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Annual Report on the Alternative Form of Regulation for Telephone Utilities

Report to the Utilities and Energy Committee from the Maine Public Utilities Commission September 1, 2005

Title 35-A M.R.S.A., section 9105 requires the Maine Public Utilities Commission to provide the Utilities and Energy Committee with an annual report describing the Commission's activities under Chapter 91 and the effectiveness of any adopted alternative form of regulation (AFOR) in achieving the objectives of Chapter 91. This report constitutes the Commission's compliance with the annual reporting requirement of Chapter 91.

In 1994, the Maine Legislature enacted Chapter 91 of Title 35-A, which authorized the Commission to adopt an AFOR for any telephone utility in the State, provided certain conditions were met. In 1995, the Commission adopted an AFOR for Verizon, then known as NYNEX. In 2001, the Commission extended the Verizon AFOR for an additional five years, but it made several significant changes to the pricing rules and Service Quality Index (SQI) mechanism. The Office of the Public Advocate (OPA) and the American Association of Retired Persons (AARP) appealed the Commission's Order to the Law Court. In February 2003, the Law Court remanded the case back to the Commission for further proceedings because the Court found that the Commission had failed to make the determination required in Section 9103 (1) that rates under the AFOR would be no higher than they would be under traditional regulation for the duration (five years) of the AFOR.

After conducting further proceedings, in September 2003, the Commission issued its Order Reinstating AFOR, finding that it was not possible to make the comparative finding contained in Section 9103(1), at least not with the degree of certainty indicated by the Court. Instead, the Commission made the alternative finding, which the Court had indicated was permitted by Section 9103, that it was not in the public interest to make the comparative rate assurance described in the statute. The reinstated AFOR contained identical provisions to those present in the AFOR that was vacated by the Law Court. The Public Advocate and the AARP appealed the Commission's AFOR reinstatement order, and in January 2005, the Law Court vacated the Commission's Order and remanded the matter back to the Commission. The Court found that to determine whether bypassing the rate comparison is in the best interests of ratepayers, as well as to determine the feasibility of making a revenue requirement assessment and five-year comparative rate assurance, the Commission must have a more complete record.¹

¹ The extensive litigation over the Verizon AFOR resulted largely from the Commission's difficulty in finding a meaningful way of complying with section 9103(1) which states that ratepayers "may

To comply with the mandate of the Law Court remand, on March 5, 2005, the Commission issued a Notice of Investigation that opened a new proceeding to consider a new AFOR for Verizon. The proceeding will address the requirements of the AFOR statute, and any AFOR adopted will replace the one vacated by the Court. Based on discussions with the parties, the Commission divided the AFOR case into two phases, with Phase 1 addressing the current revenue requirements of Verizon, based primarily on traditional ratemaking principles, such as costs, capital investment and rate of return. Phase 2 will address the structure of the AFOR, including pricing rules for all services, service quality issues and the multi-year rate comparison prescribed by the statute and required by the Court.

Verizon did not file written testimony, but it did provide details of its Maine financial results, which formed the basis for initiating Phase 1 of the case. The initial discovery portion of Phase 1 (on Verizon's financial results) is almost complete, and initial testimony from the intervenors (OPA and AARP) is due on September 1, 2005. Verizon will have an opportunity to file rebuttal testimony. Phase 2 will begin in mid-September with simultaneous filing of testimony by all parties and will proceed on a parallel track with Phase 1. The parties have proposed a schedule that would complete both phases of the case in early spring of 2006. Unless an acceptable settlement is reached, the Commission will issue its order on both phases at that time.

While the current AFOR case is in progress, Verizon remains subject to all provisions of the remanded AFOR, including pricing flexibility on almost all services except basic exchange and the Service Quality Index, which requires that Verizon pay penalties for actual performance that is below the benchmark for any metric. During the July 2004 to June 2005 AFOR year, Verizon failed to meet two of the SQI metrics, and therefore under the terms of the AFOR, it owes a credit to all customers, which most likely will appear on December bills. The amount of the credit is not finally established at this time, because Verizon has asked for an adjustment to the types of complaints that are included in the calculation of the PUC complaint ratio metric, one of the benchmarks that the Company failed to meet. If the Commission rejects Verizon's requested adjustment, the maximum amount of penalty incurred by Verizon for 2004/2005 would be approximately \$639,000, but if the Commission allows the adjustment sought by the Company, the penalty amount could be reduced to about \$596,000. The Commission will render its decision on this request during September.

not be required to pay more for local telephone service as a result of the implementation of an alternative form of regulation than they would under traditional rate-base or rate-of-return regulation." Although the objective of this provision is eminently reasonable, determining what rates would have been under a system of regulation that has not been in effect for several years and making a comparison with a system that has been in effect is a highly speculative undertaking that does not easily lend itself to the level of certainty the statute seems to contemplate.

Two independent telephone companies, Pine Tree Telephone Co. and Saco River Telephone Co., have asked the Commission to allow them to operate under an AFOR mechanism, pursuant to the AFOR statute. In June 2005, the Commission opened an investigation into the companies' requests, and the cases are in their initial stages. The Commission is waiting for the companies to file financial data and the parties to propose a schedule for each case, as ordered by the Commission.