STATE OF VERMONT
PUBLIC SERVICE BOARD

Docket No. 6957

Investigation into Compensation for Failure to Meet)
Performance Measures under the Service Quality Plan)
For Verizon New England Inc., d/b/a Verizon Vermont)

Order entered: 6/1/2005

I. INTRODUCTION

During calendar year 2003, Verizon New England Inc., d/b/a Verizon Vermont ("Verizon"), was subject to a Retail Service Quality Plan ("Plan") in connection with its Incentive Regulation Plan approved by the Public Service Board ("Board") in Docket Nos. 6167 and 6189. Based upon its performance for calendar year 2003 under the Plan, Verizon is obligated to pay approximately $8 million in compensation to consumers.

On February 18, 2005, Verizon and the Vermont Department of Public Service ("Department") ("Parties") filed a Memorandum of Understanding ("MOU") regarding an agreed-upon mechanism by which they propose Verizon will discharge its obligation to pay compensation to Vermont consumers under its Plan. Such agreement entails the payment of approximately 75% of such compensation in the form of network improvements and 25% in the form of cash rebates to consumers.

The parties' proposal sets out a reasonable mechanism for returning the $8 million to ratepayers. Because, by its terms, the Plan requires the payment of service quality compensation through the issuance of a one-time cash rebate to consumers, the MOU submitted by the Parties cannot be effectuated without a modification to the Board's Order in Docket Nos. 6167 and 6189. Accordingly, this Proposed Decision recommends that the Board modify its Order in Docket Nos. 6167 and 6189, as set forth below, and approve the MOU submitted by the Parties.

II. Background and Procedural History

On March 31, 2004, Verizon filed its retail service quality results for calendar year 2003[1] pursuant to the Retail Service Quality Plan that is incorporated in its Incentive Regulation Plan adopted on March 24, 2000, in Docket Nos. 6167 and 6189.[2] As reflected in that filing, Verizon missed the applicable Baseline Standard for the following Performance Areas: (1) Average Speed of Answer-Repair Centers; (2) Percent Troubles Not Cleared Within 24 Hours-Residence; (3) Percent Troubles Not Cleared Within 24 Hours-Business; (4) Busy Rate-Repair Centers; and (5) Installation Held Orders-Residence and Business Combined-Average Delay Days for Missed Installations. Based upon these misses, Verizon's calculated service quality compensation under the Plan for calendar year 2003 is eight million eighty-five thousand six hundred thirty-five dollars ($8,085,635) (the "Calculated Compensation").

By Order dated May 11, 2004, the Board opened this investigation, pursuant to 30 V.S.A. §§ 203, 209, and 226b, into the manner in which Verizon is to compensate customers for its failure to meet performance measures under the Plan.

On May 20, 2004, I convened a prehearing conference in this proceeding. At the prehearing conference the parties agreed to a schedule for the remainder of the docket. However, due to the pendency of Verizon's motion for reconsideration of the penalty amount, the schedule was put on hold until that proceeding was resolved. On September 20, 2004, the Board issued an Order denying Verizon's motion for reconsideration. On December 7, 2004, I convened a status conference to determine a revised schedule for the remainder of the docket.

On February 18, 2005, the Parties filed the MOU with the Board. By memorandum dated March 9, 2005, I circulated to the Parties a number of specific questions to be addressed through pre-filed testimony. On March 30, 2005, Ms. Pamela Porell of Verizon and Mr. Larry Lackey and Ms. Deena Frankel of the Department pre-filed testimony in support of the MOU, including,

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1. Verizon simultaneously sought a waiver of the imposition of service quality compensation points associated with its failure to meet the baseline standards for Average Speed of Answer-Repair Centers.

2. Docket No. 6167, *Investigation into an Alternative Regulation Plan for New England Telephone and Telegraph Company, d/b/a Bell Atlantic-Vermont*, Order dated Mar. 24, 2000.

among other things, a response to each of the questions reflected in my March 9, 2005 memorandum. On May 5, 2005, Ms. Pamela Porell filed an update to her testimony regarding the identification of past outages. Following the filing of the prefiled testimony, I conducted a telephonic status conference, at which time the Parties agreed to the admission of the prefiled testimony into evidence and expressed their view that an evidentiary hearing was not necessary. Based upon my review of the prefiled testimony, I agree that no hearing is necessary.

III. Findings

Based upon the evidence of record, I hereby report the following findings to the Board in accordance with 30 V.S.A. § 8.

2003 Service Quality Compensation

1. The total service quality compensation for 2003 of $8,085,635 is a result of Verizon's failure to meet baseline standards pursuant to the Plan established in Docket Nos. 6167 and 6189. Porell pf. at 3.

2. Because Verizon is unable to determine those customers affected by the service quality failures, Verizon would otherwise return the total service quality compensation to all Verizon retail consumers as a one-time credit of approximately $27.14 per access line whether they had service difficulties or not. Porell pf. at 3.

3. The large amount of compensation due presents an opportunity to make significant improvements in Verizon's network to improve future reliability. Returning the full amount of compensation to consumers in the form of bill credits misses the opportunity to create lasting value on consumer's behalf, particularly in the area of service reliability. Frankel pf. at 5.

4. The MOU is the result of discussions between Verizon and the Department. As testified by Ms. Porell and Ms. Frankel, the agreed-upon plan reflects the Department's criteria for establishing such a plan: (1) a portion of the compensation should be returned directly to Verizon's customers through bill credits; (2) a larger portion of the compensation should go toward network investment; (3) the network investment should be completed in a timely fashion; and (4) the network investment should be made in network diversity and service quality related projects rather than Digital Subscriber Lines ("DSL"). Porell pf. at 6; Frankel pf. at 5-7.

Network Investment Plan

5. Consumers will benefit from the network investment plan because Verizon will make incremental network improvements that will reduce the possibility of service outages caused by interoffice facilities damage. Porell pf. at 4.

6. The network investment plan includes projects that establish, or make progress toward establishing, diverse interoffice transport facilities that connect remote central offices to host central offices. Without diverse transport facilities between a remote central office and the host central office it subtends, a failure of the single transport connection disables all inter-office calling, the primary means of E911 access, as well as various call features that rely upon intelligence that is located in the host central office. Lackey pf. at 4.

7. These improvements would not otherwise have been planned or completed within the timeframes committed as they are not driven by customer demand or service quality issues and, therefore, would not be budgeted within the current investment period. Porell pf. at 4.

8. The specific network projects identified in the MOU were identified by Verizon as having significant reliability benefits for the amount of capital expenditure required. Lackey pf. at 4.

9. The network projects that are the subject of the MOU fall into four categories: (1) additional SONET ring infrastructure; (2) additional fiber routes; (3) umbilical rearrangements; and (4) power. Porell pf. at 7-9.

10. Consumers will additionally benefit from the lower maintenance associated with fiber optic cable (versus copper facilities), potentially resulting in fewer customer service problems as well as the completion of one of the prerequisites for the provisioning of DSL, which requires the availability of fiber cable in the interoffice facilities. Porell pf. at 9.

11. In instances where existing copper cable is replaced by fiber optic cable, the copper cable will be available to competitors if the cable remains part of Verizon's inventory. Porell pf. at 9-10.

12. Verizon's total estimated cost of these projects is approximately $6,064,000. This total includes $1,150,000 for the building of the OC192 ring, $3,725,000 for the fiber routes,

$867,000 for the rearrangements of umbilicals for 26 offices and host-to-host facilities, and $322,000 for generators. Porell pf. at 10.

13. Verizon conducted preliminary engineering reviews for each of these projects and developed high level estimates using existing cost models that took historical time and material costs into consideration. Porell pf. at 10.

14. The effect of these capital expenditures shall be removed from any cost of service calculation. Porell pf. at 11.

15. Although bill credits could be issued much sooner than the time it will take to complete the network projects, the resulting improvement to network diversity is worth taking the time to implement. Lackey pf. at 8.

16. The projects will extend over a substantial period of time for a number of reasons. First, the completion of some of the projects is based on the completion of other projects. Second, the construction of new and replacement fiber routes is an extensive undertaking. Third, any pole replacements or plant rearrangements will require coordination with other utilities. Fourth, Verizon must complete engineering surveys, secure permits and easements, and place or replace poles. Finally, once fiber is placed, Verizon will need to complete splicing and rearrangements, which will require hundreds of technician hours. Porell pf. at 11-12.

17. Verizon would not otherwise have completed the specific projects included in the MOU for the sole purpose of providing diversity. None of the projects is included in Verizon's current plans, and Verizon has no reason to believe that its plans would have been revised to include any of the projects. Nonetheless, it is possible that, if growth or service problems or new service products warranted, Verizon may eventually have constructed some of these projects. Porell pf. at 13.

18. These network projects would not have been proposed in any program due to the extensive undertaking and Verizon's strategy to incorporate diversity capabilities where other service demands and economics support it. Porell pf. at 14.

19. These projects address a substantial number of instances in which remote central office/host remote interoffice routes lack diverse interoffice transport, but will not address all such instances. Lackey pf. at 5.

20. After the completion of the projects, the number of offices with diversity will increase from 11 to 37, resulting in approximately 61% of Verizon's access lines in service being served by diverse routes. Given the difficulty and additional costs to place fiber spans to some central offices, 100% diversity may never be achieved. Porell pf. at 15.

21. Since 2001, there have been seven outages that resulted from Verizon's interoffice facilities being damaged (torn down or dug up) by third parties for which no diverse facilities were available. The projects included in the MOU will eliminate the potential of the proposed offices experiencing isolation conditions resulting from interoffice facility damage. Porell pf. at 17.

22. Reliability projects are identified as a priority in the *Vermont Telecommunications Plan* issued in September 2004. Frankel pf. at 14.

23. The proposed settlement will serve the public good more effectively than returning the full $8 million to consumers in the form of bill credits. First, unlike a one-time credit, the network investment plan will provide lasting benefits to ratepayers. Second, a significant portion (25%) of the credits will be returned directly to consumers. Third, consumers will receive a clear public benefit in the form of route diversity. Fourth, the proposed use of the funds for investment will achieve ends that would not be realized through the operation of market forces. Finally, the use of service quality compensation funds for investment will supplement – rather than supplant – capital investments Verizon would have made in the normal course of business. *See* Frankel testimony at 5-7.

IV. Discussion

The MOU

The Parties seek the Board's approval of their jointly filed MOU, which reflects the terms of their proposal for a plan that includes both network investment and customer billing credits. The salient provisions of the MOU are as follows:

Customer Billing Credits

- Verizon will apply two million twenty-one thousand four hundred and nine dollars ($2,021,409) as a one-time billing credit to Vermont retail consumers.

- Beginning with the first monthly billing cycle commencing no later than ninety (90) days after the Board's approval of the MOU, Verizon agrees to issue equal one-time billing credits to all retail access lines reflected in Verizon's billing system during the ensuing monthly billing cycle (the "Customer Billing Credits"). The total Customer Billing Credits will be two million twenty-one thousand four hundred and nine dollars ($2,021,409).
- Verizon will include the following message to consumers in connection with all billing statements reflecting Customer Billing Credits:

> As part of an *Incentive Regulation Plan*, Verizon Vermont must meet baseline standards in twelve retail service quality categories.
>
> In calendar year 2003, Verizon Vermont exceeded the baseline standards in several categories, including network performance and reliability, frequency of meeting installation appointments, and the timely answering of calls to customer service centers.
>
> During the same period, Verizon Vermont missed the plan standards for the completion of repairs within 24 hours, the timely answering of calls to repair centers, and the time installing a line when facilities were not readily available.
>
> As a result of these missed standards, your bill reflects a one-time credit of $x.xx. This credit is part of approximately $8 million that Verizon Vermont is paying including $2 million in direct bill credits and $6 million in network reliability upgrades.

<u>Incremental Network Reliability Investment</u>

- The parties agree that the incremental network reliability projects identified in the MOU will decrease the risk of outages for affected communities in Verizon's territory that are not currently served by diverse network facilities.
- Verizon will perform four specific incremental network reliability investment projects, which are identified in Attachment B to the MOU (the "Network Projects").
- Based on preliminary engineering surveys and estimates, Verizon estimates that it will incur costs of approximately six million sixty-four thousand two hundred twenty-six dollars ($6,064,226) to complete the Network Projects (the "Estimated Project Costs").

Verizon's estimated timeframes for construction and completion of the Projects as of January 2005 (the "Estimated Timeframes") are reflected on Attachment B to the MOU.

- Upon the Board's approval of the MOU, Verizon will conduct more detailed engineering surveys concerning the Network Projects and, within sixty (60) days of the Board's approval, will revise the Estimated Timeframes reflected on Attachment B based upon the results of such engineering surveys (the "Updated Milestones") and submit the Updated Milestones to the Board and Department. Timeframes in the Updated Milestones shall be narrowed to calendar quarters. The Updated Milestones will be deemed approved thirty (30) days after filing unless the Board or Department notifies Verizon of any objection, in which case the Board shall conduct a proceeding to resolve the objection.
- Verizon will afford the Network Projects priority in design and construction, and will make all reasonable efforts to construct and complete the Network Projects according to the Updated Milestones.
- In connection with the Network Projects, Verizon will provide written reports to the Board and Department as follows: (a) within thirty (30) days of completion, Verizon will provide notice of the actual in-service date; and (b) within one-hundred and twenty (120) days of completion, Verizon will report its actual expenditures associated with such project(s).
- To the extent that any of the Network Projects or sub-projects (defined as a separately-identified route or office reflected on Attachment B to the MOU) is not completed and in service by the end of calendar year 2005, Verizon will provide quarterly reports to the Department and the Board until such projects or subprojects are completed. The quarterly reports will be provided on December 31, March 30, June 30 and October 31. The reports will describe the extent of completion of the project or subproject, the expenditures to date on such project, and the estimated project completion date.
- Following the issuance of each quarterly report, Verizon and the Department agree to meet quarterly to discuss any Network Project or sub-project that is not

progressing according to the Updated Milestones. To the extent that delays are the result of factors that are beyond Verizon's control and within the control of another regulated utility, the Department will assist in resolution of the issues causing delay to the extent it has the means or authority to do so.

- In the event that the actual costs to Verizon to complete the Network Projects are more than three hundred thousand dollars ($300,000) less than the Estimated Project Costs, Verizon will negotiate with the Department for the completion of additional projects, subject to Board approval, such that total estimated expenditures equal but do not exceed the Calculated Compensation, except that *de minimus* shortfall may be accepted by the Department and the Board.
- Verizon bears the sole risk in the event that the actual costs to complete the Network Projects are greater than the Estimated Project Costs, and Verizon waives its right to seek direct or indirect compensation or other dispensation from the Department, the Board, or Verizon's customers.
- In the event that any Network Project or sub-project is not completed by the Updated Milestones, Verizon will report to the Board and the Department in writing within two (2) weeks. Such written report will include an explanation of the status of the project or sub-project, the expenditures to date on such project, the reasons for the delay, the efforts to resolve the delay, and the expected completion date for the project.
- Verizon's performance of the Network Projects and related provisions reflected in the MOU constitutes the complete fulfillment of its obligations under the Plan for 2003 performance. The Department may propose and the Board may prescribe appropriate remedies in the event that Verizon does not fulfill its material obligations under the MOU.
- Based upon Verizon's representation, Network Project 1 is the most cost-effective means of relieving capacity on the existing geographically-diverse interoffice transport facilities (OC48 Rings), enabling Verizon to rearrange the circuits connecting remote offices to their respective host on to these existing facilities.

- Based upon Verizon's representation, (i) the sub-projects described as Network Project 2 are the most cost-effective means to construct the facilities necessary to establish SONET-based geographically-diverse interoffice transport facilities for the transport of voice traffic between the end offices listed for Project 2 and (ii) additional network improvements, which are not the subject of the MOU, will be necessary in order to establish SONET-based, geographically-diverse interoffice transport facilities between the end offices listed for Project 2 and their respective host end offices. Additional rearrangement of the facilities between the remote and host offices will be required.
- With the completion of Network Project 3, Verizon will have established SONET-based, geographically-diverse interoffice transport facilities that will connect the remote end offices listed for Project 3 to the respective host end offices.
- The Parties will work cooperatively to develop procedures enabling Verizon to demonstrate that the expenditures associated with the Network Projects are incremental to its normal planned capital expenditures over the next three years. Verizon will establish a specific project code to track all expenditures associated with the projects reflected in the MOU, and Verizon and the Department shall together prepare a report to ensure that the investment is incremental. (*See* Porell testimony at 14.)

Modification of the Board's Order in Docket No. 6167

The Department and Verizon jointly propose that the Board amend its Order adopting the Plan to permit the combination of specific customer credits and network infrastructure improvement reflected in the MOU as an alternative means of compensating ratepayers when service quality compensation is due. Frankel pf. at 5. I believe that this is reasonable *in this case*, based upon the large amount of compensation dollars and the benefits of the network diversity projects.

In order to permit Verizon to compensate customers under the Plan in the manner contemplated herein, viz., to permit Verizon to expend six million sixty-four thousand two hundred twenty-six dollars ($6,064,226) of the Calculated Compensation for specific network investment projects that promote improved reliability of service and the balance of the Calculated Compensation ($2,021,409) as a one-time billing credit to Vermont consumers, I recommend that the Board amend its Order dated March 24, 2000, in Docket Nos. 6167 and 6189 as set forth below.

Paragraph C(3) of the Plan agreed to by the Parties and approved by the Board in Docket Nos. 6167 and 6189 should be modified by adding the sentence reflected in italics below:

> Service quality compensation dollars shall be paid to customers by a one-time rebate. The Company shall propose at the time of its annual Retail Service Quality filing to which customer service quality compensation shall be paid. *In the alternative, the Company and DPS may jointly propose a combination of specific customer credits and network infrastructure improvements as a means of benefitting ratepayers, subject to Board approval.*

V. CONCLUSION

For the foregoing reasons, I conclude that the public interest will be best served by adoption of the settlement, and I therefore recommend that the Board approve the MOU and modify its Order in Docket Nos. 6167 and 6189 as set forth above.

All parties to this proceeding have waived their rights to comment on the Proposal for Decision in accordance with 3 V.S.A. § 811.

Dated at Montpelier, Vermont, this 27th day of May, 2005.

Gregg Faber

Gregg Faber
Hearing Officer

VI. ORDER

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

1. The findings and recommendations of the Hearing Officer are adopted.
2. The Service Quality Plan approved by the Board in its Order dated March 24, 2000, in Docket Nos. 6167 and 6189 is hereby modified as set forth above.
3. The Memorandum of Understanding filed by the Parties on February 18, 2005, is hereby approved.

DATED at Montpelier, Vermont, this 1st day of June, 2005.

s/Michael H. Dworkin	)	PUBLIC SERVICE
	)	
	)	BOARD
s/David C. Coen	)	
	)	OF VERMONT
	)	
s/John D. Burke	)	

OFFICE OF THE CLERK

Filed: June 1, 2005

Attest: s/Susan M. Hudson
Clerk of the Board

NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or in writing) of any apparent errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)

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