any particular level of investment. Rather, it calls upon the Board to put in place an environment in which all providers of telecommunications services -- both incumbent local exchange carriers and other providers -- will have reasonable incentives to invest in infrastructure and introduce technology in an "appropriate" and efficient manner.⁴⁷⁶

The Department also cautions against requiring particular investments.⁴⁷⁷ According to the Department, investment commitments shift the risks from the Company to ratepayers, often for investments that the Company already intended to pursue.⁴⁷⁸ Second, investment requirements, even of a general nature can result in stranded costs for which, because the Company was under a regulatory mandate, ratepayers in general become responsible.⁴⁷⁹ Instead of requiring specific investments, the Department argues that its modified plan will

474. In particular, Criterion no. 2: (1) protection of the price and quality of basic local exchange telephone service; and (2) provision of the benefits of advanced telecommunications technologies by the support of competition through the reduction or suspension of regulatory requirements. Bell Atlantic maintains that its Price Points Plan meets these goals and provides "reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies." Bell Atlantic Brief at 5, 19.

provide Bell Atlantic incentives to deploy truly new services (as opposed to packages of existing services and special contracts of existing services) and directly profit from their success in the marketplace.⁴⁸⁰

Vermont law makes clear the importance of infrastructure deployment and advanced services to the state. Section 202c(b) outlines the state goal "to direct the benefits of improved telecommunications technology to all Vermonters." Subsection (b) (2) of that section restates that purpose as to "provide the benefits of advances in telecommunications technology to Vermont residents." And as stated above, Section 226b(c) (6) requires that we find an alternative regulation plan provides reasonable incentives for the creation of a modern infrastructure.

The Vermont Telecommunications Agreement achieved these aims through specific commitments to improve Bell Atlantic's infrastructure in Vermont, including modernization of switches and deployment of digital connectivity between Bell Atlantic central offices. In contrast, Bell Atlantic proposes no specific infrastructure deployment. In our approval of the proposed Bell Atlantic/GTE Merger, the Board has directed Bell Atlantic to maintain its current level of investment:

For the next four years, beginning in calendar year 2000 and ending in calendar year 2003, BA-Vermont shall continue to invest in telecommunications infrastructure within Vermont at a rate at least comparable to the average rate of investment for the four-year period from 1996 through 1999.⁴⁸¹

In that proceeding, Bell Atlantic also committed to deploy Digital Subscriber Line technology in its host central offices in Burlington and Essex by the end of 1999.⁴⁸² Bell Atlantic has made no

of information over the internet feasible. The question is how best to obtain these benefits for Vermont ratepayers.

Ultimately, we concur that approval of the Incentive Regulation Plan itself, without specific investment commitments represents the best approach. Bell Atlantic obtains the incentive to deploy new services, products, and technology to meet customer demand. The Company also bears the risk of its new investments.⁴⁸³ In reaching this conclusion, we rely not only on the incentives inherent in the alternative regulation plan, but also on the express statements of the Company's Vermont President that its deployment of capital and new technology is based upon forecasts of customer demand, not other factors.⁴⁸⁴ As Bell Atlantic said:

if we have a streamlined process and the ability to deploy new services and we have the pricing flexibility for those services we have sought, we can bring them to market more quickly and that would drive technology.⁴⁸⁵

Thus, in the case of the infrastructure necessary to provide high speed connectivity, the Company asserts that the market now exists and will prompt deployment of Digital Subscriber Line technology to meet that demand.⁴⁸⁶ We expect that Bell Atlantic will move rapidly to fulfill this commitment.

G. Education Plan

1. Findings

143. The Distance Learning Network will consist of connectivity among 59 schools in

144. Bell Atlantic will provide the Distance Learning Network from January 2000 to May 31, 2005. *Id.*

145. Bell Atlantic will connect nine sites in year 2000, twenty-five additional sites in year 2001, and twenty-five more sites in year 2002. *Id.*

146. Bell Atlantic will provide connectivity in the form of a T1 to each identified site, and four T3s to the centrally located Asynchronous Transfer Mode Video Bridge.⁴⁸⁷ Bell Atlantic will build the Asynchronous Transfer Mode Video Bridge. Bell Atlantic will build any additional capacity required in the central office Asynchronous Transfer Mode switch to support the Distance Learning Network. *Id.* at 1-2; Department of Public Service Letter of October 29, 1999.

147. Bell Atlantic will provide technical support for testing the T1s and T3s for Asynchronous Transfer Mode access at each site. Bell Atlantic will provide ongoing maintenance of all T1s, T3s and Asynchronous Transfer Mode ports in the appropriate Bell Atlantic central office. Bell Atlantic will incur costs, including capital, expense and foregone revenue associated with installing and maintaining the T1s, T3s, Video Bridge, and circuits. Bell Atlantic's commitment to ongoing maintenance does not include inside wiring or customer-provided equipment at each of the 59 sites. *Id.*

148. In addition to those technical personnel required to install and maintain the Distance Learning Network over the term specified above, Bell Atlantic will fund three full-time support personnel for the Distance Learning Network who will be phased in over the period of the project. Funding for these personnel is to end coincident with the ending of the project. *Id.*

the expected life of any incremental investment needed to supply this service. *Id.*; Letter of 10/29/99 from Department's Counsel; Letter of 7/9/99 from Bell Atlantic's Counsel; tr. 6/10/99 at 18-21 (McCarren); tr. 6/9/99 at 12-13 (Fenoff).

150. The Department and Bell Atlantic agree that the information contained in the "Bell Atlantic-Vermont Proposal for Vermont Distance Learning Network," July 9, 1999, and the Department's Letter of October 29, 1999, that describes Bell Atlantic's proposal regarding the Video Bridge and both Bell Atlantic's and the Department's agreement with respect to the Distance Learning Network, should be made part of the record.⁴⁸⁸ Department of Public Service, Letter of October 29, 1999.

151. Bell Atlantic will not seek to recover either the expense or the capital costs of the Distance Learning Plan from regulated ratepayers. Tr. 6/10/99 at 20-22 (McCarren).

2. Discussion

Bell Atlantic characterizes its "commitment to education" as one of the major elements of its Price Points Plan. The Company proposes to construct and maintain a distance learning network ("Distance Learning Network") connecting 59 high schools in Bell Atlantic's service territory.⁴⁸⁹ Bell Atlantic also states that it will absorb the costs of the Distance Learning Plan and that no Vermont ratepayers will bear any of these costs because we should not consider the costs of this commitment in calculating Bell Atlantic's cost of service.⁴⁹⁰ Bell Atlantic's proposal has the support of the Department, the Vermont Institute for Science, Math and Technology ("VISMT") and the Department of Education ("DOE")⁴⁹¹

Only Hyperion opposes Board approval of the Distance Learning Network. Hyperion argues that Bell Atlantic's "well intentioned" educational proposal is not "below the line," and, thus, is inconsistent with the Section 254(f) and (k) of the Federal Telecommunications Act ("Act") and 30 V.S.A. § 226b(c)(10).⁴⁹² Although Congress and the FCC recognized the value of providing greater access to telecommunications services for schools and libraries, says Hyperion, "they also recognized that such access should not be promoted to the detriment of the incumbent carriers' captive ratepayers or competitors." Further, according to Hyperion, subsection (k) prohibits incumbent carriers such as Bell Atlantic-Vermont from using services that are not competitive to subsidize services that are subject to competition. Essentially, says Hyperion, the Distance Learning Network would result in other Bell Atlantic customers cross-subsidizing the education plan and, thereby, unfairly favoring Bell Atlantic over competitive carriers that could also provide the service.⁴⁹³

Bell Atlantic's Distance Learning Plan is a positive proposal that will provide significant benefits to schools in the Company's service territory. The Plan will facilitate high-speed access by schools for uses such as the Internet and, more significantly, distance learning. And, Bell Atlantic has committed to provide all of the network functionality necessary for the distance learning effort to become effective, except for the customer premises equipment necessary to send and receive signals, which remains the responsibility of each school. The Board applauds Bell Atlantic's efforts.⁴⁹⁴ We encourage other telecommunications providers (whether incumbent local exchange companies or their competitors) to pursue similar offers, so that the distance learning capabilities enabled by this plan can be shared among all schools, not just high

The Distance Learning Plan will provide benefits not only to high schools throughout Bell Atlantic's service territory, but also to Bell Atlantic itself and other telecommunications carriers. The deployment of distance learning capabilities will meet many existing needs of the educational community, but it also is likely to stimulate greater demand for interactive video services as schools begin to take advantage of advanced network functions. Bell Atlantic and other carriers can be expected to meet these increased needs and receive additional revenues.

We note that the Distance Learning Plan set out in the letters filed subsequent to the close of hearings is not fully consistent with the testimony of parties during the hearings. Bell Atlantic's original proposed Education Plan consisted of the commitment to fund certain positions and to work with the state to develop a more comprehensive plan.⁴⁹⁶ During hearings, Bell Atlantic stated that they had yet to reach agreement with the state Department of Education on a distance learning proposal, but explained the outlines of a three-year plan to build a distance learning network among all the high schools in Bell Atlantic's service territory.⁴⁹⁷ The Department of Education outlined a broader plan.⁴⁹⁸ As a result, the Board directed the parties to submit a more concrete distance learning proposal subsequent to hearings, which was embodied in a July 9, 1999, Letter from Bell Atlantic and October 29, 1999, Letter from the Department. In the final Distance Learning Plan, Bell Atlantic commits to provide (over a five-year period) both high speed connections to high schools and the Department of Education and a video bridge that supports multi-site videoconferencing, which allows for connectivity between any locations using optical fiber, all at no charge to

authority to establish universal service rules that extend beyond the federal program, those rules may not be inconsistent with the FCC's rules.⁵⁰⁰ Moreover, state universal support mechanisms must be "specific, predictable, and sufficient."⁵⁰¹ These sections do not, however, apply to the Distance Learning Plan. The Distance Learning Plan is not a federal universal service program. Nor is it part of any independent state universal service support program, to which subsection 254(f) would apply. No exchange of money between carriers, or even classes of Bell Atlantic ratepayers, takes place. Rather, Bell Atlantic simply seeks Board approval for a program in which the Company will incur costs to support schools, but those costs will not be charged to ratepayers. Thus, we conclude that the Distance Learning Plan is not inconsistent with subsection 254(f) or federal rules implementing subsection 254(h).

Similarly, we conclude that the Distance Learning Plan is not inconsistent with subsection 254(k) of the Act, which prohibits cross-subsidization of competitive services by non-competitive ones. As proposed by Bell Atlantic, the costs of the Distance Learning Plan will not be charged to firm ratepayers; rather they will be borne by the Company's stockholders. To the extent that the Distance Learning Plan is below cost and its offering may constitute a competitive service (both of which premises we accept), the Plan does not involve use of funds from non-competitive services and thus does not run afoul of subsection 254(k).

Hyperion also argues that the education proposal violates Board rulings and does not meet the requirement that the Board safeguard against cross subsidization contained in 30 V.S.A. § 226b. According to Hyperion, Bell Atlantic can make up its cost of providing the education plan through above-cost rates paid by customers that have no competitive alternative

We cannot agree. First, as we noted, the funding for the Distance Learning Network will not be paid for by ratepayers, but is funded instead by from Bell Atlantic's shareholders. Second, Bell Atlantic's commitment provides no basis for concluding that the Distance Learning Network will create any undue negative effects on competition. In fact, other companies are free to make similar offers; as we noted above, Adelphia has done precisely that in recent hearings on its request for renewal of its Certificate of Public Good. We conclude, therefore, that there are no legal constraints to adopting Bell Atlantic's Distance Learning Network proposal, and that the Distance Learning Network complies with Section 226b and the Act as a matter of law.

In Comments on the Proposed Order, Hyperion reiterated its concern that the Distance Learning Plan was not consistent with Section 226b, particularly since Bell Atlantic had significant overearnings available to it that would enable the Company to offer the Plan. This, Hyperion argues, represents a source of ratepayers funding for the discounts. Hyperion stated, however, that it would not challenge the Plan or request additional hearings. As explained previously, we do not agree with Hyperion's concerns.

H. Retail Service Quality Standards

1. Findings

152. The need to ensure a high level of service quality is a fundamental public policy goal. McCarren pf. at 4.

was entered into by Bell Atlantic and the Department. DPS Letter of May 5, 1999; Stipulation of May 5, 1999.

154. On July 15, 1999, the Department submitted a proposed Addendum to the Service Quality Stipulation, entitled "Appendix B." The addendum was adopted by Bell Atlantic and the Department.⁵⁰³

b. The Plan: Term and Performance Areas

155. The Service Quality Plan establishes a method by which the Department and the Board will be able to monitor and evaluate Bell Atlantic's retail service quality performance in 11 areas of performance during the term of Bell Atlantic's alternative regulation plan. Performance areas include: (1) Network Trouble Report Rate; (2) Troubles Not Cleared within 24 hours-Residence; (3) Troubles Not Cleared within 24 hours-Business; (4) Average Speed of Answer-Repair Centers; (5) Calls Not Answered within 20 seconds-Residences; (6) Calls Not Answered within 20 seconds-Businesses; (7) Busy Rate-Repair Centers; (8) Percentage of Installation Commitments Not Met for Company Reasons-Residence and Business Total; (9) Installation Held Orders Residence and Business Combined (Missed Installation Rate and Average Delay Days for Missed Installations); (10) Service Reliability (consisting of Service Outage, Interoffice Facility Failure, and Signaling System Failure); and (11) Network Congestion (a. Umbilical Blockage, and b. Dial Tone Speed). Service Quality Plan at Appendix A and B.

156. The Service Quality Plan establishes Baseline Standards for each performance

Quality Plan does this by measuring the frequency of violations in each performance area, and then by calculating compensation for customers whose service has not met applicable standards. Appendix A at 3-5.

158. The Service Quality Plan will run for a term of five (5) calendar years, *i.e.*, 2000-2004, whether or not Bell Atlantic's alternative regulation plan is approved for a shorter time. *Id.* at 1.

c. Monitoring: The Annual Retail Service Quality Filing

159. To track service quality performance, Bell Atlantic will submit a "Retail Service Quality Annual Filing" ("Annual Filing"). The Annual Filing will contain a section that reports monthly and annual results for each performance area in the Service Quality Plan. The Annual Filing also will contain a calculation of service quality compensation, if any, expressed in terms of dollars. Appendix A at 2.

160. Bell Atlantic's first Annual Filing, due on or before March 31, 2001, will measure Bell Atlantic retail service quality for the 12 months ending December 31, 2000. For subsequent Service Quality years, the Annual Filings will contain retail service quality results for 12 months ending December 31 for the year preceding the filing. *Id.* at 2-3.

161. Bell Atlantic may petition the Board for a waiver of the imposition of service quality compensation points at the time of its Annual Filing. *Id.* at 3.

162. Once Bell Atlantic submits its Annual Filing, the Department may object to that filing within 30 days. If the Department fails to file an objection within 30 days, the Annual

164. If service quality compensation is necessary, at the time Bell Atlantic submits its Annual Filing, it will propose the manner of communication to its customers concerning Bell Atlantic's service quality performance for the prior 12 months. *Id.* at 2-3.

165. All eleven Performance Areas are measured separately so that performance in one area cannot offset performance in another. *Id.* at 3.

166. For Performance Areas 1-9, actual performance in each performance area is compared to a Baseline Standard in that performance area. Any deviation of the actual performance from the baseline standard is expressed as points (by multiplying the percent, as expressed as a decimal, by 100) so that each point equals one percent of deviation from the baseline. Points are assigned each year and are based upon Bell Atlantic's actual performance during the annual 12-month reporting period. *Id.* at 3-4.

167. Only where Bell Atlantic fails to achieve the baseline standard will applicable points be calculated for each performance area and totaled. The total of these points is referred to as "service quality compensation points." *Id.* at 4.

168. Performance area 10 - Service Reliability, including all three categories, *i.e.*, (a) Service Outage; (b) Interoffice Facility Failure; and (c) Signaling System Failure, is measured per event. Under this performance area, if there is more than one event for any or all three subcategories, Bell Atlantic will pay service quality compensation as follows. One Service Outage or one Signaling System Failure equals ten service quality points. In the case of an Interoffice Facility ("IOF") Failure, the service quality compensation points accrue according to the duration of the outage: five service quality points are assessed for an IOF Failure of greater

valued at \$22,500 each, and so on. Service Quality Plan at attachment C. These compensation points are assessed up to a maximum one year total of \$10,515,650 which is equal to 300 service quality compensation points. Appendix A at 4.

e. Measurement Procedures

171. Bell Atlantic's performance will be measured and reported to one decimal place for Performance Areas 1, 2, 3, 7, 8, to two decimals places for Performance Area 9(a), in whole second increments for Performance Area 4, and in whole numbers (no decimal places) for Performance Areas 5, 6, 9(b), 11A and 11B. *Id.* at 5; Appendix B.

172. Commencing with the start of the Service Quality Plan, Bell Atlantic will retain all internal reports, and data supporting these reports, that document the results of each of the Performance Areas of the Service Quality Plan for a term not less than 12 months after the Annual Filing. Bell Atlantic will provide the Department data and, on reasonable notice and at reasonable times, will allow the Department to audit retail service quality data associated with each Performance Area of the Service Quality Plan. Appendix A at 5.

173. The Service Quality Plan links violations in each performance area with compensation for customers whose service has not met applicable standards. *Id.* at 3-5. The Service Quality Plan does this by measuring the frequency of violations in each performance area, and then by calculating compensation for those customers. *Id.* With the exception of performance area 10, which is measured per event, the measurement frequency of each Performance Area is at least once a month. *Id.* at 3 5

Service quality criteria are a fundamental component of the Company's Price Points Plan. The statute specifically recognizes this importance, requiring the Board to find that any incentive regulation plan "is consistent with the public's interests relative to appropriate quality telecommunications services."⁵⁰⁴ Our acceptance of many aspects of the incentive regulation proposal, such as forbearance on future pricing issues, elimination of earnings regulation, and relaxation of many filing requirements are directly linked to, and directly reliant upon the understanding that customer service quality will be maintained or enhanced.⁵⁰⁵ Particularly for basic telecommunications services for which there are few or no competitive alternatives, it is essential that Bell Atlantic maintain the quality of its services.

The Department and Bell Atlantic have reached agreement on a Service Quality Plan that they argue meets these objectives. The Service Quality Plan measures Bell Atlantic's service quality performance in eleven areas of performance from the inception of the plan to the year 2004.⁵⁰⁶ Each of the performance areas is measured separately so that performance in one area cannot offset performance in another. In this way, there is little risk of monitoring information masking possible regional disparities in quality of service. The Service Quality Plan links violations in each performance area with compensation for customers whose service has not met applicable standards.

Bell Atlantic's Service Quality Plan contains several types of service quality benchmarks. The plan consists of historical benchmarks, *i.e.*, those established under prior year's performance. In certain cases, where performance was considered to be in need of improvement the historical standards have been tied to ratchet mechanisms designed to raise

The Service Quality Plan provides for quarterly monitoring reports to go to the Department. It also provides for an Annual Filing that summarizes quarterly service quality data for each performance area in the Service Quality Plan, and calculates service quality compensation points (based upon Bell Atlantic's failure to meet one or more standard) for the twelve months preceding the filing. If Bell Atlantic has failed to meet one or more standard, Bell Atlantic will propose, at the time of the annual filing, which customers will receive a one-time rebate. The Department has 30 days to review and, if necessary, file any objections to Bell Atlantic's proposal.

We conclude that the Service Quality Plan, in general, is reasonable.⁵⁰⁷ The performance measures are sufficiently broad to provide a valid measure of the service that Bell Atlantic provides its customers during the term of the Plan. Similarly, the overall scheme, with payments to customers for failure to meet service quality standards, will ensure that those customers that do not receive the service they should expect are compensated.

Two facets of the Service Quality Plan merit further comment. The Service Quality Plan permits Bell Atlantic ability to change methods or procedures that might alter service quality data measurement and assessment. If any proposed change in measurement procedures or internal reporting methods affects a mutually agreed upon Performance Area definition and corresponding Baseline Standard, Bell Atlantic will negotiate with the Department an appropriate performance definition and the Baseline standard. Although the Department may challenge and potentially exclude from the results any data based upon significantly altered measurement procedures or internal data acquisition methods (unless agreed to) these

acquisition could result in the dissolution of an entire performance area, associated compensation points, and rebates to customers experiencing below standard service quality. However, we also recognize that the Service Quality Stipulation represents a good-faith compromise between Bell Atlantic and the Department. We also expect that Bell Atlantic will make every possible effort to reach agreement on replacement service quality performance measures expeditiously should the Company alter its systems or methods. Therefore, we accept the parties' Stipulation on this issue. If, during the term of the Incentive Regulation Plan, Bell Atlantic makes changes to performance measures such that a party believes that the Service Quality Plan no longer accurately reflects Bell Atlantic's provision of service in that area, parties may request a modification of the Service Quality Plan.

I. Wholesale Service Quality Standards

1. Findings

175. On May 28, 1999, Bell Atlantic filed a stipulation in which Bell Atlantic and the Department agree to, in effect, remove all issues of wholesale service quality from this docket. Stipulation Regarding Wholesale Service Quality, May 28, 1999 ("Wholesale Service Quality Stipulation"). Wholesale Service Quality Stipulation at 1.

176. Under the Stipulation, Bell Atlantic and the Department jointly petition the Board to open a proceeding on wholesale service quality ("Wholesale Service Quality Proceeding") to expeditiously consider the issue of wholesale service quality providers of telecommunications services in Vermont *Id* at para 2.

standards and measures include five issues set forth in a Compliance Filing and Limited Motion for Reconsideration filed by Bell Atlantic in the New York Proceeding, and contained in Exh. A to the Wholesale Service Quality Stipulation. The five issues involve: (1) service order accuracy; (2) competitive local exchange company requested due dates vs. incumbent LEC committed due dates; (3) performance times for hot cuts; (4) percentage of orders given jeopardy notices; and (5) invoice/carrier billing accuracy. *Id.* at para. 3; exh. 1 at 1-4.

179. Bell Atlantic and the Department further intend for the reference to "standards and measures that remain pending in the New York Proceeding" to refer to an additional fourteen issues set forth in Appendix 3 to the February 16, 1999, Order in the New York Proceeding, entitled *Carrier Metrics/Standards, Issues Requiring Further Consideration by the Parties. Id.*

2. Discussion

In its original testimony, the Department submitted prefiled testimony from David Brevitz regarding wholesale service quality ("Brevitz Wholesale Service Quality Testimony"). Bell Atlantic then moved to strike the Brevitz Wholesale Service Quality Testimony. Before the onset of hearings, the Department and Bell Atlantic negotiated the Wholesale Service Quality Stipulation under which the Department agreed to withdraw the prefiled testimony, to refrain from raising wholesale service quality issues in this docket, or to impose wholesale service quality obligations on Bell Atlantic as part or condition of Bell Atlantic's alternative regulation plan.⁵⁰⁸ Instead, the Department and Bell Atlantic agreed to defer wholesale service quality

agreed to recommend that the Board adopt wholesale service quality standards subsequently adopted by New York.

We find Bell Atlantic and the Department's proposal a reasonable resolution of wholesale service quality issues. In fact, the Board has already initiated a proceeding to establish wholesale service quality standards -- Docket 6255 -- in which the parties are now negotiating on a number of major issues. The wholesale service quality standards adopted in that proceeding will apply to Bell Atlantic's provision of service to its competitors and will help to ensure that other market participants can fairly compete with Bell Atlantic in the provision of retail telecommunications services.

AT&T does not object to the arrangement concerning wholesale service quality, but AT&T argues that we must establish wholesale standards prior to the effective date of the Plan.⁵⁰⁹ We disagree. While we agree with AT&T as to the desirability of establishing such standards expeditiously (and recognize that AT&T is not participating in negotiations aimed at achieving that result), we do not conclude that our ability to grant Bell regulatory flexibility must await the establishment of wholesale service quality standards. Until the adoption of wholesale service quality standards, the Board has ample regulatory authority, which is not altered by the Incentive Regulation Plan, to address any issues related to carrier-to-carrier responsibilities.

For these reasons, we approve the Wholesale Service Quality Stipulation submitted by Bell Atlantic and the Department.

182. The Service Quality Plan establishes methods by which the Department and the Board will be able to monitor and evaluate Bell Atlantic's retail service quality performance in 11 areas. The Service Quality Plan includes performance incentives. The Plan will run 5 years from 2000-2004. The Service Quality Plan establishes Baseline Standards for each performance area. The Service Quality Plan includes an obligation on the Company to track performance and to submit a "Retail Service Quality Annual Filing." Findings 152-174.

Discussion

At the time the Board approves an incentive regulation plan, the Board must establish standards and procedures by which the effectiveness of the Plan can be determined.⁵¹⁰ At the close of hearings, the Board directed Bell Atlantic to submit recommended standards.⁵¹¹

The Department recommends that the Board largely rely upon the existing Merger Benchmark Report that resulted from the Board's investigation into the merger between Bell Atlantic and NYNEX. These reports provide benchmark comparisons between Bell Atlantic's service in Vermont and the service it provides in other Bell Atlantic states. The Department proposes additions and modifications outlined in further detail below.

Bell Atlantic cautions the Board against reliance on the merger benchmark report comparisons required from Docket 5900. The Company argues that "[a]lthough this information may be useful to evaluate in part some of the statutory criteria governing the alternative regulation plan, it is not sufficient in and of itself to evaluate the effectiveness of the Plan."⁵¹² However Bell Atlantic does not make a specific recommendation related to the

For purposes of meeting the statutory obligations under 30 V.S.A. § 226b(d), we will use the substantive standards in Section 226b(c) to evaluate the Incentive Regulation Plan during its term. For monitoring and reporting, the Board will rely upon a combination of reports that Bell Atlantic already provides this Board (with some modifications) or has agreed to provide as part of the Incentive Regulation Plan. The latter category consists primarily of the reports provided under the Service Quality Plan.

During the term of the Plan, Bell Atlantic also shall continue to provide the Department and the Board with the same reports it currently provides, including construction, financial, and service quality reports. However, we are concerned that the existing financial reports do not accurately reflect the adjustments ordered by the Board.⁵¹⁴ This difference means that parties cannot use the financial report to determine the Company's performance, since the rate of return set forth in the report understates the return calculated in our Orders. The Company must modify the financial report to incorporate Board ordered adjustments.⁵¹⁵ The Company also shall maintain full records of accounts for revenues, expenses, and investments for the full term of the performance regulation plan.

In addition, the Merger Benchmark Report, with modifications, will provide information to meet the statutory performance monitoring and evaluation.⁵¹⁶ We adopt the modifications to the Merger Benchmark Report (as recommended by the Department) set forth below. Bell Atlantic shall file this report on a semiannual basis and shall be referred to as the "Bell Atlantic Performance Benchmark Report" in subsequent filings to reflect the broadening nature of its application to review of this Incentive Regulation Plan. An initial Bell Atlantic Performance

- Bell Atlantic shall add annual depreciation expense. A comparison of depreciation expense to gross construction expenditures would permit the Board to assess trends in net telephone plant in service in Vermont, over time, and in relation to other Bell Atlantic states.⁵¹⁷
- The Company shall add to the report the total end of year access lines for each state. The addition of this statistic to the report and its relationship to the investment figures in the report will facilitate more meaningful comparisons between investment levels among the Bell Atlantic states.⁵¹⁸
- Bell Atlantic shall modify the service availability portion of the report to reflect meaningful proportions of service availability in each of the states. As the report currently stands, it merely provides for a "yes" or "no" under the category headings. The breadth of service availability is also at issue and the report should provide additional detail to reflect the scope of service availability.
- The current average revenue per minute ("ARPM") measure aggregates all types of toll traffic and prices, including Message Toll Service calling, operator and card calling, and optional call in plans. This measure is useful and should remain. In addition, Bell Atlantic shall add separate categories disaggregating the average revenue per minute for Message Toll Service and Optional Calling Plans into a residential and business category on the reports.⁵¹⁹ In its compliance filing, Bell Atlantic provided a proposal that failed to separate business from residential rates. As recommended by the Department,⁵²⁰ we conclude that the Bell Atlantic filing was deficient in this regard; Bell Atlantic shall refile its proposed Performance Benchmark Report template to incorporate this requirement.
- For similar reasons, Bell Atlantic should continue to present the local revenue per access line measure along with a statewide weighted average local rate comparison.⁵²¹ Bell Atlantic should further disaggregate this figure broken down by business and residential customers.⁵²²

- Bell Atlantic shall add access charges and Digital Subscriber Line prices to the list of prices included in the report.⁵²³

IV. SUMMARY

A. Findings

Promotion of the General Good:

183. The Incentive Regulation Plan, as modified herein, will promote the general good. Findings 1-179.

Consistency with 30 V.S.A. § 202c:

184. The Incentive Regulation Plan, as modified herein, is consistent with Vermont's telecommunications policies established under 30 V.S.A. § 202c. It ensures affordable basic service, sets out standards for continued high quality service, and provides appropriate incentives for promoting a modern infrastructure. Findings 1-179; McCarren pf. at 5.

Consistency with the Ten-Year Plan:

185. The Incentive Regulation Plan, as modified herein, is consistent with the Department's Ten-Year Telecommunications Plan. In general, the Ten-Year Plan calls for affordable basic service and the reasonable pricing of all services, reasonable competition, prudent and reasonable network investment, and continuous reevaluation of service quality standards to ensure optimal service. Findings 1-179; McCarren pf. at 5-6.

Service Quality:

186. The Incentive Regulation Plan, as modified herein, is consistent with the public's

Telecommunications Infrastructure:

188. The Incentive Regulation Plan, as modified herein, provides reasonable incentives for the creation of a modern telecommunications infrastructure and the appropriate implementation of new cost-effective technologies. The Board and Department will monitor the Company's capital plans and service quality performance over the term of the Incentive Regulation Plan. Section III.E.; McCarren pf. at 8-9; tr. 6/1/99 at 206 (Taylor); tr. 6/3/99 at 144, 146 (Ostrander); tr. 6/9/99 at 208 (McCarren); tr. 6/10/99 at 173 (Brevitz).

Economic Development:

189. The Incentive Regulation Plan, as modified herein, reasonably supports economic development in NET's service territory. Findings 104-179; Brevitz pf. at 41; McCarren pf. at 9.

Protection of Consumer Privacy Interests:

190. Privacy protections provided for under the Incentive Regulation Plan strike a reasonable balance between consumer privacy expectations and consumer interests in the delivery of beneficial new services. The Incentive Regulation Plan, as modified herein, adequately protects customer privacy interests. McCarren pf. at 9; see Discussion in Section III.E.4.

Competition:

191. The Incentive Regulation Plan, as modified herein, supports reasonable competition. See, Sections III.D.1, III.E., III.E.6., and III.I.; McCarren pf. at 9-10.

Competitive Safeguards:

192. The Incentive Regulation Plan as modified herein includes adequate safeguards to

We conclude that the Incentive Regulation Plan, as modified in the preceding pages, satisfies the criteria set out in Title 30, Section 226b.

V. ORDER

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The Incentive Regulation Plan, as discussed in this Order (and set out in Attachment A to this Order), is approved, effective 30 days from the date of this Final Order.
2. Within 15 days of the Final Order, New England Telephone and Telegraph Company d/b/a Bell Atlantic-Vermont ("Bell Atlantic") shall file tariffs with rate reductions consistent with the Order and the Compliance Filing submitted on March 21, 2000.
3. The Education Plan set out in Bell Atlantic's Letter of July 9, 1999, and as modified by the Department's Letter of October 29, 1999, is approved as part of the Incentive Regulation Plan. Bell Atlantic will not include the costs of the Education Plan in its cost of service.
4. Bell Atlantic shall comply with the reporting requirements in Section III.I. of this Order. Bell Atlantic shall file a revised Performance Benchmark Report format within 15 days of this Order.
5. Within 60 days of this Order, Bell Atlantic shall file a proposal for tracking unbundled network element costs and revenues. The Department and other parties shall submit comments on the proposal no later than 15 days thereafter.
6. Bell Atlantic shall comply with all other directives set out in this Order.

OFFICE OF THE CLERK

FILED: March 24, 2000

ATTEST: s/Judith C. Whitney
Deputy Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board of any technical errors, in order that any necessary corrections may be made.

Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.