Annual Report on Alternative Forms of Regulation for Telephone Utilities

Report to the Utilities and Energy Committee
by the Maine Public Utilities Commission

September 4, 2008

I. INTRODUCTION

Title 35-A M.R.S.A. Chapter 91 governs alternative forms of regulation for telephone companies. Section 9105 requires the Maine Public Utilities Commission (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 for 2007.

II. SUMMARY OF COMMISSION ACTION SINCE LAST ANNUAL REPORT

A. Verizon

1. Background Concerning Pending AFOR Proceeding (Docket No. 2005-155)

In 1994, the Maine Legislature enacted Chapter 91 which authorizes the Commission to adopt an AFOR for any telephone utility in the State, provided certain conditions are 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 5 years, but it made several significant changes to the pricing rules and Service Quality Index mechanism. The Office of the Public Advocate (OPA) and the American Association of Retired Persons (AARP) appealed the Commission's 2001 AFOR Order to the Law Court. In February 2003, the Law Court remanded the case back to the Commission for further proceedings after finding that the Commission had failed to make the determination required in § 9103(1) that rates under the AFOR would be no higher than they would be under traditional regulation for the duration (5 years) of the AFOR.

In September 2003, after conducting further proceedings, the Commission issued its Order Reinstating AFOR, finding that it was not possible to make the comparative finding contained in § 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 § 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 OPA and the AARP appealed the Commission's 2003 AFOR Reinstatement Order, and in January 2005, the Law Court vacated the Commission's Order and again 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 5-year comparative rate assurance, the Commission must have a more complete record.[1]

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. This proceeding was assigned Docket No. 2005-155. The proceeding was intended to address the requirements of the AFOR statute, and any AFOR adopted would replace the one vacated by the Court. After discussions with the parties, the Commission divided the new AFOR case into two phases. Phase I addressed the current revenue requirements of Verizon, based primarily on traditional ratemaking principles, such as costs, capital investment and rate of return. Phase II was to 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.

The witnesses for all parties filed written testimony between September 2005 and June 2006, and hearings were scheduled for the summer of 2006. Several parties raised the possibility of a negotiated settlement of the case, and during the summer of 2006 the parties, including the Commission's Advisory Staff, engaged in settlement discussions in an attempt to resolve the issues surrounding both phases of the case. When those discussions proved unsuccessful, hearings covering all issues in both phases of the case were held during the fall of 2006.

2. Current Status of AFOR Case

After the completion of hearings in the Fall of 2006 but prior to the date on which briefs were initially due to be filed, the parties again engaged in negotiations attempting to settle all (or at least some of) the issues in the case. In December 2006, the parties notified the Commission that an agreement still could not be reached. Because of time devoted to the

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

negotiations, briefs on Phase I were delayed for a short period, but were eventually filed on January 26, 2007.

Around the same time, on January 31, 2007, Verizon Maine and FairPoint Communications, Inc. filed a request for approval of a transfer of Verizon's assets and employees' and customers' relationships (with the exception of some enterprise and governmental lines of business) in Maine, New Hampshire and Vermont to FairPoint Communications. FairPoint currently owns six rural telephone local exchange carriers in Maine. Under the proposal, FairPoint would take over all of Verizon's local exchange, long distance and Internet business operations in the three states.

On May 9, 2007, the Hearing Examiner issued his Report on the Phase I issues. The Examiner's Report recommended that the Commission find that Verizon presently was over earning, and its revenues should be reduced by $32.4 million on an annual basis. Concurrent with the release of the Report, the Examiner asked for comments on what the Commission should do with any findings it might make as a result of considering the Examiner's Report. The Examiner also requested comments on the rate design that the Commission should employ, assuming the Commission were to find that a rate reduction was necessary. Phase II issues were not briefed.

Just prior to the deadline for exceptions to the Phase I Examiner's Report in the AFOR case, the parties requested an extension of the deadline to allow for continuing negotiations that, they asserted, could lead to a resolution of a "significant portion of the case" and could result in accelerated broadband build-out. The Commission granted the extension request and on July 3, 2007, the OPA and Verizon filed a Stipulation in the AFOR case that would (1) suspend further proceedings in that case until after the conclusion of the Commission proceeding involving the proposed transfer of Verizon's assets to FairPoint Communications, and (2) require Verizon, prior to the conclusion of the proposed transfer proceeding, to invest $12 million in infrastructure that would provide DSL service to additional customers.

The AARP opposed the Stipulation, both in written comments and at a hearing concerning the Stipulation that was held on July 24, 2007. The Telephone Association of Maine (TAM) did not sign the Stipulation, but it supported the agreement in written comments and at the hearing.

On July 26, 2007, the Commission held a Deliberative Session on the Stipulation, and on July 30, 2007, the Commission issued its Order Rejecting the Stipulation. The Commission was unable to find that the agreement met applicable legislative mandates or that the stipulated result would be in the public interest. In its Order, the Commission directed the parties to file exceptions to the Phase I Examiner's Report in the AFOR case by August 10, 2007, and if the parties intended to file a revised stipulation, they were also to do so by that same date.

On August 8, 2007, the OPA and Verizon filed an *Amended Stipulation* in the AFOR case that purported to resolve most of the concerns expressed by the Commission during its deliberations on the original Stipulation. The Amended Stipulation contained essentially the same terms as the original agreement, but it also (1) identified the locations (central offices and remote terminals) and the number of lines at each location where Verizon would make DSL service available pursuant to its commitment to spend $12 million; (2) established February 1, 2008, or the merger closing date, whichever would occur first, as the date certain for Verizon to complete its DSL build-out commitment; (3) established a date certain (180 days after the Verizon/FairPoint transfer closing or its termination), but in no event later than July 31, 2008, as the date for the dissolution of the stay of the AFOR proceeding; and (4) enhanced the Commission's ability to enforce the terms of the Stipulation via an escrow account, which would be invoked if Verizon failed to meet its $12 million DSL commitment prior to the transfer closing date or at February 1, 2008 (whichever would occur first), and expanded the reporting requirements by Verizon with monthly (instead of bi-monthly) reports that would delineate specific deployment progress. With the filing of the Amended Stipulation, the OPA and Verizon also requested that the Commission extend the deadline for filing exceptions to the Examiner's Report in the AFOR case until after the Commission had considered the Amended Stipulation.

On August 14, 2007, the Commission held a hearing on the Amended Stipulation, and it considered the agreement at Deliberations that followed the hearing. The AARP continued to oppose the Amended Stipulation, and TAM expressed its continued support for the agreement. The Commission found that the Amended Stipulation met the criteria for acceptance and voted unanimously to approve it. In doing so, the Commission expressly stated that it retained its authority to reopen its approval and lift the stay in the AFOR case for any reason (after appropriate due process), should it find it necessary to do so. The Commission acknowledged its responsibility to process the AFOR case, but found that delaying consideration of the AFOR issues for a short period in order to complete work on the transfer of assets proceeding, while simultaneously promoting the availability of DSL service to about 35,000 additional Verizon customers, was in the public interest.

During October 2007, the Commission held evidentiary hearings in the transfer of assets proceeding, which is also known as the merger case. Witnesses supporting and opposing the merger were heard and cross examined, and all parties filed briefs on November 2, 2007. On November 26, 2007, the Commission's Advisory Staff issued its Hearing Examiner's Report, which recommended denial of approval of the transaction. However, the Examiner's Report also contained a list of 47 conditions (in eight topic areas) that the Commission should impose on any approval of the merger, should the Commission disagree with the Examiner's overall recommendation to reject the transaction. The Advisor's recommended conditions were designed to protect the interests of retail and wholesale customers in Verizon's service territory, improve service quality, expand the availability of broadband in the acquired service territory and improve the financial integrity of FairPoint after the merger. The most important conditions were a reduction in the purchase price of $600 million and a reduction in FairPoint's dividend level after the merger, with the cash used to pay some down some of the relatively high debt amount that FairPoint would take on in order to complete the transaction.

The Commission scheduled deliberations on the Examiner's Report for December 13, 2007, and in the early morning of December 13th, Verizon, FairPoint, the OPA and the Commission's Advocacy Staff submitted a partial, contested Proposed Stipulation for the Commission's consideration. The Proposed Stipulation purported to resolve a number of issues in the merger case and to resolve all issues associated with the AFOR proceeding. On the same day, the Labor Intervenors filed a Motion for Evidentiary Hearing and notified the Commission that it contested the Proposed Stipulation. Another intervenor, the Privacy Complainants, also informed the Commission that they opposed those portions of the Proposed Stipulation relating to privacy issues.

The Commission held both a hearing and deliberations on December 20, 2007 to consider: (1) whether the Proposed Stipulation partially met the Commission's three-part test for stipulations; (2) whether the consideration of a partial contested stipulation was in the public interest; and (3) Labor Intervenors' Motion for an Evidentiary Hearing. The Commission heard from all parties on these issues, and the Commission only deliberated the Labor Intervenors' Motion for an Evidentiary Hearing. The Commission determined that Labor had not presented any genuine issues of material fact requiring an evidentiary hearing and scheduled a hearing on the Proposed Stipulation for December 26, 2007. The Commission also raised certain areas of concern about the Proposed Stipulation and set a deadline of December 21, 2007, for the filing of any amendments to the Proposed Stipulation.

On December 21, 2007, the Hearing Examiner granted the motions of both the Labor Intervenors and the OPA to delay the hearing until January 3, 2007. That same day, an Amended Stipulation was filed for the Commission's consideration by FairPoint, Verizon, the OPA, the Commission's Advocacy Staff, GWI, Cornerstone and the AARP.

On January 3, 2007, the Commission held a hearing on the Amended Stipulation. Additional amendments to the Amended Stipulation were made during the course of the hearing. After completing the hearing, the Commission commenced its deliberations of the Amended Stipulation. On

January 9, 2007, the Commission deliberated all remaining issues, including those not addressed by the Amended Stipulation.

The Amended Stipulation was joined by FairPoint, Verizon, the OPA, the Advocacy Staff, GWI, Cornerstone, and AARP. In addition, U.S. Cellular and Oxford Networks supported it, and Mid-Maine Communications, Pine Tree Networks, One Communications and TAM took no position either for or against it. Labor contested the Verizon/FairPoint Transaction portions of the Amended Stipulation, arguing that it was the only party that represented certain employee-related interests and that the financial provisions of the Amended Stipulation were not sufficient to protect ratepayer interests. The Privacy Intervenors also contested the Verizon/FairPoint Transaction provisions of the Amended Stipulation that address FairPoint's privacy policy and the Commission's jurisdiction over the *NSA Proceeding.*

The Commission made various findings, based on statutory criteria and the standards that it had previously articulated for the approval of stipulations. The Commission found that the parties to the Amended Stipulation represented a sufficiently broad spectrum of interests that was sufficient to satisfy its standard in this area. The Commission also found that the process leading to the Amended Stipulation was fair and that all parties had an equal opportunity to participate. Finally, the Commission found that the stipulated result, as amended by the parties and conditioned by the Commission, was reasonable and was consistent with legislative mandates and the public interest – both for the merger case and for the AFOR proceeding.

In regard to the merger transaction, the Commission found that the Amended Stipulation, as further conditioned by the Commission, resulted in benefits for Maine consumers. First, FairPoint has much experience serving rural areas, and unlike Verizon, will direct its focus to Northern New England. In addition, FairPoint will install new back office systems that should allow the Company to better manage its business and to provide superior service to customers. FairPoint also committed to service quality improvements, specific infrastructure investment, rate stability and the creation of at least 280 new jobs in Maine. The Amended Stipulation also settled all issues in the AFOR proceeding and provides an immediate rate decrease of $18 million annually, as well as five years of rate stability. In addition, FairPoint has agreed to spend $57.55 million over the first five years of its ownership to increase broadband availability, with the specific target of reaching 90% of all access lines in its territory, including 82% of the lines in the most rural areas. Certain penalties will be imposed if the Company does not attain its broadband availability goals, or if it fails to spend the full amount of money agreed to, any shortfall will be contributed to Connect ME.

In terms of risks, the long-term financial viability of FairPoint has been the primary concern, both for the Commission and for the parties to the case. A much smaller company with significant debt leverage had proposed to take over the largest telephone utility in the State. In order to meet its commitments as a public utility, FairPoint's financial condition must allow it to meet its debt obligations, especially when the time comes to refinance its debt in 2013 and subsequent years. The OPA and Labor witnesses, as well as the Advocacy and Advisory Staff, accurately highlighted the risks associated with the debt burden of the proposed Transaction. Labor continued to press the point in its arguments opposing the Amended Stipulation, claiming that the commitments made by Verizon and FairPoint were not financially sufficient.

The Commission pursued this issue during the January 3rd hearing when it asked numerous questions regarding whether the working capital adjustment made by Verizon (an additional infusion of $235.5 million) and the dividend adjustments FairPoint had committed to in the Amended Stipulation were enough to bring FairPoint into a financial condition that would be consistent with the public interest. The Commission also expressed concerns that the Amended Stipulation did not go far enough in reducing FairPoint's debt.

The Commission believes that public utilities should have a reasonable prospect of being investment grade because it increases a company's financial stability and reduces its cost of borrowing. While the Amended Stipulation contains a number of potential benefits for Maine ratepayers, the Commission felt that still more was needed to improve the financial strength of FairPoint to assure that FairPoint, under reasonable risks associated with this Transaction (such as an increase in line losses), will be better able to achieve investment grade by the time of its next refinancing event. The Commission specifically found that the Amended Stipulation did not go far enough in reducing FairPoint's debt. Therefore, the Commission conditioned its approval of the Amended Stipulation on FairPoint's specific commitment to the following:

> If on December 31, 2011, FairPoint's Leverage Ratio of Total Indebtedness to Adjusted EBITDA is 3.6 or higher, FairPoint will reduce its debt by $150 million by December 31, 2012 and FairPoint will also comply with the debt reduction provision of the Amended Stipulation if it is in effect at that time. If FairPoint's debt is not reduced by $150 million by December 31, 2012, FairPoint will suspend its dividends until the bank debt is refinanced.

This additional commitment by FairPoint helped address the Commission's principle financial concerns with the Transaction and will afford FairPoint a better opportunity to become investment grade by 2013. While the Transaction still has some risks, the additional commitments made by FairPoint and Verizon in the Amended Stipulation, including Verizon's additional contribution to working capital, Verizon's commitment not to seek reimbursement from FairPoint or offset any of the $12 million obligation to expand DSL in the *AFOR Proceeding*, and the $2.5 million one time cash payment to ConnectME, improves FairPoint's financial condition by $400 million over the Transaction as originally filed. The Commission believes that these commitments satisfy the Commission that the benefits of the Transaction outweigh the risks.

The Amended Stipulation left several issues for a Commission decision, and it also did not address several issues, which required decisions by the Commission. The most important of these probably involves the Commission's authority to suspend cutover by FairPoint from Verizon's back office systems to FairPoint's own new systems. The Commission will be conducting an expedited process during September to determine if FairPoint is sufficiently ready to proceed with cutover at the end of November.

In summary, FairPoint's operation of the former Verizon service territory is and will be regulated under the terms of an AFOR for five years ending August 1, 2013. the most important changes to the revised AFOR are that FairPoint effectively reduced its rates for local service by $18 million annually effective on August 1, 2008, and the Company is now subject to a revised Service Quality Index (SQI) mechanism, which allows some leeway for three of the indices during the first two years of FairPoint's operation, but then reverts to the current benchmarks. The revised SQI mechanism also increases the potential penalty for repeated missing of the established benchmarks. All other aspects of the current AFOR, including pricing flexibility, remain in place.

3. FairPoint's Service Quality Index Results for 2007/2008

As of April 1, 2008, FairPoint took over the Maine territory formerly operated by Verizon and, under the terms of the merger, became subject to the provisions of the SQI that formerly applied to Verizon. As part of the Amended Stipulation approved by the PUC in the merger and AFOR dockets, several changes were made to the SQI mechanism under which FairPoint will operate. While FairPoint will remain subject to the penalty mechanism and amounts, for two of the fifteen SQI indices that were in effect for the 2007/08 SQI period, FairPoint will receive a temporary (twenty-four month) relaxation from the benchmarks, but the benchmarks will revert back in steps to their original levels after the two-year period. The ramp-up period began on April 1, 2008, and it applies to the following current metrics: 1) Customer Trouble Reports per 100 Lines and 2) Residential Trouble Reports Not Cleared in 24 Hours. Verizon had experienced significant difficulty over the past few years in meeting the benchmarks for these metrics, and FairPoint asserted that it could improve on the results, but it needed some time to analyze the cause of the problems and to implement changes to its operating and management procedures that would allow it to provide better service as measured by these metrics. Also, FairPoint committed to examining the physical characteristics of the exchanges that recently experienced the highest level of trouble reports and to devising a plan that could eliminate many of those problems before they occurred by improving the infrastructure of its plant in those exchanges. The intent of the slight relaxation and ramp-up of the two benchmarks was to allow FairPoint a reasonable period of time to accomplish the analysis and implement the process and technical improvements necessary. Also, as part of the Amended Stipulation, the 2007/08 SQI period was extended from12 to 13 months, to end on July 31, 2008, which was the expected cutover date at the time the Amended Stipulation was negotiated in late December 2007/early January 2008. Therefore, for the thirteen months of the 2007/08 SQI period, FairPoint would have owned and operated the former Maine territory of Verizon for four months, but it was fully responsible for the annual performance and any penalties that resulted. Because of the two-year ramp-up period described above, the benchmarks for the two metrics subject to the ramp-up were adjusted on a pro-rated average basis for 2007/08, with nine months of the former benchmark averaged with four months of the ramp-up benchmark to determine the overall "annual" benchmark. All other benchmarks were unchanged, although the benchmarks for the two metrics that are calculated on a cumulative basis were adjusted to account for the effect of the 13-month SQI "year."

For the 2007/08 SQI 13-month period, which ended on July 31, 2008, FairPoint met 13 of the 15 benchmarks. The Company was able to meet one of the ramp-up metrics, Customer Trouble Reports per 100 Lines, due to the relaxation of the benchmark, but the Company was unable to meet the relaxed benchmark for Troubles Not Cleared Within 24 Hours. Verizon has been unable to meet the benchmark for the latter metric for the past several years, and FairPoint was not able to improve sufficiently on the performance of that metric during the four months it was managing the business in Maine. The Company also was unable to meet the benchmark for "Percentage of Business Office Calls Answered in Over 20 Seconds," which was not subject to a ramp-up provision.

The Company's failure to meet two of the benchmarks resulted in a total penalty amount of $401,114, which the SQI provisions require to be credited to customers' bills in December. However, the Commission is aware that FairPoint may request a one-month delay (to January 2009) in providing the bill credits, due to the impending back office systems cutover, which is scheduled to occur on December 1, 2008. [ONE TIME 4 MONTH CREDIT ALSO IN DEC.] FairPoint presumably would like to have the first month of producing customer bills under its new system free from the "anomaly" of one-time credit. The Commission would likely find such a request reasonable under the circumstances. The credit amount is estimated to about $.94 per line.

In addition to the ramp-up provision described above, other changes have been made to the SQI mechanism under which FairPoint will operate, effective with the 2008/09 SQI year which started on August 1, 2008. First, two former metrics, Dial Tone Speed and Percentage of Blocked Calls, have been eliminated and a new metric, Duration of Residential Outages, has been implemented. The two eliminated metrics are ones that have effectively outlived their usefulness, as Verizon always was able to do better than the benchmark for each by a considerable margin. The new metric will compliment the existing metric that measures the percentage of customer trouble reports that are not cleared within 24 hours. The new metric will measure the full average duration of customer reported outages, and its benchmark will be based on Verizon's most recent results as reported to the FCC. However, by agreement in the Amended Stipulation, FairPoint also will receive a two-year ramp-up for the benchmark of this new metric. Again, this is to allow the Company some time to implement operational, management and technical improvements that should help it to consistently meet the standard. The other change to the SQI mechanism involves the calculation of the penalty amount when FairPoint fails to meet the benchmark in consecutive SQI reporting years. For any metric that FairPoint fails to meet in consecutive years, the penalty for that metric will be multiplied by the number of consecutive years that the benchmark was missed.

The revised SQI mechanism continues to measure the most important aspects of service quality provided by FairPoint and gives the Company the appropriate incentives to continue to provide good service in most aspects and to improve its service where necessary. The Commission will continue to monitor closely FairPoint's progress in achieving improvement where it is needed.

B. Independent Telephone Companies

NOTE: We could eliminate everything from last year's report and instead begin below at the "UPDATE" insert.

Last year, a Workgroup to Discuss AFORs for Rural Telephone Companies (Workgroup) was formed in response to a letter dated January 23, 2006, from the Chairs of the Utilities and Energy Committee to the Commission. The Workgroup consists of representatives of the rural telephone companies (the Telephone Association of Maine, or TAM), the OPA and members of the Commission Staff. As outlined in the January 23rd letter from the Committee Chairs, the purposes of the Workgroup are:

> 1) To review and discuss the current process that exists for establishing an AFOR and how that process impacts small, rural telephone companies, and
>
> 2) To evaluate options for streamlining and simplifying the process for a rural telephone company to adopt an AFOR, including:
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> > * Opportunities to streamline the rate review and evaluation process, including the potential for a two-tier (short-term and long-term) model for rate cases associated with AFOR proceedings, and
> >
> > * Options for and costs and benefits of developing a standardized AFOR model, or "template" for rural telephone companies.

The January 23, 2006, letter also requested the Commission to "report the results of the group's work and policy recommendations to the committee no later than January 1, 2007." On January 4, 2007, the Commission Staff notified the Committee Chairs of a possible impasse in the Workgroup's discussions, but requested an extension of the reporting deadline to allow the parties a final opportunity to explore alternatives before declaring impasse. The extension was granted, and on March 5, 2007, the Commission filed its Interim Report to the Committee.

The Interim Report described the history of the discussions that had occurred and indicated that the parties believed that additional discussions would be useful. The Interim Report also indicated that the parties had agreed to monthly meetings that would address specific topics related to the AFOR issue. Finally, the Interim Report requested that the Chairs allow the parties an extension until on or about November 15, 2007, for filing their final report. The purpose of the final report will be to summarize the results of the monthly meetings and to propose any additional action recommended by the parties. The Committee Chairs granted this request.

The parties have adhered to the monthly meeting schedule set forth in the March 5th Interim Report, although the discussion topics for each meeting have been slightly altered based on the results and progress of previous meetings. The parties have discussed extensively whether pricing flexibility, rather than a formal AFOR that fully complies with the provisions of Chapter 91 of

Title 35-A, represents a better and more readily attainable method of providing rural telephone companies with the tools they need to remain viable and competitive in today's rapidly changing telecommunications environment.

The meetings have been conducted in a collegial manner, with all parties concentrating on (1) identifying and understanding differences of opinion and (2) reaching a consensus resolution that allows companies the flexibility they need, protects captive local exchange customers who may lack competitive options and meets all statutory requirements and regulatory principles. The parties have made considerable progress in identifying and addressing the various issues surrounding pricing flexibility and hope that an agreement that satisfies all parties can be achieved with continued effort. The schedule of meetings remains on track, and the parties will submit a status report to the Utilities and Energy Committee by November 15, 2007.

UPDATE begins here; I've borrowed heavily from the NOI and the Order Adopting Rule

On November 15, 2007, the Commission submitted to the Committee the "Final Report of the Staff of the Public Utilities Commission, the Office of the Public Advocate, and the Telephone Association of Maine To the Utilities and Energy Committee On Discussions Regarding the Current Regulatory Structure and Process for Maine's Rural Telephone Companies" (the Report). The Report contained the background regarding possible alternative forms of regulation (AFOR) for Maine's rural telephone utilities. It described a series of discussions and stakeholder meetings that occurred during 2006 and 2007 to review and analyze various options for instituting some type of AFOR for the rural companies. As the report points out, the group of stakeholders concluded that an AFOR was not necessarily needed, but rather the rural companies needed pricing flexibility in order to meet the demands of increasing competition, both actual and potential, in their service territories. The stakeholders then embarked on a further set of meetings described in the Report. Those meetings led to a consensus recommendation that the Commission should adopt a rule that would establish the parameters under which the rural companies could offer bundles of regulated and unregulated services. The Report also describes the proposed rule section by section and indicates that the proposed rule would be submitted to the Commission for its consideration.

On January 15, 2008, the Commission issued its Notice of Rulemaking for Chapter 289 in Docket No. 2008-15. The Proposed Rule submitted by the Commission Staff, OPA and TAM was attached to the Notice, and standard rulemaking procedures were established, including a comment period and a hearing at which testimony was received. On June 24, 2008, the Commission issued its "Order Adopting Rule and Statement of Factual and Policy Basis," which adopted Chapter 289 substantially in the form of the

Proposed Rule, although some minor changes were made based on the comments received. The Rule became effective on July 13, 2008.

The Rule establishes 1) consumer protection requirements associated with the provision of bundled services by incumbent local exchange carriers; 2) "safe harbor" financial and pricing procedures that shall be considered reasonable during future ratemaking or universal service proceedings; and 3) terms governing miscellaneous other factors associated with the provision of bundled services. The Commission believes that additional competitive products will likely develop as the telecommunications market matures, and the principles adopted in the Rule may apply to those products as well. Thus, the approaches and procedures required by the Rule for bundles will form a platform for future relaxed regulation.

A "bundled service" is a single retail telecommunications service offering that includes local exchange service and at least one additional service, and is offered at a single price. This type of service has become pervasive throughout the telecommunications industry and across all types of carriers. Bundled services are offered by landline and wireless providers, by providers of Voice over Internet Protocol (VoIP) service and by both incumbent and competitive local exchange carriers (ILECs and CLECs).

In many recent decisions, it has been necessary for the Commission to determine when to impose identical requirements on CLECs and ILECs and when to impose differing requirements that acknowledge the differing characteristics of these two types of carriers. Telephone carriers have different technologies, different market and commercial situations and likely operate under different customer expectations. With that in mind, the Commission has had to decide what the most effective and sensible regulatory approach would be for the goal the Commission was trying to achieve. Chapter 289 extends to ILECs and CLECs consistent treatment of bundled services to areas other than tariffing requirements, thereby creating consistency among carriers when consistency is reasonable and in the public interest.

Bundled services offered by CLECs, wireless carriers and VoIP providers are widely available in the competitive market and appear to offer the strongest competition for ILEC services. Losing customers to a competitor results in lost revenue, which in turn may lead to increased rates for remaining ILEC ratepayers, as fixed costs are spread across fewer customers. To the extent that regulation makes competitive response more difficult for ILECs than for CLECs – by slowing the ILECs market-response time or by adding costs – this problem is exacerbated. Developing procedures that allow ILECs to more expeditiously and profitably offer bundled services, which in turn may allow them to retain customers, provides an effective response to an immediate and an ongoing need of ILECs and their customers. Chapter 289 supports this goal by removing regulatory financial uncertainty for ILECs offering bundled services and by clarifying the consumer protection requirements and programs as they apply to bundled services.

Relaxed regulation of bundled services will not remove necessary protections for consumers who choose these services from ILECs. This is because consumers affirmatively choose bundled services offered by an ILEC, just as they affirmatively choose service from a CLEC or other alternative provider of voice service. The Commission has generally believed that consumers protections for competitive products may be less prescriptive, because consumers may decide for themselves if the price and terms of service are acceptable and if they adequately understand what they are buying. However, the Rule retains basic protections for customers who choose to take bundled service offerings from ILECs. Removing other potential regulatory burdens is a complementary step toward treating ILECs' competitive similarly to products offered by other competitive carriers.

Weighed against our efforts to lessen regulation of competitive products, the Commission must consider that ILECs remain carriers of last resort for many customers in Maine. The ILECs retain some ability to obtain rate relief through higher rates or increased support from the Maine Universal Service Fund (MUSF). The ILECs have stated that they do not wish to obtain relief through either of these methods, as such relief only serves to make their service less competitive. Nonetheless, the Commission still has a statutory obligation to ensure universal service to all customers at reasonably comparable rates. The Rule offers flexibility that protects existing ratepayers from harm while allowing the ILECs to compete to retain customers. Chapter 289 includes pricing and accounting guidelines that are intended to limit the exposure to risk that other ratepayers experience as a result of flexible regulation of bundles. Conversely, ILECs should not receive an advantage over competitive carriers through the ILECs ability to obtain rate or MUSF relief. The financial parameters in Chapter 289 serve to keep the playing field level for all providers.

In summary, Chapter 289 represents a balancing of the interests of the rural ILECs in competing against alternative providers of bundled services while providing appropriate protections to consumers of those services, as well as to the ILEC's remaining customers. The Commission will monitor the activities of ILECs under the Rule and retains its ability to modify the Rule if necessary.