

STATE OF MAINE
PUBLIC UTILITIES COMMISSION

January 13, 2005

PUBLIC UTILITIES COMMISSION
Investigation into Verizon Maine's Alternative
Form of Regulation

Docket No. 1999-851

NOTICE OF CONSIDERATION
OF CHANGES TO SQI REBATE
STRUCTURE

PUBLIC UTILITIES COMMISSION
Investigation into Verizon Maine's Service
Performance

Docket No. 2005-24

NOTICE OF INVESTIGATION

WELCH, Chairman; DIAMOND and REISHUS, Commissioners

I. SUMMARY

By this Notice, we take the following actions: 1) we provide notice that we will consider whether to modify the penalty structure of the Service Quality Index mechanism for Verizon Maine (Verizon); and 2) we initiate an investigation into Verizon's service performance. In the latter proceeding, we will explore whether Verizon's customer service performance has degraded past acceptable levels and, if so, determine whether regulatory action beyond changes in the SQI and penalty-rebate structure are necessary.

II. LEGAL AUTHORITIES

Verizon presently is regulated by an alternative form of regulation (AFOR) authorized by 35-A M.R.S.A. §§ 9101-9104. The AFOR includes a Service Quality Index (SQI) and a penalty-rebate mechanism for service quality that does not meet a set of established benchmarks. We established the initial AFOR and SQI in *Public Utilities Commission, Investigation Into Regulatory Alternatives for the New England Telephone and Telegraph Company d/b/a NYNEX*, Docket No. 94-123, Order (May 15, 1995) ("First AFOR Order") and modified them in *Public Utilities Commission, Investigation into Verizon Maine's Alternative Form of Regulation*, Docket No. 99-851, Order (June 25, 2001). Under 35-A M.R.S.A. § 1321 the Commission "may at any time rescind, alter or amend any order it has made," provided it affords appropriate processes to the utility that is the subject of the order and, to the extent feasible, all parties to the original proceeding. Because Verizon's performance for certain of the metrics has deteriorated substantially and has been at levels below the SQI benchmarks for several years, we will consider changes to the penalty-rebate structure of the SQI and the potential penalty amounts.

Title 35-A M.R.S.A. § 301 requires every public utility to furnish safe, reasonable and adequate facilities and service. Pursuant to 35-A M.R.S.A. §§ 1303 and 1304, the Commission may, on its own motion, take action when it believes that an investigation of any matter relating to a public utility should for any reason be made, including when a service is inadequate or cannot be obtained. When the Commission finds, after public hearing, that a service provided by a utility is inadequate or that reasonable service cannot be obtained, it may, by order, establish or change terms, conditions, measurement, practice, service or acts, as it finds to be just and reasonable. 35-A M.R.S.A. § 1306(2).

III. SERVICE QUALITY INDEX

A. The Commission's Authority to Change the SQI

As noted above, 35-A M.R.S.A. § 1320 gives the Commission broad powers to alter any order. In the first AFOR Order, we established a rate structure designed to give Verizon incentives to operate more efficiently, i.e., at lower cost. We recognized that incentives to cut costs could lead to a deterioration of service quality:

We are concerned about the effect of alternative regulation on the level of service quality. In *Central Maine Power Company, Proposed Increase in Rates*, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings at 22 (Jan. 10, 1994)...we questioned whether our current authority under rate of return regulation to penalize a utility for service quality deficiencies is an effective regulatory tool to ensure high quality service. Since alternative regulation is in part intended "to motivate a firm to deliver its product or service at the lowest cost to maximize its profit potential," according to Staff witness Alexander, there is a legitimate concern that the incentives designed to encourage efficiency may instead cause "a firm with near monopoly power to slash operations and maintenance costs with a resulting drop in service quality."

First AFOR Order at 69. We therefore established the SQI as a separate incentive plan for service quality:

Because a reasonable level of efficiency is built into the AFOR price cap formula and because separate incentives to maintain service quality are established, consumers will benefit in at least the following ways:

- Prices most likely will be lower than under ROR regulation...
- The present high levels of customer service will be encouraged....

First AFOR Order at 4.

By establishing the AFOR, we relinquished control over some aspects of rate-setting, but not over other matters subject to regulation, including service quality.

There is nothing ... in the AFOR we are adopting that limits the Commission's ability to regulate NYNEX,¹ other than the restriction on traditional rate cases, and some provisions that would grant NYNEX increased pricing flexibility. In all other respects, the Commission's powers are preserved. These powers include the ability to address service quality concerns directly (in addition to the service quality rebate mechanism that is included in the AFOR), and authority over billing and collection practices, disconnections, deposits, and any other matter that may need to be investigated and remedied pursuant to 35-A M.R.S.A. §§ 1302, 1303 and 1306. Section 9102 effectively allows us to suspend those portions of Chapter 3 (sections 301-312) that require rate-base, rate-of-return regulation. They do not permit the suspension of the statutory prohibitions against unjustly discriminatory rates (35-A M.R.S.A. §§ 701-703). All other requirements of Title 35-A remain fully in effect and fully enforceable under sections 1302, 1303 and 1306.

First AFOR Order at 13.

The SQI relies exclusively on incentives (or penalties) to ensure a reasonable level of service quality. It does not follow, however, that Verizon simply has the "right" to allow service quality to deteriorate and instead pay the penalties, in other words, to make a business decision that it is cheaper to pay the penalties than to maintain good service quality. Under the AFOR, we intended that Verizon maintain the same (or better) service quality that it provided under rate-of-return (ROR) regulation. In the First AFOR Order, we quoted from the Order that established the alternative rate plan (ARP) for Central Maine Power Company:

We believe that service quality and reliability are an essential element of the ... ARP. If the ... ARP is to succeed it must receive general acceptance from CMP's ratepayers and from the public at large. No ARP that substantially reduces customer service and reliability is likely to receive the ratepayer and public support that it must have.

First AFOR Order at 69, quoting *Central Maine Power Company, Proposed Increase in Rates*, Docket No. 92-345(II), Detailed Opinion and Subsidiary Findings (Jan. 10, 1995) at 23.

We expressed a similar concern with regard to the AFOR and stated that the purpose of the incentive-penalty mechanism in the SQI was to ensure a high, or even better, level of quality:

¹ Through the process of two mergers, NYNEX is now Verizon.

To ensure the continued high quality of service now provided by NYNEX, we have adopted a Service Quality Index (SQI) and a mechanism to provide rebates to customers if service quality does not meet the standards established by the Index. ...

Service quality is our concern regardless of its current level, and is specifically reflected in the goal we reiterated [above in this Order]. The service quality mechanism is a vitally important part of the AFOR. NYNEX may well have the desire and incentives to preserve current levels of service, but it is crucial that we provide reasonable guarantees to the public that excellent quality service will continue as we move to a new form of regulation.

We do not intend to penalize NYNEX for good performance, but we do wish to provide an explicit incentive to NYNEX to maintain, if not improve, its current service quality levels.

First AFOR Order at 1, 85.

In that Order we also rejected a specific "trade-off" proposal by Verizon, thereby indicating our concern with the proposition that Verizon can simply pay to provide poor service quality. Verizon had proposed "symmetric scoring," under which it could offset poor performance in one service category with performances that were better than the benchmark in other categories. We responded:

Staff criticized NYNEX's "symmetric scoring" proposal as enabling NYNEX to offset a poor score in one category with a good score in another, subjecting the index to possible manipulation. Staff witness Alexander characterized NYNEX's proposal as one which offsets deteriorated performance in one area with adequate performance in others as "the equivalent of NET² having the authority to decide which portions of a Commission service quality rule it would implement and achieve and which portions it would fail to achieve." Staff suggested scoring each category separately to provide a disincentive to NYNEX to avoid a deterioration of performance in any single category. While NYNEX criticized Staff's SQI approach, it did not identify any specific concerns with Staff's scoring methodology. We agree with Staff that each SQI category should be scored individually so that incentives will exist for NYNEX to maintain service quality in all SQI categories in the future and to minimize the possibility that service quality in one category might be "traded" for that in another.

First AFOR Order at 82.

² NET (New England Telephone) and NYT (New York Telephone) were the Bell Operating Companies that made up NYNEX.

We believe that “trading” good service quality for paying penalties raises a similar concern: it was not the purpose of the SQI incentive-penalty mechanism to allow Verizon to “trade” money for good service. Rather, as described above, we intended the mechanism to ensure that service quality under the AFOR would be the same as or better than under ROR regulation. Verizon’s SQI performance in recent years, however, indicates the present incentive-penalty mechanism may not have accomplished its purpose. Therefore, as discussed below, we believe it is necessary to consider whether to change the mechanism so that the incentives will achieve our original goal.

B. Performance Metric Benchmarks

The SQI contains 15 performance metrics.³ Each of these has a benchmark that Verizon must meet to avoid paying a rebate to customers for below standard service quality. (The metrics, and benchmarks for each metric, are shown in Table 1.) Verizon submits monthly reports to the Commission on its performance for each metric. The benchmarks for two of the performance metrics, the “Major Service Outages” and the “PUC Complaint Ratio,” are based on annual totals, i.e., the sum of the 12 monthly results. The benchmarks for all other metrics are based on the average of the 12 monthly results. The annual average (or annual total) for each metric is compared to its benchmark; if the average (or total) for the year is higher (i.e., worse)⁴ than the benchmark, Verizon must credit its customers with a rebate for that benchmark. The total customer rebate is the sum of the rebates for all below standard metrics. (The SQI does not provide for any reduction in a customer rebate if Verizon’s performance is better than a metric’s benchmark.)

The benchmarks for the original SQI performance metrics, established in 1995, were set at Verizon’s *worst* annual performance over the previous three years; as noted above, five of the metrics remained unchanged in 2001. The benchmarks for the two revised metrics and for the eight new metrics added in 2001 were set at the *average* annual performance over the previous three years. (See Table 1 for the basis of each metric’s benchmark.)

³ On June 25, 2001, in Docket No. 99-851, we extended the Alternative Form of Regulation (AFOR) for Verizon until May 31, 2006. As part of the AFOR, we modified and continued the Service Quality Index (SQI) mechanism adopted for the initial phase of the AFOR. The original SQI had twelve metrics. In the 2001 modification of the SQI, we retained five metrics unchanged, revised two metrics, eliminated five metrics, and added eight new metrics. Thus, the number of SQI metrics was increased from twelve to fifteen: seven from the original SQI and eight new metrics, a net increase of three metrics.

⁴ All metrics are designed so that a performance number higher than the benchmark represents service that is poorer than the benchmark. A performance number that is lower than the benchmark represents service better than the benchmark.

Table 1: SQI Metrics

Metric	Benchmark	Worst of Previous 3 years' Performance 1995	Average of Previous 3 Years' Performance 2001
<u>Customer Service</u>			
Business Office Calls % Answered Over 20 Seconds	31	√	
Premise Installations % Appts Not Met Co. Reasons	12.64		√
Mechanized Installations % Appts Not Met Co. Reasons	0.10		√
Premise Repairs % Appts Not Met Co. Reasons	16.11		√
Mechanized Repairs % Appts Not Met Co. Reasons	7.21		√
Held Orders Avg Total Delay Days	6.21		√
Repair Service Calls % Answered Over 20 Seconds	23.10		√
<u>Service Reliability</u>			
Customer Trouble Reports Rate per 100 Lines – Network	1.08	√	
Repeat Trouble Reports Rate per 100 lines	0.12		√
% Troubles Not Cleared Within 24 Hrs. – Residence	21.10	√	
% Troubles Not Cleared Within 24 Hrs. – Business	9.00	√	
Dial Tone Speed % Over 3 Sec.	0.36	√	
Major Service Outages	614 ⁵		√
% Blocked Calls	0.03		√

⁵ This number does not represent the number of outages. Rather, it is a number produced by a formula that takes into account the number of outages, their lengths, and the number of customers affected.

Metric	Benchmark	Worst of Previous 3 years' Performance 1995	Average of Previous 3 Years' Performance 2001
<u>Customer Satisfaction</u>			
PUC Complaint Ratio	0.52		√

C. Customer Rebates

The customer rebate for each metric is calculated as follows:

$$\frac{1}{100} \times \frac{(\text{Annual Performance} - \text{the Benchmark})}{\text{The Benchmark}} \times \$75,000,000$$

The "Annual Performance" for a metric is the average of the monthly results for 12 months or, in the case of the Major Service Outages and PUC Complaint Ratio metrics, the sum of the monthly results for 12 months. The greater the difference between the Annual Performance and the Benchmark for a metric, the greater the customer rebate.

The SQI caps the total annual customer rebate at \$12.5 million. The rebate for each metric is capped at \$1.135 million, except for the "Major Service Outages" metric, which is capped at \$2.27 million. Table 2 shows the customer rebates Verizon has paid annually since the inception of the SQI in 1995. None of the rebates approached the per metric cap, much less the total cap.

Table 2: Annual Customer Rebates

<u>1995/96</u>	<u>1996/97</u>	<u>1997/98</u>	<u>1998/99</u>	<u>1999/00</u>	<u>2000/01</u>	<u>2001/02</u>	<u>2002/03</u>	<u>2003/04</u>
\$134,566	\$220,211	\$79,147	\$455,243	\$0	\$0	\$524,905	\$876,670	\$576,404

D. Effectiveness of the Customer Rebate Mechanism

The Commission included monetary penalties in the SQI (in the form of rebates to customers) for below-standard service quality to provide Verizon with a financial incentive not to cut costs at the expense of service quality. The penalty incentive apparently was reasonably effective for several years, but in the past three years Verizon has repeatedly failed to meet the benchmarks for several metrics – most notably metrics related to its performance in repairing customers' service troubles.

Table 3 shows the benchmarks and Verizon's performance over the past three years for each metric.

Table 3: Verizon's SQI Performance
(performance in bold italics is worse than benchmark)

Metric	Benchmark	2001/02	2002/03	2003/04
<u>Customer Service</u>				
Business Office Calls % Answered Over 20 Seconds	31	20	24	23
Premise Installations	12.64	8.53	10.65	10.62
Mechanized Installations % Appts Not Met Co. Reasons	0.10	0.04	0.06	0.03
Premise Repairs % Appts Not Met Co. Reasons	16.11	14.23	16.58	17.36
Mechanized Repairs % Appts Not Met Co. Reasons	7.21	6.26	9.02	7.33
Held Orders Avg Total Delay Days	6.21	5.46	6.52	6.34
Repair Service Calls % Answered Over 20 Seconds	23.10	19.3	29.5	15.8
<u>Service Reliability</u>				
Customer Trouble Reports Rate per 100 Lines – Network	1.08	1.01	0.93	1.11
Repeat Trouble Reports Rate per 100 lines	0.12	0.08	0.09	0.11
% Troubles Not Cleared Within 24 Hrs. – Residence	21.10	24.1	29.3	34.3
% Troubles Not Cleared Within 24 Hrs. – Business	9.00	6.3	7.9	7.8
Dial Tone Speed % Over 3 Sec.	0.36	0.05	0.03	0.03
Major Service Outages	614	253	404	333
% Blocked Calls	0.03	0.01	0.00	0.00
<u>Customer Satisfaction</u>				
PUC Complaint Ratio	0.52	0.81	0.61	0.52

As shown in Table 3, Verizon's worst performance is for repairs of its residential customers' service troubles. Verizon failed in each of the last three years to

meet the “% Troubles Not Cleared Within 24 Hours—Residence” metric (referred to below as “Residential Troubles Not Cleared”). In the 2003-2004 SQI year⁶, Verizon failed to meet the Residential Troubles Not Cleared metric in 10 out of 12 months, and its annual performance was 63% worse than the benchmark. As discussed above in connection with Table 1, the Residential Troubles Not Cleared benchmark was set not at Verizon’s *average* performance in the three years prior to 1995, but at its *worst* performance, making it a less stringent standard to meet than if the average were used as the benchmark. Moreover, it does not appear that the repair workload for retail customers has increased: as shown in Table 3, the number of customer troubles (shown as “Customer Trouble Reports, Rate per 100 Lines—Network”) has not changed markedly over the past three years. Verizon has consistently met the “*Business Troubles Not Met*” benchmark; its failure to meet the “*Residential Troubles Not Met*” benchmark suggests that it may not have enough maintenance and repair technicians to keep up with its residential customers’ service troubles, although there could be other reasons for Verizon’s consistent failure to meet this and other benchmarks. To determine whether stronger penalty-rebate incentives are necessary, however, it is not essential to uncover all the underlying reasons for Verizon’s performance in this area. We do know that it is likely that the present SQI penalty mechanism does not provide a sufficient incentive for Verizon to meet the benchmarks for Residential Troubles Not Met and certain other repair-related metrics. .

In addition, Verizon has continued to perform worse than the benchmark for Residential Troubles Not Cleared in the current SQI year. Verizon’s performance for this metric was 42.1% in July 2004, 40.8% in August, and 30.4% in September; thus Verizon’s average performance over those months was 37.8%, or 79% worse than the benchmark of 21.1%. Table 3 also shows that Verizon had two consecutive years of below-standard performance for four other metrics: Premise Repair Appointments Not Met, Mechanized Repair Appointments Not Met, Held Orders, and PUC Complaint Ratio.⁷

In responding to questions about its residential repair performance at a service quality meeting with the Commission on October 14, 2004, Verizon observed that since 1995, when the benchmarks for the original SQI metrics were set (including that for Residential Troubles Not Cleared), the Telecommunications Act of 1996 took effect, requiring Verizon to open its network to competition. As a result, Verizon’s technicians, in addition to installing and repairing services for its retail customers, must also install and repair network elements for competitive local exchange carriers (CLECs). According to information the Commission obtained in its investigation of

⁶ In the Verizon AFOR, the “SQI Year” begins July 1st and ends the following June 30th.

⁷ If the CAD continues to receive consumer complaints about Verizon at the same rate as in the first five months of the current SQI year, Verizon will exceed the benchmark for the “PUC Complaint Ratio” by about 40%.

Verizon's performance in the January 2002 ice storm,⁸ Verizon gives priority to CLEC services over its retail services. Despite these workload additions for Verizon's outside plant workforce, however, Verizon also reported at the service quality meeting that it has *reduced* the number of outside plant technicians by 17% over the past four years.

Another reason Verizon gave for its poor performance on the SQI's repair metrics is that the SQI benchmarks are the most stringent of all the Verizon states; an assertion Verizon has also made in the past.⁹ We do not view this claim as relevant, however. As we indicated above, the original 1995 benchmarks, and the additional 2001 metrics were both set at Verizon's actual performance in Maine over 3-year periods; the 1995 benchmarks were set at Verizon's *worst* performance over the three years and the benchmarks for the revised 1995 and additional 2001 metrics were set at Verizon's *average* performance over a more recent 3-year period. We therefore have set Verizon's service quality standards to reflect its performance in Maine, and not its performance (or any other telephone utility's performance) in other states.. As we emphasized in the First AFOR Order and above in this Notice, it was our intent that Verizon should provide the same (or a better) level of service quality that it did in the years prior to the AFOR.

IV. ADDITIONAL SERVICE QUALITY PROBLEMS

A. Length of Repair Times

We are also concerned about both the number and the duration of the outages experienced by some Verizon customers. Only a small percentage of total outages (as shown in the Troubles Not Cleared within 24 Hours metrics) result in complaints filed with the Commission's Consumer Assistance Division (CAD) (which contribute to the PUC Complaint Ratio). Nevertheless, the number of complaints about

⁸ Public Utilities Commission, Investigation into the Adequacy of Utility Services in Maine During Power Outages, Docket No. 2002-151.

⁹ Prior to the most recent service quality meeting, the staff had specifically asked Verizon to present other Verizon states' benchmarks. Verizon's response at the meeting, however, was that every state measures service performance differently, so that the benchmarks are not comparable. But if that is true, there is no way Verizon can know the benchmarks in Maine are the most stringent of all Verizon states. The limited information staff has independently obtained from other states indicates that Verizon is correct that most states' benchmarks are not comparable, but also that its claim that Maine's standards are more stringent than other states is unsupported. The Staff was able to find one state, Illinois, that had a comparable metric ("On a monthly basis, each local exchange carrier shall clear 95% of all out-of-service troubles up to the customer network interface within 24 hours after such troubles are reported by the customer." Illinois Admin. Code, Title 83, Section 830.535), but its benchmark (5%) is far more stringent than Maine's (21.1% for Residential customers, 9% for Business customers).

all outages received by the CAD from Verizon customers has increased each year of the past three SQI years. If those complaints continue at the same rate as in the first six months of the current SQI year, the number of outage complaints for 2004-2005 will be more than double the number received in 2003-2004.

We do not propose in this Notice to address the number of outage complaints filed with the Commission because these are measured by the Troubles Not Cleared and PUC Complaint Ratio metrics. We do propose, however, to address the length of outages. Of the outages complained about to the CAD, most lasted significantly longer than 24 hours. We recognize, of course, that customers with long outages are more likely to complain than those experiencing an outage of one or two days. From July through mid-December 2004 (nearly the first six months of the current SQI year), the CAD received a total of 21 outage complaints from Verizon customers. As shown in Table 4, 15 were about outages that were longer than 48 hours; all but one were for 3 days or more. During the nearly 6-month period, the average customer outage resulting in a complaint to the CAD lasted 6 days.

Table 4: Outage Complaints Filed with the CAD for Outages Lasting More Than 48 Hours

	48-72 hrs	4-5 days	6-8 days	9-11 days
No. of Complaints	1	7	3	4

The existing Residential and Business Troubles Not Cleared metrics do not distinguish among outages that last only a short time beyond 24 hours and those that last many days; outages of all lengths are given equal weight. The SQI recognizes lengthier outages as different in kind only to the extent that they are included in the CAD Complaint Ratio when customers complain about them to the CAD.

Customers filing complaints also complained about repeated outages; some claimed that service appointments scheduled by Verizon were not kept until days after the outage report was filed or were not kept at all. Some examples of recent outage complaints made to the CAD include:

- A customer in Woodland notified Verizon on July 1 that he was without service. His service was not restored until July 12. The outage occurred when Verizon cut the customer's pairs while performing a cable rearrangement.
- A customer in Monroe lost his service on July 2. He contacted Verizon on July 2, 3, 4, and 5, but his service was not restored until July 6 when a damaged cable was repaired.
- Seven customers in Richmond were without service for 5 days in July and August due to a cable failure and software issues.

- A customer in Portland lost service in early August and was not restored until August 16. The customer's line had to be rewired at the frame.
- About 20 customers in South Portland lost service on August 12. One customer complained that Verizon made a repair appointment for August 14, but never showed up. Service was restored August 18 when a cable was repaired.
- A customer in Auburn lost service on August 11 and contacted Verizon. Service was restored August 18. The outage occurred because Verizon crossed the customer's pairs with another customer.
- A customer in Center Lovell lost service on August 13. When he reported the outage, Verizon was unable to tell him the cause or when it would be fixed. Service was restored August 18 when a split cable was repaired.
- Several customers in Springvale lost service on November 30. The customers complained that each time they called Verizon they were told their service would be restored by 6 p.m. However, service was not restored until December 9 when a wet cable was repaired. Several of these customers continued to be without service until December 13 because their cable pairs were crossed, so they could not receive telephone calls.

B. Billing Errors

Numerous billing errors by Verizon have also come to our attention in the past year. Between November 2003 and August 2004, Verizon failed to bill per-minute charges to customers who had subscribed to the BSCA economy option for calls made to premium areas within their BSCAs; in June 2004, Verizon failed to file a rate schedule change for an increase to MTS rates, but charged customers the increased rates anyway;¹⁰ on July 4, 2004, all MTS customers were charged the incorrect rate for calls placed that day; customers whose bills were issued July 15 and July 18, 2004 were charged twice for Verizon toll charges incurred in the previous billing period; in August 2004, Verizon incorrectly assessed \$8,094.83 in late charges to 11,963 customers who paid their bill on the same day the bill was due; and all bills issued

¹⁰ Title 35-A M.R.S.A. § 309(1) prohibits a utility from charging a "greater or lesser" rate than is contained in its rate schedule. Verizon also failed to notify MTS customers of the rate increase, as required by 35-A M.R.S.A. § 7307 and Chapter 292, § 9 of our Rules. Even if Verizon had included the increase in its rate schedule, under Section 7307(2), a rate increase cannot become effective until the customer has been provided with notice of at least 25 days, as required by Section 7307(1)(B).

August 18 and August 21, 2004 charged MTS customers the incorrect rate for calls placed between August 18 and August 21.

Verizon reported and corrected all of these problems quickly. Nevertheless, we are concerned these billing errors may indicate a more systematic problem with Verizon's billing system or that its service quality problems extend beyond its repair operations. It is possible that Verizon's problems may be linked to the significant reduction in staff, as well as loss of expertise, associated with its early retirement offering and past layoffs. There is no present metric that measures billing errors or the number of customers they affect; they are included in the SQI (the PUC Complaint Ratio) only to the extent that customers complain about them to the CAD.

IV. DESCRIPTION OF POSSIBLE CHANGES TO THE SQI PENALTY-REBATE MECHANISM

A. Need for Modifications

We intended the SQI penalty mechanism for below-standard service quality to provide Verizon with a financial incentive to maintain pre-AFOR service quality even though the pricing provisions of the AFOR serve as a powerful incentive to cut costs. It appears that the SQI's penalty incentive has not achieved its purpose, at least over the past three years. Verizon has failed to meet several service-related benchmarks during that period and has not taken the steps necessary to correct its below-standard service quality.

We are concerned that Verizon may have decided that the cost savings that it realizes from a degraded level of service quality (perhaps due to a decreased number of service technicians) may exceed the penalty amounts for the residential trouble reports cleared and other repair metrics, and that it has decided to accept the penalties as a cost of doing business. Our concern is heightened by the fact that the service quality problems of Verizon New England (the Verizon operating company that provides service in five New England states) appear to extend beyond Maine. The New Hampshire PUC opened an investigation into Verizon's service quality on March 19, 2004. In its Notice of Investigation, the New Hampshire Commission stated that its staff found that "...as Verizon's work force and capital spending have been reduced, several quality of service indices, most notably the repair service indices, have deteriorated." The repair service response time metric is one of the primary problems for Verizon in New Hampshire. In addition, Vermont recently assessed Verizon an \$8 million penalty for non-compliance with its service quality measures. The experience in these other New England states suggests that it cannot be claimed that the data in Maine over the past few years is insufficient to indicate a systematic problem.

Accordingly, we will consider whether to strengthen the incentive for Verizon to meet the service quality benchmarks by revising the penalty mechanism refunds to customers.

B. Possible Revisions

We will consider revisions to the SQI's customer rebate mechanism as described below. If we make changes to the rebate-penalty structure, we propose that they will be prospective and request comment concerning when they should become effective. We seek comments on the possible revisions.

We do not plan to consider changes to the basic per-metric rebate formula, but will consider *additional* rebates for each metric for performance in repeated months and years that is worse than the benchmark, and for performance that is worse than the benchmark by specified significant amounts. We also do not intend to consider any change to the total rebate cap, but will consider eliminating the per metric rebate caps.¹¹ Leaving the per-metric caps in place might limit the effect of some of the new penalties described below. As one of the examples below indicates, the cumulative effect of the existing and additional penalties for a metric could exceed the per-metric cap. The purpose of the new penalties that we are considering is to provide Verizon with stronger incentives than at present to meet the SQI's service quality benchmarks; leaving the per-metric caps in place might significantly diminish those additional incentives.¹²

We will consider the following new penalties:

1. If Verizon fails to meet a metric's benchmark for three or more consecutive months, Verizon would owe a rebate (in addition to any rebate owed under the current SQI structure) equal to the number of consecutive months divided by 12, times the amount determined by the per metric rebate formula (the "base rebate"), using the average of the consecutive months' performance rather than annual performance in the formula. This penalty would apply even if there is no annual penalty-rebate under the existing Annual Performance structure. It would not apply to either the "Major Service Outage" or the "PUC Complaint Ratio" metrics because their benchmarks are based on cumulative, rather than average, performance.

2. If Verizon's annual performance is worse than a metric's benchmark in two or more consecutive years, Verizon would owe an additional customer rebate amount equal to the number of consecutive years times the base rebate, with the average of the consecutive years' performance replacing the annual

¹¹ The rebate cap for the Service Outage metric is \$2.27M; the cap for all other metrics is \$1.135M.

¹² On the other hand, we see no need to modify the overall cap (for all metrics) of \$12.5 million, as there is no present indication from the examples below that Verizon is likely to exceed that aggregate amount.

performance in the per metric rebate formula. This additional penalty/rebate would apply only if Verizon failed to meet the annual benchmark in the current SQI year, i.e., if it incurs a penalty under the existing Annual Performance structure.

3. If average performance for a metric is worse than the benchmarks by specified levels stated below, the penalty will be multiplied by the factors also stated below. These enhanced penalties will apply under the existing Annual Performance penalty and under the additional penalties described in paragraphs 1 and 2 above. If the average performance under any of these three penalty categories is worse than the benchmark by more than:

- 25%, each resulting base rebate would be multiplied by two;
- 50%, each resulting base rebate would be multiplied by three;
- 75%, each resulting base rebate would be multiplied by four;
- 100%, each resulting base rebate would be multiplied by five.

An additional penalty under this paragraph could be imposed for annual performance that is significantly below average (i.e., under the existing penalty-rebate structure) and for consecutive monthly performance that is significantly below average (the new penalty described in paragraph 1). It could be imposed for consecutive annual performances that were significantly below average only if Verizon incurs a penalty in the current SQI year under the existing Annual Performance structure.

All rebates resulting from these changes to the customer rebate mechanism would be accrued, and the total rebate will be credited to customer bills after the end of the SQI year.¹³

C. Sample Calculation of Additional Customer Rebate Revisions

1. Additional Annual Penalties for the 2003-04 SQI Year

The following examples show the effect of the potential changes described above if they were applied to the 2003-04 SQI results, assuming they had been in effect at the beginning of the 2003-04 SQI year. Under that assumption, Verizon would have incurred the following *additional* penalties:

Premise Repairs: % Appointment Not Met—Company Reasons

Verizon incurred an annual penalty of \$58,194 for this metric. Because Verizon performed worse than the benchmark for seven consecutive months (July 2003—January 2004), and because its average performance over those seven

¹³ As it is in the present SQI, if the total rebate is at least \$1 million, the rebate is divided by 12 and the resulting amount would be credited on customer bills in 12 consecutive months.

months was 31.5% worse than the benchmark, the resulting additional penalty would have been \$137,880.

Mechanized Repairs: % Appointments Not Met—Company Reasons

Verizon incurred an annual penalty of \$12,483 for this metric. Because Verizon performed worse than the benchmark in five consecutive months (October 2003—February 2004), and because its average performance over those months was 40.4% worse than the benchmark, the resulting additional penalty would have been \$65,534.

Held Orders: Average Total Delay Days

Verizon incurred an annual penalty of \$15,700 for this metric. Because Verizon performed worse than the benchmark in three consecutive months twice (November 2003--January 2004 and March—May 2004), the resulting additional penalty would have been \$51,429.

Customer Trouble Reports: Rate per 100 lines – Network

Verizon incurred an annual penalty of \$20,833. Because Verizon performed worse than the benchmark for three consecutive months (April—June 2004), the resulting additional penalty would have been \$14,468.

%Troubles Not Cleared Within 24 hrs—Residence

Verizon paid \$469,194 penalty for this metric. Under the additional penalty-rebates Verizon would have paid the following amounts: 1) \$938,388 because it performed 63% worse than the benchmark over the 2003-04 SQI year; 2) \$1,606,632 because it performed 92% worse than the benchmark in seven consecutive months (July 2003—January 2004); and 3) \$177,724 because it performed 47% worse than the benchmark in three consecutive months (April—June 2004). The total additional penalties for this metric would have been \$2,722,746.

Total Additional Annual Penalties for the 2003-04 SQI Year

If the changes to the rebate mechanism described above had been in effect at the beginning of the 2003-04 SQI year, the total additional penalty for the five metrics described above would have been \$2,992,057.

2. Additional Multi-Year Penalties

If the changes described above for additional penalties-rebates for poor multi-year performance had been in effect beginning with the 2001-02 SQI

year,¹⁴ Verizon would owe additional customer rebates of \$1,285,878 for two consecutive years of below-standard performance for four metrics: Premise Repair Appointments Not Met, Mechanized Repair Appointments Not Met, Held Orders, and the PUC Complaint Ratio. The base rebate of each of those four metrics would be doubled because of Verizon's worse than benchmark performance in two consecutive years. In addition, the resulting Complaint Ratio rebate would be doubled again, because Verizon's two-year average performance was 31.7% worse than the benchmark.

Verizon also would have owed \$1,727,460 for three consecutive years of below-standard performance for the Residential Troubles Not Cleared metric. The base rebate for this metric would have been tripled because of Verizon's worse than benchmark performance in three consecutive years, then that result would be doubled, because the 3-year average performance was 38.4% worse than the benchmark.

The additional customer rebate for below-standard service quality in consecutive years would have been \$3,013,338.

3. Total Effect

If both the annual and multi-year changes described above had been in effect during the periods described in the example, the total *additional* customer rebate for the 2003-04 SQI year would be \$6,005,395.

V. ISSUES FOR PARTIES TO ADDRESS

In addition to the question of whether we should adopt the changes described above, we request the parties to address three other issues. First, if we decide to make the changes to the SQI rebate-penalty structure described below, should we implement those changes immediately or should we implement them only when we commence a new AFOR (or other form of regulation) following the expiration of the current AFOR (June 30, 2006)? Second, does the Commission have the authority to require an SQI and a penalty-rebate mechanism outside of the context of an AFOR?

Third, the modifications under consideration include penalty-rebates for below-benchmark performance in consecutive months or years. If we adopt these, we do not propose to apply them directly to SQI performance that took place during periods prior

¹⁴ For the purpose of this example, we have assumed that the years (here, the 2001-02 through 2003-04 SQI years) that occurred prior to the effective date of any new penalty-rebates could be used in calculating a penalty under the potential new penalty for below-benchmark performance in consecutive years. In Part V, we request comment on whether we should use pre-change years in such a calculation.

to the effective date of the change. Thus, penalties imposed or incurred for performance prior to the changes would not be affected. There remains a separate question, however, whether below-benchmark performance during a pre-change year or month may serve as a period used in the calculation of a penalty for failing to meet a benchmark in two or more consecutive years or three or more consecutive months, as long as the last of those years or months occurs after the effective date of the change.

There are at least two possible considerations that might be relevant to this issue. First, Verizon never received notice during years (and possibly some months) prior to the change that its performance in those prior periods might be used in the future for calculating consecutive-period penalties. Second, the purpose of any of the potential new penalties is to provide incentives for future performance, and Verizon could avoid the imposition of penalties for sub-benchmark performance in consecutive periods simply by improving its performance in post-change periods. We request parties to address both of these considerations as well as others they may want to raise.

VI. INVESTIGATION OF VERIZON'S SERVICE QUALITY

We also open an investigation into the level of Verizon's service quality and its activities resulting in what appears to be a deterioration of that service quality. We open the investigation pursuant to 35-A M.R.S.A. § 1303, which allows us to investigate whether "a service is inadequate or cannot be obtained" or "any matter relating to a public utility." Under 35-A M.R.S.A. § 1306(2), the Commission may find that a "practice, act or service" of a utility is "unreasonable" or "insufficient" or "otherwise in violation of this Title." Title 35-A M.R.S.A. § 301(1) requires all public utilities to furnish "safe, reasonable and adequate facilities and service." Section 1306(2) also allows the Commission to find that "a service is inadequate or that reasonable service cannot be obtained." Finally, Section 1306(2) grants the Commission broad remedial powers: the Commission "may by order establish or change ... practice, service or acts, as it finds to be just and reasonable."

We open this investigation for two purposes. The first is to determine whether we should take any direct action (e.g., issue an order requiring changes to Verizon's service practices) with regard to the service parameters that are the subject of the various metrics of the SQI that Verizon has had difficulty meeting, as described above. Second, we need to determine whether any direct action is necessary with regard to the billing mistakes and lengthy repair delays (well in excess of 24 hours) described above. Existing SQI metric do not directly track billing errors or the length of repair delays.¹⁵

¹⁵ As discussed above, the lengthy outages will be included in the Troubles Not Cleared metrics, but will be indistinguishable from shorter outages. Both the lengthy outages and billing errors may be reflected in the CAD Complaint ratio, but only to the extent that customers complain about them to the CAD.

Initially, we need to determine the extent of the problems in those two areas. If we find that remedial action is necessary, we must then consider what actions we might take, including possible orders that would require specific changes in Verizon operations or, if sufficient baseline data are available, additional metrics.

VII. CONCLUSION

Over the past three years, we have observed persistent problems with the adequacy of Verizon's response to residential outages. We believe, as the regulatory agency charged with oversight of utility service, that it is our obligation to ensure that these problems are corrected and that degradations in other areas of service are not occurring. Because of Verizon's ongoing and apparently increasing customer service problems, we decide that Verizon's customer service performance warrants comprehensive review at this time. We therefore take two actions in this Notice. First, we reopen the AFOR case (Docket No. 99-851) to consider whether we should modify the penalty-rebate structure of the SQI as described above. Second, we open a formal investigation of Verizon's customer service practices pursuant to 35-A M.R.S.A. § 1303 to determine whether the service quality provided by Verizon is deficient, whether to require Verizon to modify its operations, and whether to create additional incentives (e.g., new metrics) for improved service quality. In the latter investigation, we will issue data requests to Verizon, requiring it to provide detailed information about trouble reports not cleared within 24 hours for the past three years, including the locations and durations of outages, the number of customers affected, and the causes and resolutions.

Accordingly, we

1. REOPEN the investigation of Verizon's alternative form of regulation (AFOR) in Docket No. 99-851, for the purpose of considering changes to the penalty-rebate mechanism of the service quality index that is part of the AFOR;
2. OPEN a formal investigation in Docket No. 2005-24 to address the quality of service provided by Verizon to its customers and the remedies, if any, that are necessary to ensure that Verizon provides reasonable customer service levels;
3. ORDER that the persons who were parties in the AFOR Investigation in Docket No. 99-851 shall continue to be parties in that proceeding and shall be parties in the new Investigation in Docket No. 2005-24, unless they provide notice to the Commission that they do not wish to participate. If a party that is a party in this proceeding solely because it was a party in Docket No. 99-951, and does not file comments as permitted by paragraph 4, that party will continue to be a party only if it files a letter by the comment deadline stating that it wishes to continue to be a party; and

