COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Investigation by the Department of Telecommunications and Energy on its own Motion into the Appropriate Regulatory Plan to succeed Price Cap Regulation for Verizon New England, Inc. d/b/a Verizon Massachusetts' intrastate retail telecommunications services in the Commonwealth of Massachusetts	)	D.T.E. 01-31 Phase II

ATTORNEY GENERAL'S APPEAL TO COMMISSION OF HEARING OFFICER'S DENIAL OF SCHEDULE NEEDED TO REVIEW GENERAL RATE INCREASES

I. INTRODUCTION

This appeal concerns case scheduling, a procedural issue that may have major rate consequences for the residential customers of Verizon Massachusetts ("Verizon" or "Company"). On August 22, 2002, the Department of Telecommunications and Energy ("Department") held a conference to discuss the Procedural Schedule for Phase II in this matter.[1] At the end of the procedural conference, after receiving written and oral comments from the Attorney General, Verizon, and AT&T Communications of New England ("AT&T"), the Department's Hearing Officer ordered essentially the same schedule that was proposed by the Department on August 1, 2002, and did not order an accounting audit as requested by the Attorney General. The schedule ordered by the Hearing Officer does not allow sufficient time for the Department to fulfill its statutory mandate to determine, after hearings and investigation, whether the proposed general rate increases would be "just and reasonable", non-discriminatory and "necessary to obtain a reasonable compensation for the service rendered". G.L. c. 159, §§14 and 20.

[1] On August 1, 2002, the Department proposed a procedural schedule dividing its retail rate investigation into two tracks and creating a third phase. Track A will review Verizon's Phase I Order compliance filing for retail business services, and Track B will review appropriate regulatory frameworks and service quality plans proposed by Verizon and others for retail residential services. DTE August 1, 2002, Memorandum, p. 1. This appeal concerns only Track B, in which the Department intends to decide the appropriate regulatory mechanisms and rates for residential customers.

II. STANDARD OF REVIEW

Under Department rules, a party may appeal to the Commission in writing a decision of the presiding officer. 220 C.M.R. 1.06(d)(3). The rules provide that the "presiding officer shall prescribe a reasonable time for the submittal of the appeal and any response to be filed by other parties." *Id.* In this case, the Hearing Officer ordered that any appeal of the schedule be filed within three business days, and denied the Attorney General's request for additional time. Tr. 1, p. 26. The Attorney General files this appeal in accordance with Department rules and the deadline ordered by the Hearing Officer.

III. ARGUMENT

A. Verizon Has Requested Approval To Implement General Increases In Rates.

On April 12, 2001, Verizon proposed to cap basic dial-tone and local usage rates for three years.[2] Phase I Final Order, p. 16. Verizon thus proposed rate freezes and reductions for residential customers, not general rate increases. On June 5, 2002, however, Verizon reversed course and filed a regulatory plan ("Verizon 2002 Plan") that included a request for authority to implement, without further Department review, a potentially infinite number of annual rate increases to its Residential Basic Services of up to five per cent each year. Verizon's 2002 Plan, p. 1.[3]

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[2] Under the cap, rate reductions would be permitted, but rate increases would be prohibited.

[3] Verizon also proposed to raise all MA residential customers' basic monthly rate for telephone services this year by between $1.90 and $2.37 per month (by increasing the monthly dial tone charge from the current $9.91 to between $11.81 and $12.28). Residential rates purportedly would be raised to recover Verizon's claimed lost revenues ($59 million annually) from changes in access fees it previously recovered from interexchange carriers like AT&T, WorldCom, and Sprint. Also, Touch-Tone service (formerly optional) would be rolled into the dial tone rate.

Each such annual rate increase would affect the majority of the Company's customers, as well as the vast majority of customers whose services the Department will continue to regulate.[4] Each such annual rate increase would cause Verizon's aggregate revenues to increase. The Department has found that where the operation of a price cap formula could increase aggregate revenues, it would most likely constitute a "general increase" in rates. *NYNEX*, D.P.U. 94-50, p. 219 (1995); G.L. c. 159, §20. Verizon's request in this case for authority to implement such annual rate increases without further review, without even a price cap formula with an offsetting productivity factor, would constitute a "general increase" in rates. G.L. c. 159, §20.

B. The Department Must Conduct A Review of Earnings and Class Specific Costs.

By statute, where a carrier proposes a general increase in rates, the Department must hold a public hearing and make an investigation as to the propriety of proposed rate changes. G.L. c. 159, §20. The statute also specifies that the Company has " the burden to show that such increase is necessary to obtain a reasonable compensation for the service rendered." *Id*. Verizon has not provided any evidence to support the necessity of any increase in residential rates, much less five per cent annual increases that may extend for years into the future without further Department review.

The Department conducted its last full rate case, reviewing the Company's revenue requirement, affiliate transactions, cost allocation and rate structure, in 1986 and 1987, based on data that are now more than 15 years old. *New England Telephone and Telegraph Company*,

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[4] Verizon has not shown, or even attempted to show, that residential services are "sufficiently competitive." The Department has granted Verizon market-based pricing flexibility for its business services, but not its residential services. DTE 01-31-Phase I, p. 99, May 8, 2002.

D.P.U. 86-33 (1987). In 1994, when the Department was considering a move to price cap regulation for NYNEX, Company rate data were seven to eight years old; the Department recognized that an earnings review was needed. *NYNEX*, D.P.U. 94-50, p. 274 (1995).[5] The price cap that the Department implemented in D.P.U. 94-50 expired August 15, 2001, and the Department now is again considering a new mechanism for setting rates. As in D.P.U. 94-50, it has again been eight years since the last earnings review was conducted.

The Department has recognized that telecommunications is an industry in which overall costs have been declining. This declining cost nature of telecommunications is reflected in the fact that, under the Department-approved Price Cap Plan, Verizon's customers as a whole, primarily business customers, received $296 million in rate reductions. Only last year, in this very case, Verizon proposed to cap residential dial tone and usage rates for three years, allowing reductions but prohibiting increases, and to change rates for other residential services only on a revenue-neutral basis. Given the declining cost nature of telecommunications, Verizon should not be allowed to raise rates for the majority of its customers without proving that those increases are just and reasonable, are needed for reasonable compensation and would not be discriminatory.

While existing rates are presumed to be reasonable until changed, G.L. c. 159, §17, that presumption does not apply to proposed rate increases, which must be shown to be just and

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[5] Similarly, the Department conducted full reviews of revenue requirements and class-specific rate design before beginning price caps for two gas companies. *Boston Gas Company*, D.P. U. 96-50, (Phase I)(1996); *Berkshire Gas Company*, D.T.E. 01-56 (2002). The Department suspended the effective date of proposed rates and investigated for six months in all three of these price cap cases. *NYNEX*, D.P.U. 94-50, Suspension Order, April 20, 1994; *Boston Gas Company*, D.P. U. 96-50, Suspension Order, May 23, 1996; *Berkshire Gas Company*, D.T.E. 01-56, Suspension Order, July 17, 2001.

reasonable based on reasonably current data. G.L. c. 159, §20. The Department may not properly rely on full rate case data from the 1980's or earnings review data from the early 1990's to presume in 2002 that increased rates would be just and reasonable and needed to yield reasonable compensation. *Id.* In addition, Verizon has the burden to show that increases falling entirely on the residential class would not be discriminatory.[6] G.L. c. 159, §§14 and 20. Before authorizing Verizon to implement any residential rate increases, the Department should order the Company to file, and should investigate over six months: 1) a full cost of service/revenue requirement, or, at a minimum, complete earnings data; and 2) a fully allocated Cost of Service Study/"Stand-Alone" Study so that it can properly determine the need for any proposed increase.[7]

C. The Department's Proposed Schedule Is Inconsistent With Statutory Requirements.

In order to satisfy the statutory requirements, the Department should adopt a procedural schedule that will allow for a full investigation of Verizon's proposal for residential rate increases. The Hearing Officer's schedule does not provide sufficient time for either a general rate case investigation, including revenue requirements, or even a more limited review of

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[6] The Department stated in its "tentative conclusions" that "historical evidence has shown that residential rates are likely below their efficient levels," citing D.P.U. 89-300. D.T.E. 01-31-Phase I, p. 96 and 100, May 8, 2002. The Department cannot reasonably conclude, based on 1980's data without additional review of recent residential stand-alone costs, that it would be just and reasonable and non-discriminatory to raise residential rates as Verizon proposes for 2002 and beyond.

[7] The Department indicated in its "tentative conclusions" that any price between a floor of incremental cost and a ceiling of stand-alone costs "must perforce be just and reasonable." D.T.E. 01-31-Phase I, p. 102, May 8, 2002. Putting aside whether such a conclusion is correct legally, the Department would still need to investigate up-to-date earnings data and studies of recent residential stand-alone costs, which Verizon has not submitted. Only after such investigation could the Department properly conclude that raising residential rates above current levels would not exceed the ceiling and would yield just and reasonable and non-discriminatory rates necessary to provide reasonable compensation to Verizon. G.L. c. §§14 and 20.

earnings and appropriate return on investment. The schedule does not allow time for proper investigation of timely class-specific cost of service studies that might serve as a basis for residential rate increases. Nor does the schedule allow time for proper auditing of Verizon's regulatory accounting. The Department should also amend the schedule to reflect that it is Verizon, not intervenors or the Department, that, by statute, bears the burden of proof for the proposed general rate increases to basic residential rates. G.L. c. 159, §20.

To permit proper investigation, the Department should suspend the effective date of proposed rates for six months after proper filings by Verizon, as authorized by statute. G.L. c. 25, §18. The Commission should order Verizon to file data to permit a complete revenue requirements review. At a minimum, the Commission should order a full review of earnings and return on investment, with full cost of service/stand-alone studies and proposed tariffs by October 22, 2002, for effect on November 21, 2002. This would yield a Department order after adequate review by May 21, 2003.

D. The Department Should Order an Independent Audit of the Company's Regulatory Accounting.

Recently there have been disastrous accounting irregularities at telecommunications and energy companies such as WorldCom and Enron. Verizon also has had accounting and reporting irregularities, both nationally and in California. Last week, Verizon Communications, Inc., entered a consent decree and agreed to make a $260,000 "voluntary payment" regarding improper reporting to auditors for the Federal Communications Commission. *Verizon Communications, Inc.*, DA 02-2017; *see also Verizon California Incorporated*, Docket # R.01-09-001, I.01-09-002, August 6, 2002 (Proposed Order finding that Verizon California had

understated its profits from 1996-2001 after a similar audit by the Office of Ratepayer Advocates). As part of this case, the Department should order an audit of Verizon's regulatory accounting by an independent third party auditor selected by the Attorney General.[8] Such an audit is necessary to restore public confidence in light of recent accounting problems and assure the public that rates are not yielding revenues in excess of reasonable compensation.

IV. CONCLUSION

For these reasons, the Attorney General urges the Department to adopt an amended procedural schedule that will allow the Department to fulfill its statutory mandate to investigate proposed rate increases and to order an independent audit of Verizon's regulatory accounting.

Respectfully submitted,

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[8] To maintain impartiality, the Company should pay the costs associated with the examination, but the Attorney General should retain the auditor to conduct the review.