D.T.E. 01-31

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

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INTERLOCUTORY ORDER ON SCOPE

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INTERLOCUTORY ORDER ON SCOPE

I. INTRODUCTION

On February 27, 2001, the Department of Telecommunications and Energy ("Department") opened an investigation to review the appropriate plan to succeed price cap regulation for Verizon New England, Inc.'s d/b/a Verizon Massachusetts' ("Verizon" or "VZ–MA") intrastate retail telecommunications services.[1] The investigation was docketed as D.T.E. 01-31. The Department began its investigation by directing Verizon to file with the Department a proposed retail price plan for its Massachusetts intrastate operations. On April 12, 2001, Verizon filed an Alternative Regulation Plan accompanied by the direct testimony of Robert Mudge, Paula L. Brown, and Dr. William E. Taylor.[2] Pursuant to a deadline established at the first procedural conference and later extended by request of the parties, on May 23, 2001, comments on the scope of the proceeding were filed by

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1 In Petition of New England Telephone and Telegraph Company d/b/a NYNEX for an Alternative Regulatory Plan for the Company's Massachusetts intrastate telecommunications services, D.P.U. 94-50 (1995) ("Price Cap Order"), the Department approved a petition by NYNEX, now Verizon, to replace traditional rate of return regulation with an alternative form of regulation called a price cap. The Department determined that it would begin review of the price cap after six annual price cap filings and that the approved price cap plan would be in effect until August 2001. Price Cap Order at 272-273.

2 Verizon's proposed alternative regulation plan as filed on April 12, 2001 eliminates the residential Touch Tone charge on a revenue-neutral basis, after which the residential dial tone and usage rates are capped for three years. Rates for other residential services may only be changed on a revenue-neutral basis, while rates for all other intrastate services, including business services, may fluctuate according to market demands. In accordance with the Department's directive, Verizon's plan provides for the possibility of a reduction in intrastate switched access rates. In addition, under Verizon's proposed plan, Verizon would continue to be subject to the Service Quality Plan established in the Price Cap Order, with a modification to the penalty payment methodology.

Network Plus, Inc. and Allegiance Telecom of Massachusetts, Inc. (jointly, "Network Plus"); WorldCom, Inc. ("WorldCom"); AT&T Communications of New England, Inc. ("AT&T"); and the Attorney General of the Commonwealth ("Attorney General" or "AG"). On May 31, 2001, Verizon filed a response to the comments on scope ("VZ–MA Response").

II. POSITIONS OF THE PARTIES

As noted above, Network Plus, WorldCom, AT&T, the Attorney General, and Verizon have all filed comments regarding the scope of this proceeding. Each party's position is discussed below.

A. Network Plus

In its Comments, Network Plus argues that the Department may not act in derogation of its statutory responsibility to ensure just and reasonable rates by simply deregulating local telephone service (Network Plus Comments at 5). Network Plus asserts that competition alone cannot be relied upon to achieve the statutorily mandated outcome of just and reasonable rates (id. at 7-9). Network Plus argues that even if the Department has the authority to allow Verizon's proposal, the Department could only do so after substantial inquiry, followed by a conclusion that the competition Verizon faces in relevant markets is sufficient to constrain Verizon's rates to just and reasonable levels (id. at 10-12). Network Plus asserts that Verizon must be required to establish on a rate-by-rate, service-by-service, and market-by-market basis, that it faces sufficient competition such that each of its rates is automatically constrained to just and reasonable levels without the need for regulatory intervention (id. at 11). Network Plus points out that the Department's own Price Cap Order requires that an extensive examination of competition is required as a prerequisite to market-based pricing (id. at 12-13).

Verizon must submit a complete market-by-market competitive analysis, Network Plus asserts, before the Department proceeds any further with its investigation (id. at 13).

Network Plus argues that the Department must require Verizon to submit a detailed analysis of its earnings and financial condition, both past and projected, in order to determine that Verizon will not possess the ability to reap monopoly profits under the pricing flexibility Verizon seeks, either on an overall total company basis or from the provision of retail services for which Verizon allegedly faces significant competition (id. at 14). Network Plus asserts that a comprehensive review of Verizon's earnings is needed to ensure that Verizon's existing rates under the price cap rules have remained at just and reasonable levels, prior to any further relaxation of retail price regulation (id.). In addition, Network Plus asserts that the Department must consider whether existing price floors are sufficient to prevent exclusionary behavior by Verizon, such as tying the sale of new to old services in bundled offerings to business customers or otherwise cross-subsidizing new services by retaining high UNE and resale rates while offering new or enhanced retail services not subject to price floors at below-cost prices (id. at 15-16). Included in this analysis, suggests Network Plus, should be the question whether existing constraints have thus far protected CLECs against Verizon's anti-competitive behavior (id. at 16).

Network Plus asserts that, as part of the scope of this proceeding, the Department should consider the need for a full range of safeguards, such as separation of Verizon's retail and wholesale functions and strict codes of conduct, to prevent Verizon from engaging in exclusionary conduct (id. at 16-17). Finally, Network Plus argues that the Department should consider adopting procedures, such

as expedited consideration of complaints, periodic reporting by Verizon of customer and competitor complaints, and regular audits by the Department, to protect those aggrieved by Verizon's anti-competitive conduct (id. at 17).

B. WorldCom

In its Comments, WorldCom argues that in considering the appropriate policy with respect to Verizon's retail rates, the Department must weigh the impact of its decision on the ability of consumers to choose competing carriers for local telephone service (WorldCom Comments at 1). WorldCom asserts that the future of competition in Massachusetts hinges on how this proceeding is decided relative to the Department's separate and ongoing investigation into wholesale rates for UNEs and resold services in D.T.E. 01-20 (id.). WorldCom asserts that if the relationship between wholesale and retail rates prohibits efficient competitors from a sustainable market entry (e.g., if wholesale rates are too high, or if Verizon engages in cross-subsidization to keep retail rates artificially low), the Department must act to establish the correct, logical relationship between wholesale and retail rates (id. at 2). WorldCom argues that, as a part of the scope of this proceeding, the Department should establish, at a minimum, a price floor methodology through which the reasonableness of Verizon's proposed retail rates would be confirmed (id.).

C. AT&T

In its Comments, AT&T argues that the scope of this proceeding must reflect and build upon the long-standing history of the Department to establish Verizon's retail prices in a manner that is consistent with the promotion of competition (AT&T Comments at 2-13). AT&T argues that, as a preliminary step in this proceeding, the Department must investigate the extent of competition in each market in which Verizon seeks pricing flexibility (id. at 14). AT&T asserts that the statutory requirement of just and reasonable rates must be met for each service performed by Verizon, not simply just and reasonable rates overall as compared with Verizon's overall costs (id. at 14-15). AT&T suggests that the Department follow the lead of the New York Public Service Commission, which has undertaken a comprehensive review of the status of competition in that state as part of that Commission's ongoing alternative regulation proceeding (id. at 16-17).

AT&T also argues that, as part of the scope of this proceeding, the Department must investigate Verizon's costs and earnings to ensure that Verizon's overall rate level is just and reasonable (id. at 17). Such an investigation, AT&T asserts, must include the question whether Verizon is currently producing excess profits and whether some services are cross-subsidizing others (id.). AT&T argues that if Verizon is earning excess profits, that indicates Verizon does not face sufficient competition to restrain anti-competitive pricing (id. at 18). In addition, AT&T asserts that the Department should investigate Verizon's rate design and rate structure to ensure that Verizon's rates for each service are just and reasonable (id. at 18). AT&T argues that if certain of Verizon's services are priced below-cost because they are cross-subsidized by excessive prices on other services, competition for the

below-cost services will never develop (id. at 18-19). This proceeding, AT&T argues, must include an investigation as to whether Verizon's rates have moved to economically efficient levels and whether pricing Verizon's residential services at the marginal cost estimates produced by Verizon's marginal cost study is anti-competitive (id. at 20). AT&T asserts that, following such an investigation, the Department will conclude that Verizon's rate design is economically inefficient and that its residential rates are anti-competitive, and, thus, this proceeding should also include a determination of the appropriate rate structure for Verizon (id.).

AT&T asserts that, as part of this proceeding, the Department should establish an imputation-based price floor and a universal service funding mechanism (id. at 20-23). AT&T contends that the Department's prior declination to approve an imputation-based price floor as stated in the Price Cap Order, is no longer valid, as the Price Cap Order will no longer be governing Verizon's performance (id. at 20-21). AT&T asserts that, in implementing a properly calculated price floor, a new study will not be required as the Department may rely on the TELRIC cost estimates that will ultimately be approved in the Department's ongoing investigation in D.T.E. 01-20 (id. at 22-23). In addition, AT&T argues that a competitively neutral universal service funding mechanism could mitigate any adverse universal service consequences of adopting the economically efficient rate structure that a proper price floor would necessitate (id. at 21). AT&T suggests that the Department undertake an investigation as part of this docket that will lead to a result that is consistent with the Department's intent in its Local

Competition Order – D,[3] and is consistent with principles of universal service and economically efficient rate design that permits the development of competition (id. at 21-22).

Finally, AT&T argues that the Department should include access pricing in its investigation of Verizon's rate structure (id. at 23-24). AT&T asserts that the Department should mandate that access be priced at its long run incremental cost with a reasonable factor for the proportionate collection of joint and common costs (id. at 23). AT&T suggests placing the issue of access rates on a separate track, while the Department approve, on an interim basis, Verizon's proposed access rate reductions pending further investigation (id. at 24).

D. Attorney General

In his comments, the Attorney General argues that this proceeding must include a revenue requirement or, at a minimum, an earnings review that includes a cost of service study to determine whether Verizon's current and future rates are just and reasonable (AG Comments at 9). The Attorney General argues that a review of Verizon's current rates is even more imperative than when the Department first considered price cap regulation for Verizon's operations, because ten years has passed since the Department's last comprehensive review and because the current price cap plan will expire in August 2001 leaving no presumption concerning the reasonableness of current rates (id. at 5-6). The Attorney General asserts that a determination whether the price of a particular type of telephone service is just and reasonable depends on the cost incurred by Verizon to produce that

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[3] Investigation by the Department on its own Motion into IntraLATA and Local Exchange Competition in Massachusetts, D.P.U./D.T.E. 94-185-D (1998).

service and, thus, this must be the basis of the Department's investigation (id. at 6-7). The Attorney General submits that the Department should require Verizon to file a fully allocated cost of service study using a calendar year 2000 test year, sufficient for the Department to conduct a full-scale revenue requirement and rate structure investigation (id. at 7).

Moreover, the Attorney General argues that this proceeding must include a close examination of market conditions and existing competition (id. at 7). The Attorney General cautions that although the Department and the FCC have concluded that the market for local competition is sufficiently open to permit Verizon to enter the long distance market pursuant to section 271 of the Telecommunications Act of 1996, such a determination is not the same as a determination that actual competition is sufficiently robust to negate the need for regulation (id. at 7-8). The Attorney General asserts that such a determination would require a demonstration by Verizon that all business customers in every corner of the state have meaningful competitive options that will provide protection from an abuse of monopoly power (id. at 7).

Further, the Attorney General argues that Verizon must demonstrate that elimination of the pricing rules included in the current price cap plan is in the public interest and must demonstrate by substantial evidence that the requested pricing freedom will ensure that rates are just and reasonable (id. at 8). Finally, the Attorney General argues that, as part of this proceeding, the Department should permit interested parties to submit alternative regulatory plans for the Department's consideration (id. at 8-9).

E. Verizon

In its response to intervenors' comments on scope, Verizon agrees that inquiries into competitive conditions in Massachusetts are within the scope of the Department's review in this case; however, Verizon argues that inquiries into revenue requirements, cost-allocation, price floors, and other mechanisms to constrain Verizon's market behavior are irrelevant and incompatible with the issues raised by the Department's Order opening this investigation and with the proposed plan (VZ–MA Response at 4). In response to the Attorney General's comments, Verizon argues that the Attorney General has misconstrued Verizon's proposal and the Department's investigation in D.P.U. 94-50 (id.). Verizon asserts that because the rates in effect today reflect the starting rates found reasonable by the Department in D.P.U. 94-50, and have changed only in accordance with the pricing rules of the price cap plan established in that proceeding and set through annual compliance filings, the current rates are just and reasonable (id. at 4-5). Verizon further argues that a time-consuming, resource-intensive, revenue-requirement/cost allocation investigation to prescribe rates, as suggested by the Attorney General, is fundamentally inconsistent with a price cap form of regulation and with Verizon's proposed plan, which permit rate changes based on market conditions (id. at 5-6). Further, while Verizon agrees with the Attorney General that market conditions and existing competition are relevant to this proceeding, Verizon disagrees with the level of detail that the Attorney General suggests the Department review (id. at 6). In addition, Verizon agrees that consideration of other parties' proposed alternatives to Verizon's plan will be part of the Department's investigation in this proceeding, as recommended by the Attorney General (id.).

In response to AT&T's comments, Verizon states that AT&T's recitation of the evolution of the Department's regulatory policies is incomplete and mis-characterizes certain aspects (id. at 6-10). Verizon argues that AT&T's contention that the Department failed to rule substantively on AT&T's proposal to establish an imputation-based price floor, and, thus, such a proposal should be included within the scope of this proceeding, is without merit (id.). Verizon asserts that the Department both fully considered and firmly rejected AT&T's suggested approach to price floors in a series of orders in D.P.U./D.T.E. 94-185, and AT&T's price floor approach should not be re-examined yet again in this proceeding (id. at 7-8). Likewise, Verizon argues that AT&T's suggestion that development of a universal service funding mechanism should be part of this proceeding is of doubtful merit (id. at 8). Such an investigation, argues Verizon, would be an enormous and daunting task that would need to be undertaken in a separate proceeding, if at all (id.). Further, Verizon indicates that AT&T's failure to include the history of the Department's regulation of AT&T in its comments is significant, in that AT&T's regulatory history in Massachusetts contains the most applicable precedent for the instant case (id. at 9-10). Verizon criticizes AT&T's suggestion to include a complete investigation of Verizon's costs, earnings, rate design, and rate structure in this proceeding as being incompatible with Department precedent and inconsistent with a market-based pricing regimen (id. at 10).

In response to Network Plus' comments, Verizon agrees with Network Plus' contention that competitive issues are within the scope of this case, but disagrees with Network Plus' other comments (id. at 11). Verizon argues that Network Plus has misstated federal law and its application to the Department when Network Plus asserts that the Department is not legally permitted to rely on

competitive forces to ensure that Verizon's rates are just and reasonable (id.). Rather, argues Verizon, the Department may, and has, interpreted its statutory authority to permit the "just and reasonable" standard to be satisfied by competitive conditions (id.). Verizon further argues that, contrary to the federal cases cited by Network Plus, both the FCC and the Federal Energy Regulatory Commission have deregulated prices in markets found subject to competitive market forces (id. at 12). Also, Verizon argues that the safeguards Network Plus recommends to ensure that Verizon does not engage in discriminatory conduct, such as a Performance Assurance Plan, and the procedures Network Plus recommends to address retail and CLEC complaints, such as expedited dispute resolution, are already in place and do not need to be expanded in the context of this proceeding (id. at 12-13).

In response to WorldCom's comments, Verizon argues that WorldCom's concerns regarding the relationship between wholesale rates and retail rates are likewise beyond the scope of this proceeding (id. at 14). Verizon asserts that because Verizon's proposed plan requires compliance with the Department's price floor requirements established in D.P.U./D.T.E. 94-185, and because wholesale rates are the subject of a separate and ongoing Department investigation in D.T.E. 01-20, those issues are outside the scope of the instant proceeding (id.).

III. ANALYSIS AND FINDINGS

The parties have requested that the Department include in the scope of this proceeding the following eight broad categories: (1) a full rate case or an extensive review of Verizon's past and projected financial information; (2) establishment of imputation-based price floors; (3) coordination of the relationship between wholesale and retail rates and the respective ongoing Department proceedings; (4) development of a universal service funding mechanism; (5) access pricing reform; (6) expansion of competitive safeguards; (7) review of alternative proposals to Verizon's plan; and (8) an investigation into the state of competition in Massachusetts. As discussed more fully below, because we decide to bifurcate this proceeding into consecutive phases, we do not specify at this time which of the above categories, other than an investigation into competitive conditions, are properly within the scope of this proceeding.

A. Background

In Petition of the Attorney General for a Generic Adjudicatory Proceeding Concerning Intrastate Competition by Common Carriers in the Transmission of Intelligence by Electricity, Specifically with Respect to Intra-LATA Competition, and Related Issues, Filed with the Department on December 20, 1983, D.P.U. 1731 (1985) ("IntraLATA Competition Order"), the Department developed a new framework of regulation for all common carriers in Massachusetts. In the IntraLATA Competition Order, the Department established our telecommunications policy goals and adopted an

overall regulatory framework and pricing approach flexible enough to react to marketplace changes.[4] In that Order, the Department created a regulatory classification of "dominant" or "non-dominant," in order to determine the level of price regulation that would be applied to all common carriers. IntraLATA Competition Order at 61-62, 67-69.[5] Under this classification, dominant carriers are subject to traditional regulatory requirements, and non-dominant carriers are presumed to be disciplined by market forces and to have no ability to exercise market power. Id. at 64. In addition, dominant carriers are allowed to petition for a change in classification in response to marketplace changes. Id. at 65.[6]

In the IntraLATA Competition Order, while retaining traditional rate-of-return regulation for Verizon and AT&T as dominant carriers, the Department stated, "[I]f an entire service class is determined to be fully competitive by the Department, we may find that prices set by the market are fair and reasonable, and we will regulate such service class in accordance with minimum statutory requirements. Such a determination may be made only upon a showing by [the carrier] that such a

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4 The three public policy goals adopted by the Department in the IntraLATA Competition Order at 19-24, are economic efficiency, fairness, and universal service. The Department later adopted the additional policy goals of simplicity, earnings stability, and continuity. New England Telephone and Telegraph Company, D.P.U. 86-33-C at 22 (1987).

5 In the IntraLATA Competition Order at 68, the Department designated both AT&T and Verizon, then New England Telephone and Telegraph Company ("NET"), as dominant carriers in the intraLATA market.

6 In 1996, in response to a petition from AT&T, the Department reclassified AT&T as a non-dominant carrier. Petition of AT&T Communications of New England, Inc. for reclassification as a non-dominant telecommunications carrier in the interLATA and intraLATA telecommunications markets in Massachusetts, pursuant to Chapter 159, s. 12 of the General Laws, D.P.U. 95-131, at 9 (1996).

service class is fully competitive." Id. at 39-40. Similarly, in a decision denying AT&T's first request to be reclassified as a non-dominant carrier, the Department noted that, "AT&T . . . may . . . request that certain services be classified as sufficiently competitive." Petition of AT&T Communications of New England, Inc., pursuant to Section 1.04 of the Department's Procedural Rules, Mass. G.L. c. 159, Section 12, and the Department's Order in D.P.U. 1731 (October 18, 1985) for approval to be reclassified as a "non-dominant" telecommunications carrier in the InterLATA and IntraLATA telecommunications markets in Massachusetts, D.P.U. 90-133, at 32 (1991). Therefore, several years before the implementation of the Telecommunications Act of 1996, the Department anticipated that Massachusetts markets could reach the point where competition, rather than traditional regulation, would govern the prices for some of a dominant carrier's retail telecommunications services.

The Department first addressed a dominant carrier's request for an alternative from traditional rate-of-return regulation for the majority of the carrier's services in Petition of AT&T Communications of New England, Inc., pursuant to G.L. c. 159, s. 12 and 220 C.M.R. 1.04, for an alternative mode of regulation of the Company's Massachusetts intrastate telecommunications services, D.P.U. 91-79 (1992) ("AT&T Alt. Reg. Order"). In the AT&T Alt. Reg. Order, the Department discussed at length a framework for measuring the level of competitiveness of a market. Id. at 31-36. The Department also indicated that a finding that a telecommunications service is "sufficiently competitive" permits the Department to approve market-based pricing of the service. Id. at 18. Also in that Order, the Department, for the first time, approved an alternative to traditional cost-based regulation for the services of a dominant carrier that are not sufficiently competitive. Id. at 44. As part of its evaluation in

that case, the Department did not undertake or require a review of AT&T's costs or earnings. See id. at 1-2 and n.3.

In Petition of New England Telephone and Telegraph Company d/b/a NYNEX for an Alternative Regulatory Plan for the Company's Massachusetts intrastate telecommunications services, D.P.U. 94-50 (1995) ("Price Cap Order"), the Department concluded that adoption of a price cap as an alternative form of regulation for Verizon, then NYNEX, did not require a specified level of competition or market structure (see Price Cap Order at 112-115); however, "[i]f NYNEX were requesting market-based pricing in the instant petition, it would certainly be required to make a showing of effective competition in order for the Department to consider granting such relief." Id. at 114-115. Indeed, over time, the Department has approved pricing flexibility for most carriers in Massachusetts, and has allowed all non-dominant carriers to employ market-based pricing.

Verizon's proposed plan filed with the Department on April 12, 2001, again asks the Department to consider a new regulatory framework for Verizon. We have the advantage this time of being able to rely and build upon the groundwork done in D.P.U. 1731 and subsequent cases, and the findings therein. Therefore, while the Department acknowledges that significant changes have occurred to the telecommunications marketplace over the years, and that the Department has recently held that the Massachusetts local exchange marketplace is "irreversibly open" to competition,[7] any new

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[7] In the Matter of Application by Verizon New England, Inc., Bell Atlantic Communications, Inc. (d/b/a Verizon Long Distance), NYNEX Long Distance Company (d/b/a Verizon Enterprise Solutions), and Verizon Global Networks, Inc., For Authorization Under Section 271 of the Telecommunications Act of 1996 To Provide In-Region, InterLATA Services in Massachusetts, CC Docket 00-176, Evaluation of the Massachusetts Department of

regulatory framework for Verizon adopted by the Department must be supported by a Verizon showing that the Department's statutory mandate of "just and reasonable" rates, as well as the Department's telecommunications public policy goals of economic efficiency, fairness, universal service, simplicity, earnings stability, and continuity, will be met.

B. Scope

We conclude that Verizon's proposal in this proceeding is more akin to AT&T's request for alternative regulation addressed by the Department in D.P.U. 91-79, than it is to Verizon's price cap plan addressed in D.P.U. 94-50. As the Department noted in D.P.U. 94-50, indexed price cap regulation is a method for rate regulation of monopolies, which does not require any showing of competition as a prerequisite. Price Cap Order at 112-115. In D.P.U. 91-79, AT&T asked that a large portion of its services be classified as sufficiently competitive and that the remaining services not be rate-regulated according to traditional cost-based standards. AT&T Alt. Reg. Order at 11-13. In the instant proceeding, Verizon is, in effect, requesting classification of a large portion of its services as sufficiently competitive, and is proposing an alternative to traditional cost-of-service regulation for the remaining services. Thus, the appropriate regulatory framework for Verizon's retail services is dependent upon how the Department responds to Verizon's showing of sufficient competition. Based on the comments on scope received by the Department, there appears to be significant disagreement about whether or not there is sufficient competition in Massachusetts to warrant either market-based pricing or a departure from cost-of-service or indexed price cap regulation. It would be inefficient for

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Telecommunications and Energy at 1 (filed October 16, 2000).

the Department, Verizon, and other parties to proceed on an evaluation of the specifics of Verizon's proposal or alternative proposals before determining whether Verizon has met its burden of showing that there is sufficient competition.[8]

Accordingly, we bifurcate this proceeding into consecutive phases. In the first phase of this proceeding, we will undertake an investigation into the levels of competition, the specific standard of review, and the necessary Department findings regarding sufficient competition.[9] The content of the second phase of this proceeding will be governed by the outcome of the first. If Verizon meets its burden of proof to show that the services for which it seeks pricing flexibility are sufficiently competitive and that competition is sufficient to warrant the use of an alternative form of regulation for other services, the second phase will consist of an investigation into whether Verizon's proposed plan, or later-filed intervenors' plans, for regulatory treatment of those services is appropriate. If Verizon has

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8 For example, if the Department determines that Verizon has not demonstrated that there is sufficient competition in Massachusetts, then market-based pricing flexibility for a large number of services would be precluded. Similarly, if the Department determines that Verizon has demonstrated sufficient competition, then an evaluation by other parties of Verizon's cost-of-service and earnings would be irrelevant. In order to avoid spending a significant amount of time and resources investigating issues and proposals that may be unnecessary, an investigation into competition should come first.

9 As noted by the intervenors, an analysis of Verizon's ability to sustain monopoly profits is relevant to an investigation into sufficient competition. However, basing such an analysis on fully-allocated, embedded costs would not be relevant to a market inquiry because fully-allocated costs are a regulatory construct only and have no economic validity. See, e.g., William Baumol, Michael F. Koehn, and Robert D. Willig, How Arbitrary is "Arbitrary?" – or Toward the Deserved Demise of Full Cost Allocation, Public Utilities Fortnightly, September 3, 1987, at 16-21. An analysis of monopoly profits as evidence of a lack of sufficient competition should be based on incremental cost and, potentially, stand-alone cost, taking into account an efficient, demand elasticity-based recovery of joint and common costs.

not met its burden in the first phase, the second phase will consist of an investigation into which form of regulation, be it a continuation of price cap, a restoration of rate-of-return regulation, or some alternative, is appropriate for the level of competition demonstrated by our investigation in Phase I. At the start of the second phase, the Department will address whether the additional categories that intervenors have argued should be included in the scope of this proceeding (e.g., universal service funding, price floors, access reform, a full rate case or earnings review, etc.) will be part of the second phase.

In sum, the scope of the first phase of this proceeding will be an evaluation of whether or not there is sufficient competition in Massachusetts to warrant: 1) a classification of "sufficiently competitive" for the services for which Verizon proposes full market-based pricing flexibility or revenue-neutral price changes; and 2) a departure from traditional cost-of-service or indexed price cap regulation for the remaining services. The Department's evaluation in this phase will be guided by its precedent established in IntraLATA Competition Order, D.P.U. 1731 (1985), NET–Centrex, D.P.U. 85-275/276/277 (1985); NET–Intellidial, D.P.U. 88-18-A (1988); AT&T Customer-Specific Pricing, D.P.U. 90-24 (1991); AT&T Alt. Reg. Order, D.P.U. 91-79 (1992); and Price Cap Order, D.P.U. 94-50 (1995).

IV. CONCLUSION

Given the above, the Department deems it appropriate to establish a procedural schedule for the first phase of this proceeding. Therefore, the Department will hold a second procedural conference on Monday, July 9, 2001, at 10:00 a.m., at the offices of the Department, to determine a procedural

schedule governing the orderly conduct of Phase I.[10] This Order shall serve as notice to parties in this case of the procedural conference. The Department encourages all parties that desire to be heard regarding the determination of the procedural schedule of Phase I to be present at the July 9, 2001 procedural conference.

V. ORDER

Accordingly, after due consideration, it is

ORDERED: That this proceeding be bifurcated into consecutive phases, and the initial phase of this proceeding will comprise an investigation into whether the services for which Verizon seeks pricing flexibility are sufficiently competitive and whether the remaining services warrant a departure from traditional cost-of-service or indexed price cap regulation; and it is

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[10] The Department's proposed procedural schedule for Phase I is attached as Appendix A.

FURTHER ORDERED: That a second procedural conference in this proceeding will be held at the offices of the Department on Monday, July 9, 2001.

By Order of the Department,

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James Connelly, Chairman

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W. Robert Keating, Commissioner

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Paul B. Vasington, Commissioner

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Eugene J. Sullivan, Jr., Commissioner

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Deirdre K. Manning, Commissioner

APPENDIX A

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	)	D.T.E. 01-31-Phase I
Verizon New England, Inc. d/b/a Verizon	)	
Massachusetts' intrastate retail telecommunications	)	
services in the Commonwealth of Massachusetts	)	
	)	

D.T.E. PROPOSED PROCEDURAL SCHEDULE FOR PHASE I

July 9	Procedural Conference
July 31	Intervenor rebuttal testimony due
August 21	Verizon sur-rebuttal testimony due
September 14	Open discovery period closes
October 1-12	Evidentiary hearings
October 24	Initial briefs due
November 7	Reply briefs due