

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE TARIFF FILING BY)
VERIZON DELAWARE INC., FOR ITS ANNUAL)
APPLICATION OF THE PRICE CAP FORMULA)
IN ACCORDANCE WITH § 707(B) OF THE) PSC DOCKET NO. 06-004
THE TELECOMMUNICATIONS TECHNOLOGY)
INVESTMENT ACT)
(FILED MARCH 31, 2006))

ORDER NO. 6993

This 25th day of July, 2006, the Commission determines and Orders the following:

1. On March 31, 2006, Verizon Delaware Inc. ("VZ-DE") filed its annual Price Index ("PI") filing for the year 2006. See 26 Del. C. §§ 701-711 (2004 Supp.). That filing reflects an increase in the PI (due to higher inflation and an exogenous cost adjustment), offset in some part by the banked aggregated amount carried forward from VZ-DE's 2005 PI filing. VZ-DE proposed upward rate adjustments to basic services to capture the net PI increase.

2. The Commission has considered VZ-DE's PI filing, the Division of the Public Advocate's comments and VZ-DE's reply, and Staff's Memorandum. Based primarily on Staff's recommendations, the Commission will approve the rate adjustments to basic services proposed by VZ-DE to be effective July 25, 2006. The Commission will also approve the one-time refunds and credits proposed by VZ-DE (as amended by its May 6, 2006 submission) for the "banked" 2005 PI decrease, subject to any modification required to reflect the July 25, 2006 effective date for the going-forward rate adjustments.

3. The Commission will enter an accompanying opinion at a later time.

Now, therefore, **IT IS ORDERED:**

1. That, for the reasons to be fully explained in a later-filed opinion, the rate adjustments (both in amount and structure) proposed by Verizon Delaware Inc. in its Price Index filing submitted on March 31, 2006 are approved. Verizon Delaware Inc. is authorized to adjustment its "basic service" rates consistent with the rate adjustments set forth in the Price Index filing.

2. That the use of a surcharge as a means to capture Price Index adjustments for residential and business classes of services is approved.

3. That the rate adjustments approved in Ordering paragraph 1 shall be effective, for basic services provided on or after July 25, 2006. Verizon Delaware Inc. shall promptly provide refunds or credits to customers for amounts collected by it because it implemented and collected such rate adjustments prior to Commission approval and prior to July 25, 2006. Verizon Delaware Inc. shall, within ten days of this Order, file a report with the Commission indicating the amount of such refunds and credits and how it will provide such refunds.

4. That the proposed one-time refunds and credits as set forth in the Price Index filing submitted by Verizon Delaware Inc. on March 31, 2006 (and amended on May 6, 2006) related to the aggregated, and banked, amounts for the Price Index filing for 2005 are hereby approved, subject to the following described modification. If the

effective date set forth in Ordering paragraph 3 causes the refund or credit amounts to change, Verizon Delaware Inc. shall, within ten days of this Order, file a report reflecting the new one-time refunds and credits calculated based on the July 25, 2006 effective date for the rate adjustments.

5. That an opinion to accompany this Order shall be entered at a later time.

6. That the Commission reserves the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

/s/ Arnetta McRae
Chair

/s/ Joann T. Conaway
Commissioner

/s/ Dallas Winslow
Commissioner

/s/ Jaymes B. Lester
Commissioner

/s/ Jeffrey J. Clark
Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary

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INVESTMENT ACT)
(FILED MARCH 31, 2006))

FINDINGS AND OPINION TO ACCOMPANY PSC ORDER NO. 6993

This 31st day of October, 2006, the Commission determines and Orders the following:

I. BACKGROUND

1. In 1994, Verizon Delaware Inc. ("VZ-DE") chose regulation under the "TTIA."¹ As Staff has reminded us, in every year since then, the Price Index ("PI") adjustments under the "price cap" mechanism used to regulate VZ-DE's "basic services" have always been "downward." In other words, in each prior year the statutory "productivity offset" of 3% was always greater than the changes in overall general input prices (as measured by the change in the GDPPI").² This was so even in years when such input price factor might have been supplemented by some additional "exogenous" costs. For more than a decade, these

¹Telecommunications Technology Investment Act, codified at 26 Del. C. §§ 704-711 (2004 Supp.). The Commission adopted "Rules and Regulations for Implementing the Telecommunications Technology Investment Act" by PSC Findings, Opinion, and Order No. 4821 (June 9, 1998) ("TTIA Rules"). There is no need to here review the mechanics of the TTIA's "price cap" mechanism as it relates to the regulation of VZ-DE's "basic services." Those details can be garnered from prior Orders approving earlier VZ-DE's annual PI filings.

²Gross Domestic Product Price Index.

downward PI adjustments resulted in reductions in prices for one or more "basic" services in each of the customer classes - residential, business, and interexchange carriers ("IXCs").

2. VZ-DE's 2006 annual PI Report reverses this streak.³ In it, VZ-DE reports that the GDPPI increased by 4.292%, a percentage increase significantly above the 3% productivity offset. And added to that upward movement in input prices is a "positive" \$190,565 "exogenous cost" amount. It arises from the 1 mil increase in this Commission's annual regulatory assessment.⁴ In translating these changes into "rate adjustments," VZ-DE first aggregated the 2006 price cap changes into a dollar amount and then reduced such 2006 amount by the \$105,000 "negative" adjustment carried-forward from the year 2005 PI filing.,⁵ VZ-DE proposed to capture this additional revenue amount for "basic" services in the following way:

- (a) implement a "new" \$.06 surcharge (inflation adjustment") for each residential line (not included in any combined pricing package);
- (b) decrease the existing business dial-tone line credit from \$1.23 to \$.42; and

³Price Index filing (Mar. 30, 2006), as amended by supplemental corrections filed May 3, 2006.

⁴See 75 Del. Laws ch. 141 § 1 (2005), amending 26 Del. C. § 115(d) to increase the utility regulatory assessment factor from .002 to .003. This 2005 legislative change explicitly allows VZ-DE to treat the increase in the assessment amount as an exogenous cost factor in its "basic services" PI filing. Id. at § 5. VZ-DE's PI Report seeks to recover the entire amount of the assessment increase from "basic services" although the regulatory assessment is calculated against all of VZ-DE's intrastate services. While one could argue that "non-basic" intrastate services should also bear at least a portion of this "tax" increase, the statutory language can be read to allow the recovery of the entire amount from the increase through adjustments to basic service prices.

⁵See PSC Order No. 6668 (July 5, 2005).

- (c) increase the interexchange carrier local switching rate to \$.009635 from \$.009344.⁶

In addition, in its Report, VZ-DE outlined customer "refund" credits to capture the downward adjustments foregone in 2005 because of the "banking" of the aggregated amount for that year's PI decrease.⁷ Those one-time refund credits would be:

- (a) \$.13 for customers with residential touch-tone service;⁸
- (b) \$1.42 for business dial-tone lines; and
- (c) various credits to interchange carriers based on the particular carrier's proportionate share of local switching minutes of use during 2004.

3. VZ-DE published notice of its proposed PI rate adjustments. No VZ-DE subscriber, other carrier, or any other interested party, filed any comments or objections to the PI Report or its proposed price adjustments. However, the Division of the Public Advocate ("DPA") did file objections. Those comments focused on the use of the "inflation adjustment" surcharge as the means to adjust prices for each residential "non-package" dial-tone line. The DPA did not challenge the amount of such adjustment (in terms of a \$.06 monthly

⁶TTIA Rule § 3.4.5(1) allows a called-for PI decrease in rates to be aggregated (changed into a dollar amount) with such dollar amount then targeted to rates for specific basic services. In this year's PI filing, the PI adjustment is upward and hence calls for an increase in rates. The TTIA Rules do not specifically authorize dollar aggregation and targeting in the case of such a PI increase. However, the Commission will allow VZ-DE to aggregate here. In fact, aggregation seems particularly appropriate where, in calculating this year's adjustment, VZ-DE has to factor in the aggregated amount (a decrease) carried forward from last year's PI filing.

⁷See TTIA Rule § 3.4.5(2).

⁸See VZ-DE letter (May 4, 2006) (amending residential refund amount from \$.07 to \$.13).

charge). Rather, it objected to VZ-DE's decision to use a surcharge mechanism to flow through the PI adjustment rather than make an upward adjustment to the actual tariffed rate for dial-tone service. According to the DPA, the use of a separate surcharge mechanism might undermine a consumer's ability to compare the price for basic stand-alone dial-tone services offered by VZ-DE and the price for the same service offered by competitors. As the DPA sees it, if the stand-alone dial-tone rate is not directly changed, retail customers might view VZ-DE's rate as unchanged (and hence lower priced) without readily appreciating that subscription to such stand-alone service from VZ-DE will also require payment of the "inflation adjustment" surcharge. In addition, the DPA suggests that "consumers' telephone bills have more than enough line items other than rates." Rather than add another surcharge to that list, the Commission should direct a change in the actual rate as the TTIA anticipates.

4. VZ-DE responded to the DPA's objections. Initially, VZ-DE countered that the use of a "surcharge" for residential customers would not, in practical terms, compromise the ability of consumers to exercise choice in selecting a local provider. According to VZ-DE, in the current climate of bundled telephone offerings, consumers mostly make decisions about using one or another provider based on advertised total bill or package charges rather than the particular rate elements for particular services or particular components within the bill or package. Thus, VZ-DE says, a surcharge versus a rate increase (for dial-tone) amounts to a difference that is without any distinction to

consumers. Turning to the Advocate's position that surcharges already proliferate and that another one should not be added, VZ-DE suggested that "at this late date" any change from its surcharge proposal to a rate element increase would waste costs already incurred by it and furthermore confuse customers. According to VZ-DE, it had committed months earlier to the surcharge mechanism and set in motion its internal processes to revise its billing systems to implement the TTIA changes (including this new surcharge) and also to notify residential customers of the new surcharge. Because the billing system revisions included both the residential and business changes, if the new residential inflation factor surcharge was to be rejected, VZ-DE would not be able to implement the dial-tone rate increase change by the traditional "effective date" for TTIA rate changes. Instead, VZ-DE posited that, if it was to begin to timely collect the additional revenues called for by the PI adjustment, it would be "forced" to go forward with the residential surcharge until it could change-over to the equivalent new rate-element increase. That would not come until some time in early 2007. VZ-DE pointed out that following such process would only confuse customers by suggesting to them that there had been two rate increases within a short time (the surcharge and then the rate element increase). Added to that would be the need for a costly second round of customer notifications. In addition, VZ-DE suggested that the use of a separate surcharge promotes rate stability, in the sense the surcharge eliminates the scenario of particular rate elements moving up and down by several cents depending

on each annual PI adjustment. It notes that, in 2004, the Commission allowed a similar "surcharge" device - the business customer credit - to be utilized for TTIA adjustments on the business-customer side. Moreover, VZ-DE says that its preference, in terms of marketing, is to adjust the actual dial-tone use rate only to reflect market conditions and the needs of the company. VZ-DE urged the Commission to approve the residential surcharge vehicle or, at a minimum, to allow its use until the implementation of the year 2007 annual PI adjustments.

5. VZ-DE implemented its adjustments and refunds effective as of July 1, 2006. It did so without the Commission first approving the proposed PI adjustments and corresponding rate and surcharge changes.⁹ Staff subsequently filed a memorandum recommending approval of the TTIA adjustments proposed by VZ-DE's PI filing (as amended.)¹⁰ With regard to the issue surrounding implementation of a residential surcharge to capture the TTIA adjustment, Staff reported that - in its view - there does not appear to be anything in the TTIA itself, or the implementing Commission regulations, that would explicitly foreclose use of a "surcharge" to recover TTIA aggregated amount adjustments. Staff noted that the statutory permission for VZ-DE to make revenue-neutral adjustments in the "rate structure" of a particular basic

⁹TTIA Rules §§ 3.4.4 and 3.4.5 allow the Commission 120 days after the filing of the annual PI Report to act on the proposed PI and accompanying rate adjustments. In this case, the 120-day period ran until August 1, 2006. However, in past years, the Commission has acted on PI filings before July 1 and, in doing so, has allowed PI rate adjustments to become effective on July 1.

¹⁰Staff specifically endorsed exogenous cost treatment for the increase in the annual regulatory assessment amount.

service is ambiguous as to the imposition of a "surcharge." At the same time, in Staff's view, the use of a surcharge mechanism (to be revised yearly) would provide VZ-DE a straight forward, easy to administer, and less costly means to implement the actual TTIA adjustments. However, while signing on to the PI adjustments, Staff did voice serious concerns about VZ-DE's inability to modify its internal billing systems for Delaware without significant (several month) lead times. In particular, Staff suggested that such inability to make changes except with several months lead time might undermine or circumscribe the Commission's decision-making prerogatives in considering VZ-DE's filings. For example, here, VZ-DE, on its own, implemented its residential surcharge proposal within its internal billing system and then, in part, relied on the momentum of such internal process (and its inability to promptly implement any alternative) as one basis for rejecting the DPA's proposal that the TTIA adjustment should be reflected in an adjustment to the actual dial-tone rate element. Staff also emphasized the fact that, in this particular matter, VZ-DE had implemented its TTIA changes effective July 1, 2006, even though the Commission had not, before then, approved the level of the adjustments or the use of a residential surcharge mechanism. Staff asserted that such unilateral action, regardless of the underlying reason, violated the basic concept of Commission oversight over basic rate changes under the TTIA. It recommended that, even if the Commission were to approve VZ-DE's PI filing in toto, the Commission should make such changes effective only

after such Commission approval and direct VZ-DE to make refunds of any PI-adjusted amounts collected prior to the effective date chosen by the Commission.

6. The Commission considered VZ-DE's PI Report at its meeting on July 25, 2006. The Commission entered Order No. 6993, approving the resulting PI adjustments and rate changes (including implementation of the residential "inflation adjustment" surcharge), but with an effective date of July 25, 2006. It directed VZ-DE to promptly refund any amounts it might have collected from subscribers in light of VZ-DE's decision - without prior Commission approval - to make those PI changes effective July 1, 2006. These are the findings to accompany that earlier Order.

II. FINDINGS AND OPINION

A. Price Index Adjustment Amounts

7. Staff does not find fault with how VZ-DE computed the amounts of the PI adjustments, nor the amount of the refunds for last year's banked PI amounts. Similarly, the DPA's objection goes to how the adjustments are to be implemented, not the level of the PI adjustments.¹¹ Consequently, the PI adjustments and the resulting

¹¹As noted, in "aggregating" the upward increase in the PI adjustment into dollar amounts, VZ-DE followed the same methodology it has previously used in "aggregating" the dollar amounts for downward PI adjustments. Thus, the "total" basic service revenue pool against which the PI percentage adjustment was applied was limited to revenues from basic services provided "above cost." Given this choice by VZ-DE to follow past practice, there is no occasion for the Commission to scrutinize whether the exclusion of revenues from "below cost" basic services - presumably premised on 26 Del. C. § 707(c)(3) (2004 Supp.) - applies in the context of "upward" PI adjustments. Moreover, as in past year PI aggregation calculations, the pool of revenues does not include revenues from "basic" services that might be included in

aggregated amounts to be allocated to the three customer classes for basic services are approved.

B. Residential Surcharge

8. The DPA objects to the use of a line-item surcharge method to implement the aggregated PI adjustment amount allocated to residential customers. In the Advocate's view, this new line item will hinder "comparative shopping" by consumers and add one more line to an already disliked bevy of line-item charges. Significantly, no competing carrier filed objections here related to this new proposed residential surcharge.

9. The Commission will approve the implementation of the residential surcharge to recover this year's PI upward adjustment for that class of customers. However, the Commission specifically reserves the right to later revisit the issue in 2007, or thereafter, in light of later PI adjustments or other changed circumstances. The Commission chooses this course in light of the experience with the similar "business credit" that, two years ago, the Commission allowed VZ-DE to utilize for a PI adjustment for its business customers. That "credit" mechanism was also a line-item surcharge to implement a PI adjustment - although as initially constructed it was a billing "credit." Most importantly, since its implementation, that credit line-item mechanism does not appear to have drawn significant criticism from competing carriers or sown significant confusion among

bundled service packages that have been classified as "discretionary" or "competitive" offerings.

VZ-DE's business subscribers about the prices of VZ-DE's basic services.¹²

10. The Commission acknowledges the DPA's position that the use of a "bottom of the bill" surcharge might make it more difficult for residential consumers to make an exact "apples to apples" comparison of the rates for stand-alone dial-tone basic service as between VZ-DE and competing carriers. However, the Commission believes that - given that the surcharge would now be only \$0.06 - such possible "confusion" is not likely to skew a consumer's choice of service providers. Perhaps, if the residential line item grows to a larger, significant amount, linkage to a particular rate element might be appropriate.¹³ Moreover, the Commission notes that bundled packages - local, toll, and other services - are increasingly becoming the standard marketing vehicles for VZ-DE and its wireline, wireless, cable, and broadband competitors. In such a world, customers are likely to shop by the

¹²The Commission has not previously formally "approved" the business subscriber line time credit as a method for PI adjustments. See PSC Orders Nos. 6443 (June 22, 2004) & 6668 (July 5, 2005). The Commission now approves that mechanism, based primarily on experience with it over the last two years. But again, the Commission reserves the right to revisit the use of this mechanism in the future if concerns or problems arise.

¹³This is not to say that the surcharge is to be ignored. If a potential subscriber inquires about the price for basic dial-tone service and local calling, the surcharge amount should be noted as part of that combined price. Similarly, in setting the "retail" price for purposes of calculating the "wholesale discount" under 47 U.S.C. §§ 251(c)(4) and 252(d)(3), VZ-DE shall factor in the residential surcharge (a positive) or the business credit (a negative) as part of the "retail" rate for dial-tone service. If questions arise as to the application of the surcharge (or business credit) in particular contexts, the Commission can decide those issues on a case-by-case basis.

entire package price, not by the prices for various individual components or individual service offerings.¹⁴

11. Finally, the Commission believes that the surcharge mechanism - at least so long as it remains at the level of a few pennies - does offer some advantages in terms of the administration of annual PI adjustments. If, in the next several years, the PI adjustments return to downward amounts, or continue at aggregated levels that translate into a few cents, then the surcharge gives a mechanism to easily implement those changes.

12. At the same time, the Commission is not prepared, at this point, to say that the provisions of 26 Del. C. § 707(c)(4) (2004 Supp.) explicitly endorse the "inflation factor" surcharge or the earlier business credit regime.¹⁵ That statutory provision allows VZ-DE (with the Commission's approval) to make adjustments to the rate structure "for a basic service." Clearly, such language allows restructuring of a particular service's rate structure. But it is less clear whether it would allow a "bottom of the bill" line charge,

¹⁴In many instances, VZ-DE has bundled one or more basic services into discretionary or competitive packages offered to residential customers. As noted earlier, VZ-DE will not impose the surcharge amount on such discretionary or competitive packages. However, the Commission expects VZ-DE to factor into the "price floor" for pricing such packages the surcharge amount approved here. See 26 Del. C. §§ 708(a)(2) and 709(2) (2004 Supp.).

¹⁵VZ-DE has cited such provision as legal support for both its earlier business credit and its current residential surcharge. VZ-DE's view is that both line items (business and residential) are "linked" to the customer purchasing a "basic" access line. Accordingly, the surcharges represent a revenue-neutral adjustment to the rate structure for such "basic" service.

linked, but not necessarily included, as a component of the rate for a particular basic service.¹⁶

13. That having been said, the Commission will still allow the line item method. The statutory directives in § 707 about the price cap mechanism speak in terms of standards, rather than particular hard and fast rules. And as Staff has pointed out, there is nothing in § 707 (or indeed in the TTIA Rules) that expressly deny the use of the surcharge or credit to implement small annual PI adjustments. In the absence of any explicit no-line-item or no surcharge directive, the Commission believes it can approve the use of the method as a policy matter. But again, such approval remains subject to Commission oversight and subsequent change of mind.

C. Refunds

14. As noted earlier, VZ-DE put its TTIA adjustments into effect on July 1, 2006, ninety days after it filed its PI Report. That effective date mirrored the effective date for TTIA rate adjustments in many prior years. But VZ-DE's actions this year came before Commission approval (which was not due until August 1, 2006).¹⁷ In Order No. 6993, the Commission made the 2006 PI adjustments effective July 25, 2006 and ordered refunds of PI adjustment amounts that might have been previously billed and paid. In ordering such

¹⁶Here, VZ-DE linked the applicability of both the surcharge and business credit to the customer purchasing a stand-alone dial-tone access line. However, VZ-DE has not specifically modified the rate components for that particular service. Indeed, in its reply to the DPA, VZ-DE posits that it prefers not to change the "rate" for the dial-tone rate element except when compelled by market demands.

¹⁷See n. 9 above.

refunds, the Commission felt no need to sort out how or why VZ-DE chose to use the July 1 effective date. Similarly, the Commission did not feel it had to parse what transpired between Staff or VZ-DE about implementing the PI rate and surcharge changes. Rather, it is enough that the TTIA Rules grant the Commission 120 days for review of PI adjustments. Until Commission action was forthcoming (or the review period expired) VZ-DE was not entitled to unilaterally implement the PI adjustments. The refunds commanded by Order No. 6993 were appropriate, if not compelled.¹⁸

D. Billing Change Implementation

15. Last, the Commission is concerned about Staff's concern that VZ-DE's internal billing and rate change processes not become - either purposefully or inadvertently - a means to channel Commission decision-making or cabin Commission prerogatives. The Commission appreciates the logistics that are necessary to internally implement rate (and accompanying bill) changes for a single jurisdiction within the huge corporate entity that is now Verizon. And the Commission does not dispute that in the context of such a corporation, a local subsidiary (such as VZ-DE) might have to get in line "early" in order to have its rate change Orders implemented by a specific time. But the TTIA's regulatory model delegates to the Commission, not the utility's internal practices, ultimate decisions concerning what

¹⁸VZ-DE, on August 7, 2006, submitted a letter outlining the amounts of such refunds and how they would be implemented.

prices consumers are to pay for "basic" services.¹⁹ But if a utility comes in asserting that the delays inherent in its own internal processes preclude the timely implementation of one possible result, then the Commission's power to approve or disapprove a particular filing (or to choose a particular rate or mechanism) is potentially undermined. The Commission expects that VZ-DE will be able to promptly and fully implement any decision that the Commission may make regarding the rates, terms, and conditions of VZ-DE's regulated retail offerings.

NOW, THEREFORE, IT IS directed this 31st day of October, 2006, that these Findings and Opinion shall be filed with PSC Order No. 6993 (July 25, 2006).

BY THE COMMISSION:

/s/ Arnetta McRae
Chair

/s/ Joann T. Conaway
Commissioner

/s/ Jaymes B. Lester
Commissioner

/s/ Jeffrey J. Clark
Commissioner

¹⁹See TTIA Rules §§ 3.4, 3.4.4, 3.4.5. Cf. 26 Del. C. §§ 703(c)(4) (rate structure may be adjusted by Commission); 703(b) (rates for basic services may be adjusted with "approval by the Commission" in case of unforeseen, exogenous costs); 703(d) (rate adjustments under 703(c)(4) and (c)(5) may be made "with the Commission's approval" at any time).

Findings and Opinion to Accompany
PSC Order No. 6993 Cont'd.

/s/ Dallas Winslow
Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary