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STATE OF MAINE
PUBLIC UTILITIES COMMISSION

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CHAIRMAN

DAVID P. LITTELL
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COMMISSIONERS

KAREN GERAGHTY
ADMINISTRATIVE DIRECTOR

August 23, 2012

Honorable Michael Thibodeau, Senate Chair
Honorable Stacey Fitts, House Chair
Energy, Utilities and Technology Committee
115 State House Station
Augusta, Maine 04333

Re: 2012 Telecom AFOR Report

Dear Senator Thibodeau and Representative Fitts:

Title 35-A M.R.S.A. Section 9105 requires the Commission to provide the Committee with an annual report describing the Commission's activities related to Alternative Forms of Regulation (AFORs) for telephone utilities. The report is due on September 1. Attached is the Commission's 2012 Annual Report.

If you have any questions regarding the report, please do not hesitate to contact us.

Sincerely,

A handwritten signature in black ink that reads "Th. L. Welch".

Thomas L. Welch, Chairman
On behalf of the Chairman and

David Littell, Commissioner
Mark Vannoy, Commissioner
Maine Public Utilities Commission

Attachment

cc: Energy, Utilities and Technology Committee Members
Jean Guzzetti, Legislative Analyst and Jon Clark, Esq., OPLA Deputy Director

Annual Report on Alternative Forms of Regulation for Telephone Utilities

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

September 1, 2012

I. INTRODUCTION

Title 35-A M.R.S.A. Chapter 91 governs alternative forms of regulation (AFORs) for telephone utilities. An AFOR is an alternative to the traditional rate of return/rate base regulation and is intended to provide incentives for telephone utilities to achieve greater efficiencies and lower prices for telecommunications services. Section 9105 requires the Maine Public Utilities Commission (Commission) to provide the Energy, Utilities and Technology Committee (Committee) with an annual report describing the Commission's activities under Chapter 91 and the effectiveness of any adopted AFOR in achieving the objectives of Chapter 91. In order to provide historical perspective and context, the report briefly describes the events of prior years as well as activities that have occurred since the Commission's last AFOR report in September 2011.

II. SUMMARY OF ACTIVITIES PRIOR TO SEPTEMBER 2010

In an Order dated February 1, 2008, the Commission approved (with numerous conditions attached) the transfer of Verizon Maine's assets, customers and operations to FairPoint Communications-NNE (FairPoint or the Company). FairPoint also received similar approvals for the transfer in New Hampshire and Vermont. The transaction closed on April 1, 2008, and FairPoint took over Verizon's operations in Maine, as well as in New Hampshire and Vermont. The Commission ordered FairPoint to step into Verizon's shoes for purposes of regulation under the AFOR that had been approved for Verizon.

As part of its approval of the transfer, the Commission made some changes in the terms of the AFOR that would regulate FairPoint. The AFOR change of most significance was the adoption of a so-called "multiplier" mechanism. The multiplier mechanism was intended to result in an increase in the amount of the Service Quality Index (SQI) rebate that would be credited to customers as a consequence of any multi-year failure by FairPoint to meet the prescribed SQI benchmark for any metric up to a fixed cap on the total of rebate payments that could be required each year. FairPoint was also allowed to relax slightly the benchmarks for several of the metrics in order to allow the Company time to implement process improvements after it took over operations from Verizon. Finally, two metrics, which were determined to be no longer relevant, were eliminated and a new metric, regarding the duration of residential outages, was added.

During the 2008/09 SQI measurement year (the first full year that FairPoint operated the telephone network in the former Verizon territory) FairPoint missed 12 metric benchmarks and the Company therefore incurred a rebate amount of \$8,021,257. For the 2009/10 SQI period, FairPoint missed 10 metric benchmarks for a base penalty amount of \$4,562,992. The SQI multiplier mechanism, described above, was applicable to each of the 10 benchmarks that FairPoint failed to meet during the 2009/10 SQI year. Consequently, the total rebate amount for that period was \$9,125,984. During the 2010/11 SQI year, which ended July 31, 2011, FairPoint failed to meet 4 metric benchmarks, resulting in a rebate amount of \$712,692. As is noted in Section V, below, the enactment of legislation during the 2011 session precluded application of the multiplier mechanism to the SQI results after July 2010.

For the 2011/12 SQI year, which ended on July 31, 2012, FairPoint missed 4 of the metric benchmarks, resulting in a penalty amount of \$1,701,719.¹ FairPoint customers will see the resulting credit on their bills beginning in December.

III. BANKRUPTCY

On October 26, 2009, FairPoint filed for protection under federal bankruptcy law. In February 2010, after negotiations with its creditors, FairPoint filed its proposed Plan of Reorganization (Plan) with the Bankruptcy Court. The Plan included a reduction in FairPoint's outstanding debt of about \$1.7 billion from a total of about \$2.7 billion. In a proceeding held at the Commission to review FairPoint's reorganization pursuant to Section 708 of Title 35-A, the Commission approved a so-called "Regulatory Settlement" which included, among other things, only minor modifications to the AFOR under which FairPoint's rates and service quality are regulated. Specifically, the Regulatory Settlement adjusted slightly the time period over which the SQI rebates applicable to the 2008/09 SQI year would be paid to its customers. In addition, the Regulatory Settlement slightly altered the description of the rebate that appeared on customer bills. Acceptance of these provisions resolved questions raised by FairPoint in the Bankruptcy Court regarding the continued enforceability of the SQI rebate mechanism. The Regulatory Settlement, accepted by the Commission in an Order issued on July 6, 2010, along with similar settlements reached with regulators in Vermont and New Hampshire, were made part of the Plan of Reorganization, and in January 2011, the Bankruptcy Court confirmed the Plan. Aside from the two minor modifications to the AFOR described above, the Bankruptcy Court did not disturb any other provisions of the AFOR, including the term of the AFOR which continues until August 1, 2013.

¹ The penalty amount is based on SQI results filed recently by FairPoint and FairPoint is conducting a final review of these results.

IV. FAIRPOINT PETITION TO APPLY SQI MULTIPLIER REBATE AMOUNTS TO BROADBAND BUILDOUT

In February, 2011, FairPoint petitioned the Commission to amend the AFOR to permit the portion of the SQI rebate funds resulting from the application of the multiplier mechanism to be used instead for a capital expenditure program to build out additional broadband facilities beyond the levels required by the Commission's 2008 Order approving the purchase by FairPoint of Verizon's assets in Maine. The Office of the Public Advocate opposed FairPoint's petition on several grounds, including that the diversion by FairPoint of rebates otherwise paid as bill credits to customers of FairPoint's regulated telephone service to a capital spending account to improve the availability of unregulated broadband service would violate Title 35-A, Section 713, which prohibits a utility from charging "its ratepayers for costs attributable to unregulated business ventures undertaken by the utility."

The amount of "multiplier" rebate funds subject to possible diversion to broadband infrastructure projects over the remaining term of the AFOR was vastly reduced as a result of the enactment of legislation during the 2011 session which, as described below, relieves FairPoint of its "multiplier" rebate obligation for failing to meet SQI performance standards after July 31, 2010. On August 11, 2011, the Commission resolved the legal questions raised by FairPoint's Petition, finding that Title 35-A, Section 713 is, in fact, a bar to the proposal made by FairPoint and the FairPoint Petition was denied.

V. RESOLVES 2011, CHAPTER 69, LD 1466

During its 2011 session, the Legislature enacted LD 1466, Resolve, To Direct the Public Utilities Commission To Develop a Plan to Reform Telecommunications Regulation. Resolves 2011, ch. 69. Section 3 of the Resolve expressly prohibited the Commission from enforcing, during the period between the effective date of the Resolve and 90 days after the adjournment of the Second Regular Session of the 125th Legislature, two features of the existing FairPoint AFOR. As a consequence, for the 2011/12 AFOR period, the AFOR was effectively modified as follows:

1. FairPoint may charge rates for nonresidential customers at any level below the rate ceiling without review by the Commission; and
2. FairPoint was relieved of the obligation to rebate to its customers that portion of the SQI rebates resulting from application of the SQI multiplier mechanism of the AFOR to the base rebate amounts on account of repeated failures to meet SQI performance standards after July 31, 2010.

VI. PUBLIC LAW, CHAPTER 623, LD 1784

During its 2012 session, the Legislature enacted LD 1784, An Act to Reform Telecommunications Regulation. P.L. 2011, ch. 623. Section A-23 of the new law prohibits the Commission from imposing certain conditions on any incumbent local exchange carrier (ILEC) that is subject to an AFOR under Chapter 91 of Title 35-A. FairPoint is the only such ILEC. In summary, the Commission may not enforce any provision in an AFOR that (1) imposes any minimum price requirement for services to nonresidential customers; (2) imposes SQI multiplier penalties for failure to meet performance standards after July 31, 2010, but it allows the Commission to continue to require payment of base penalty amounts; (3) imposes SQI standards or penalties for performance after July 31, 2012, or (4) requires tariffing of any rates or services except for provider of last resort (POLR) service.

Notwithstanding Subsection 3, as described above, in an un-numbered paragraph following Subsection 4, Section A-23 of the Act mandates that the Commission, in an adjudicatory proceeding, shall establish service standards relating to POLR service for any ILEC subject to an AFOR for the period that runs from August 1, 2012, to July 31, 2013. The statute lists the five service areas that the standards “must relate only to,” and it caps the annual penalty amount at \$2 million. The Commission established the provisions of the SQI mechanism for the 2012/13 AFOR period in Docket No. 2012-173. Seven of the current 14 SQI metrics relate only to the service attributes articulated in the statute and the Commission employed those seven metrics in the SQI that it adopted for FairPoint for the one-year period. The Commission also retained many of the current SQI provisions because they continue to provide the proper incentives for an ILEC, as is FairPoint, subject to an AFOR to maintain or improve the quality of service it provides its customers. Finally, the SQI adopted includes a \$2 million annual cap on penalties rather than the current \$12.5 million, pursuant to the statute, and based on the reduction in the overall maximum penalty the Commission reduced the maximum penalty to \$300,000 for each metric.²

Section C-11 of the Act repeals Chapter 91, the AFOR section of Title 35-A, as of August 1, 2013 which is also when FairPoint’s 5-year AFOR expires. Consequently, after August 1, 2013, FairPoint’s rates will be established pursuant to the mechanisms then in effect governing POLR rates and support under the new statute.

² Commissioner Littell dissented on this one point and would have retained the current per-metric cap of \$1.135 million.