

Analysis and Recommendations Regarding the Regulation of FairPoint Communications, LLC

Report Required By Act 53 of the 2011-12 Legislative Session



Department of Public Service

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Executive Summary

In response to a directive from the Vermont General Assembly, the Department of Public Service (“Department”) prepared the following analysis and recommendation regarding the appropriate future level of regulation for FairPoint Communications, LLC (“FairPoint). To facilitate a better understanding of this analysis and the Department’s recommendation, a brief history of the regulation of the telecommunications industry in the United States is instructive.

The Communications Act of 1934¹ established laws for the federal regulation of telephone, telegraph and radio communications. It also created the Federal Communications Commission (“FCC”) to oversee and regulate this industry. For the next fifty years, regulation of the telecommunications industry largely involved oversight of American Telephone and Telegraph Company (“AT&T”), the monopoly telecommunications provider that provided both local and long-distance telephone service.

In 1984, ten years after the U.S. Department of Justice brought an antitrust lawsuit against AT&T,² a settlement was reached in which AT&T was allowed to keep its long-distance network but had to divest itself of its local exchange networks. As a result of divestiture, seven entities referred to as regional Bell operating companies (“RBOCs”) were created, each with an exclusive service territory. Under the settlement, the RBOCs were prohibited from offering long-distance service, were required to provide non-discriminatory infrastructure access to all providers of long distance service, and were allowed to continue to provide monopoly service for the local telecommunication needs of all consumers within their service territories.

In response to continued evolution in telecommunications markets and technologies, the Telecommunications Act of 1996 (“1996 Act”) amended the Communications Act of 1934 and dramatically altered regulatory policy. Telephone companies that were in existence before the 1996 Act, including the RBOCs, became known as incumbent local exchange carriers (“ILECs”). Those companies formed after the 1996 Act became known as competitive local exchange carriers (“CLECs”). In exchange for allowing the RBOCs to enter into the long-

¹ 47 U.S.C. § 251 *et seq.*

² *U.S.A. v. American Tel. and Tel. Co.*, 524 F.Supp. 1336, D.C.D.C., (1981).

distance market, the 1996 Act required the RBOCs to open their networks to competitors in the local exchange market and imposed additional regulatory obligations.

Verizon Communications (“Verizon”), the post-1996 Act RBOC in New England, was the product of the 1997 merger between Bell Atlantic and NYNEX, and the acquisition of GTE in 2000. In 2007, Verizon entered into an agreement with FairPoint Communications (“FairPoint”) whereby FairPoint would purchase Verizon’s operations in Maine, New Hampshire, and Vermont. After receiving the required federal and state approvals, the sale was consummated on March 31, 2008, making FairPoint the successor RBOC in northern New England.

In February 2009, FairPoint transitioned from the old Verizon operating systems to its own, newly-developed systems. This process, referred to as the “cut-over,” was fraught with problems that negatively affected many FairPoint customers across Vermont and the rest of northern New England.

In October 2009, FairPoint filed for Chapter 11 bankruptcy protection. By the time FairPoint emerged from bankruptcy in January 2011, less than three years from the time it had become the successor RBOC in Vermont, it had lost more than 33% of its residential access lines in Vermont.³

The cut-over problems and 15-month long bankruptcy undoubtedly affected FairPoint’s ability to retain existing customers and secure new ones. Perhaps more importantly, greater competition, particularly in the urban areas, allowed dissatisfied FairPoint customers to choose another telecommunications provider. The fact that nearly 1/3 of FairPoint’s residential customers in Vermont were able to choose another provider during this time period is noteworthy.

For instance, in 2007, Comcast began offering telephone service⁴ in Vermont, and since that time it has gained customers at almost exactly the same rate that FairPoint has lost them.⁵ In

³ Verizon New England Inc., Vermont annual report for the year ending December 31, 2007 and Telephone Operating Company of Vermont LLC d/b/a FairPoint Communications, Vermont annual report for the year ending December 31, 2010.

⁴ This report uses the term “telephone service” in a non-technical sense, to represent any service that, from the point of view of the consumer, serves as a substitute or replacement for traditional landline premises-based telephone service.

addition, cellular service continues to expand in Vermont. Today, more than 20% of Vermont households have chosen to do away with traditional landline service in favor of cellular-only.⁶ As Vermont moves toward 100% broadband availability by the end of 2013, other means of telephony, such as nomadic VoIP, will be increasingly available to all Vermonters.

There are 239,405 E-911 addresses in FairPoint's Vermont service territory.⁷ While FairPoint remains the dominant telephone service provider in Vermont, 71.8% of the addresses in FairPoint's service territory can choose telephone service from a cable provider and 87.8% can receive telephone service from a cellular provider.⁸ In Vermont and in northern New England generally, the days of the RBOC as the dominant provider are coming to an end. FairPoint operates today in a market in which competition will continue to grow.

FairPoint retains the federal obligation to provide certain services to CLECs on a nondiscriminatory basis, at cost-based rates, as well as the federal and state obligations to provide service as Carrier of Last Resort ("COLR") to Vermonters residing within its service territory who have no alternative for telephone service—all at a time when FairPoint has lost its dominance in the profitable urban markets to competitors that have no such obligations. Meanwhile, many Vermonters do indeed still lack any alternative to FairPoint's service. FairPoint's situation therefore calls for careful and flexible state regulatory policy that recognizes, to the extent permitted by federal law, the reality of the market in which FairPoint now operates while continuing to offer regulatory protection to captive Vermont customers.

In 2005, the Vermont Legislature enacted 30 V.S.A. § 227d. This statute allows small ILECs—those that serve less than 10% of subscriber lines statewide—to elect certain exemptions from state regulation to reduce the cost and burden of regulatory oversight on these small carriers. Though FairPoint serves far more than 10% of the subscriber lines statewide, the Vermont Legislature tasked the Department under Act 53 of the 2011-12 session with performing an analysis of the relative advantages and disadvantages of allowing FairPoint to operate under 30 V.S.A. § 227d.

⁵ Based upon the annual reports of Comcast Phone of Vermont, the Department estimates that Comcast IP Phone II has gained approximately 80,000 customers since in launched its voice service in 2007, while FairPoint lost 67,000 customers over the same period.

⁶ Vantage Market Analysis at p. 19.

⁷ Vantage Market Analysis, Table 70 at p. 81.

⁸ Vantage Market Analysis, Table 42 at p. 57 and Table 54 at p. 67.

As discussed in this report, while the Department firmly believes that FairPoint should be subject to oversight and regulation that is aligned with the very real competitive pressures it now faces, the Department finds that the best way to accomplish the goal continues to be through use of an incentive regulation plan (“IRP”) allowed by 30 V.S.A. § 226b, rather than expanding the reach of 30 V.S.A. § 227d. FairPoint remains the dominant provider in Vermont; it continues to have regulatory obligations to its wholesale customers and captive retail customers as COLR. These are significant and important obligations. In light of these obligations, the Department does not believe it would be prudent to allow FairPoint the exemptions permitted much smaller carriers under Section 227d. Instead, Section 226b allows appropriate and flexible regulatory oversight, ensuring continued protections for those Vermonters who continue to rely upon FairPoint.

In 2011, the Department negotiated with FairPoint a successor IRP pursuant to 30 V.S.A. § 226 (“2011 IRP”) which recognizes the competitive market in which FairPoint operates yet protects the substantial number of customers who are captive to FairPoint.⁹ The 2011 IRP provides FairPoint nearly complete flexibility in pricing of services and reduces by tenfold the amount of penalty dollars at risk for failure to meet retail service quality standards, while continuing to require important consumer protections not afforded under the rules applicable to Section 227d carriers. The 2011 IRP is currently under review by the Public Service Board (“Board”), and, if approved by the Board, offers a far preferable regulatory solution for FairPoint and its captive customers than allowing FairPoint to elect the exemptions given to small eligible telecommunications carriers pursuant to 30 V.S.A. § 227d.

⁹ PSB Docket No. 7724.

Introduction

In January 2011, shortly before it emerged from bankruptcy, FairPoint sought the assistance of the Vermont Legislature in formulating a regulatory framework that provided relief within the competitive marketplace FairPoint faced. FairPoint sought, and continues to seek, what it describes as a “level playing field” in which it can more effectively compete against providers of telecommunications services that are subject to less state and federal regulation.

Pursuant to Act 53 of the 2011-2012 Legislative Session, the Department was asked to conduct a study, as follows:

Sec. 11. TELECOMMUNICATIONS; REGULATORY EXEMPTION

The commissioner of public service shall study the relative advantages and disadvantages of permitting certain telecommunications carriers not currently eligible to avail themselves of the regulatory exemption contained in 30 V.S.A. § 227d. In particular, the commissioner shall limit his or her analysis to telecommunications carriers that have incurred access line losses of greater than 15 percent during the immediately preceding ten years in a service area. The exemption would apply regardless of the number of subscriber lines the carrier has installed in the aggregate statewide and regardless of whether a competitive eligible telecommunications carrier has also been designated in the applicable service area. The commissioner shall determine the impact that this exemption would have on consumers as well as on other telecommunications carriers providing service in Vermont.

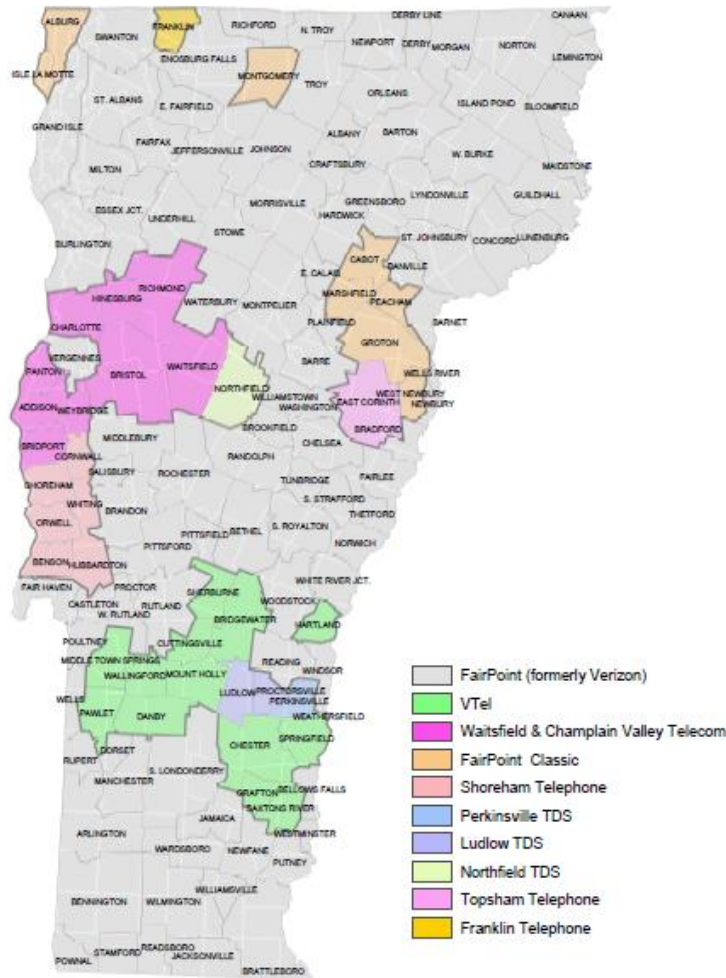
Act 53 limited the analysis: “... to telecommunications carriers that have incurred access line losses of greater than 15 percent during the immediately preceding ten years in a service area.” The only telecommunications carrier in Vermont that has incurred access line losses of more than 15 percent in the last ten years is FairPoint. Thus, the legislative charge presented in Act 53 is to determine whether FairPoint should be permitted to elect treatment as a small eligible telecommunications carrier under Section 227d.

In conjunction with this legislative study and the Board proceeding for approval of the 2011 IRP described herein, the Department commissioned Vantage Energy Consulting, LLC, to prepare a telecommunications market analysis for Vermont and northern New England (“Vantage Market Analysis”). That report is attached as Appendix A to this study.

Background Regarding Vermont Telecommunications Providers and Regulation

1. Incumbent Local Exchange Carriers

Incumbent local exchange carriers (“ILECs”) own the local exchange networks that allow phone calls to be received, routed, and delivered. There are eight ILECs in Vermont. FairPoint Communications, the successor Regional Bell Operating Company (“RBOC”) in Northern New England, is the dominant ILEC and has by far the largest service territory. The other ILECs, often referred to as the Independents, are Waitsfield-Champlain Valley Telephone Company, Vermont Telephone Company, Shoreham Telephone Company, Franklin Telephone Company, Topsham Telephone Company, TDS (Northfield, Ludlow and Perkinsville Telephone Companies), and FairPoint of Vermont (FairPoint Classic in the map below).



All ILECs have federal obligations under the 1996 Telecommunications Act to provide interconnection with competitive local exchange carriers (“CLECs”) and to offer CLECs access to their facilities at cost based rates. Speaking very broadly, there are exemptions to these requirements for ILECs that are considered to be rural. Generally speaking, the Vermont Independents are considered rural and are beneficiaries of these federal exemptions. Additionally, all ILECs have an obligation – state and/or federal – to provide service to any person in their service territories. The obligation for an ILEC to provide service to any person within its service territory is referred to as its Carrier of Last Resort (“COLR”) obligation.

As the successor RBOC, FairPoint is not the beneficiary of many of the federal exemptions that are allowed the Vermont Independents. RBOCs have more stringent federal regulation than do other ILECs; states are wholly preempted from altering these obligations.

Historically, all ILECs had traditional utility rate of return regulation. In the mid-1990s, the Vermont Legislature enacted 30 V.S.A. §226b, which allows an ILEC to elect incentive-based regulation. In 2005, in order to provide additional regulatory flexibility to the Independents, the Vermont Legislature enacted 30 V.S.A. § 227d. This statute allows ILECs that serve less than 10% of subscriber lines statewide to elect certain exemptions from state regulatory oversight. All of the Independents have elected treatment under 30 V.S.A. § 227d.

The more important exemptions provided by § 227d are: relief from traditional rate of return regulation which typically involves long and detailed rate cases; relief from the obligation to file and receive Board approval of rate schedules and tariffs (30 V.S.A. § 225; 30 V.S.A. § 226; and 30 V.S.A. § 227); and relief from the prohibition of deviating from the rates or services set in its schedules or rates in effect without the prior approval of the Board (30 V.S.A. § 229).

Section 227d also provides certain pricing constraints for Basic Local Exchange Service (“BLES”) – basic dial tone service – allowing increases in the pricing of BLES only by a certain amount each year. Price constraints for BLES are an important protection for consumers – particularly for those who are captive customers – as it ensures access to basic telephone service at a reasonable rate.

2. Competitive Local Exchange Carriers

There are numerous competitive local exchange carriers (“CLECs”) in Vermont. A few of the larger CLECs in Vermont are Sovernet, Level Three, Comcast Phone, and Verizon Business.¹⁰ Some CLECs own no facilities, providing service strictly by leasing the facilities of an ILEC. Other CLECs provide service using their own facilities, and still other CLECs own some of their own facilities and lease some facilities from an ILEC.

The Telecommunications Act of 1996 requires that ILECs provide CLECs access to their physical networks and that the ILECs allow the CLECs to interconnect with their networks. The ILECs must provide CLECs certain unbundled network elements (“UNEs”) at cost-based rates. As previously discussed, the Independent ILECs in Vermont are permitted certain federal exemptions from some of these requirements.

All CLECs in Vermont are classified by the Public Service Board as “nondominant carriers” and are regulated pursuant to 30 V.S.A. § 227c. CLECs require no approval for the pricing of the services they offer; CLECs have no COLR obligations. CLECs have been the major force in bringing competition to the telecommunications market in Vermont and elsewhere. That said, the CLECs are free to offer service anywhere they choose, and therefore tend to provide service in the more densely-populated, profitable urban areas. The only statewide CLEC that is an Eligible Telecommunications Carrier in Vermont is Sovernet. While it is technically correct to say that Sovernet could offer service to every customer within FairPoint’s territory, practically speaking, Sovernet is not a true competitor to FairPoint in all of the high-cost, low-density rural areas due largely to the costs associated with providing such service, as well as certain technology barriers.

3. Cellular Service

Cellular - or wireless - telephone service providers are subject to far less state regulation than the ILECs or CLECs. Most notably, federal law preempts the states from regulating the

¹⁰ When Verizon sold its Northern New England operations to FairPoint, it retained Verizon Business (the former MCI) which Verizon had acquired in 2005.

rates of cellular providers. The states may regulate only the terms and conditions under which wireless carriers provide service and may impose consumer protection measures. Here in Vermont, the Board, with the support of the Department, has chosen to regulate cellular providers at only a minimal level in order to encourage greater deployment statewide. Verizon Wireless and AT&T are the two most prevalent wireless carriers in Vermont. While approximately 20% of Vermonters have chosen cellular telephone service in favor of traditional landline service, the Department does not consider cellular service directly equivalent to the telephone service FairPoint or other ILECs provide due to the coverage issues that can arise (sometimes even within a residence or business property). Nevertheless, cellular clearly is a competitive option in Vermont, enjoying growing popularity.

4. Fixed VoIP

Fixed VoIP, like traditional telephone service, allows a subscriber to make calls only from a fixed address. Fixed VoIP is usually provided over a private network and not over the internet. The telephone service offered by cable companies such as Charter and Comcast is a fixed VoIP service. The level of state regulation of fixed VoIP is presently pending in Vermont. The Board has recently found that fixed VoIP is a telecommunications service under Vermont law.

5. Nomadic VoIP

Voice service that is provided entirely over the Internet is referred to as nomadic VoIP. Vonage, Skype and MagicJack are providers of nomadic VoIP. Nomadic VoIP is tied to an internet account, not to a physical address such as a residence or business. There is no regulation at the state level of nomadic VoIP.

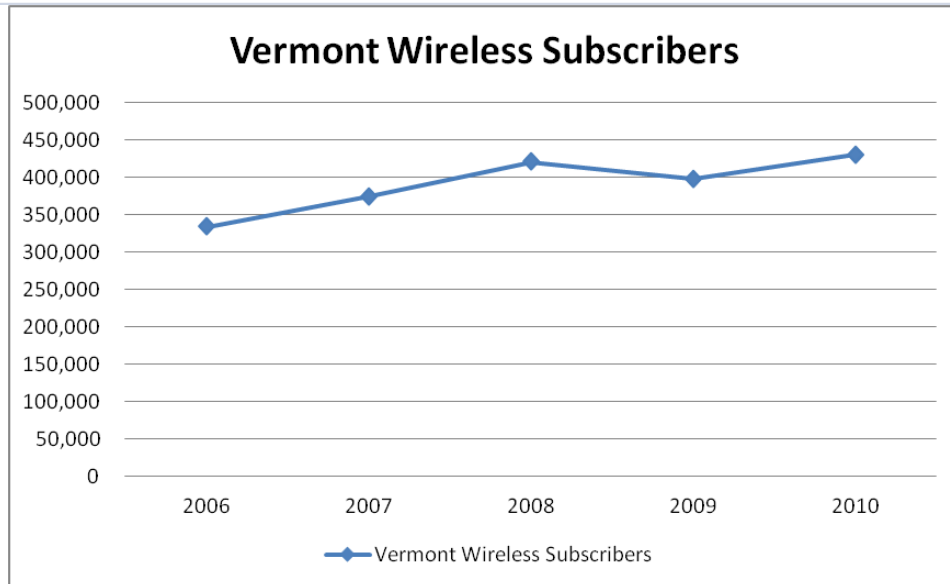
Telecommunications Competition in Northern New England and Vermont

In Vermont today, FairPoint’s competitive challenges come from cellular and cable providers.

Cellular: Vermont has a population of just over 620,000 people and, at the end of 2010, there were about 431,000 cellular access lines in the state.¹¹ 20% of Vermont households have chosen to become wireless only.¹² It is clear that many in Vermont find this service to be an adequate substitute for landline service, and the Department believes that trend will continue. The chart below shows the level of growth in wireless subscribers in Vermont in just the past five years.

<u>Vermont Wireless Subscribers: 2006-2010</u>					
	2006	2007	2008	2009	2010
Vermont Wireless Subscribers	334,000	375,000	421,000	398,000	431,000

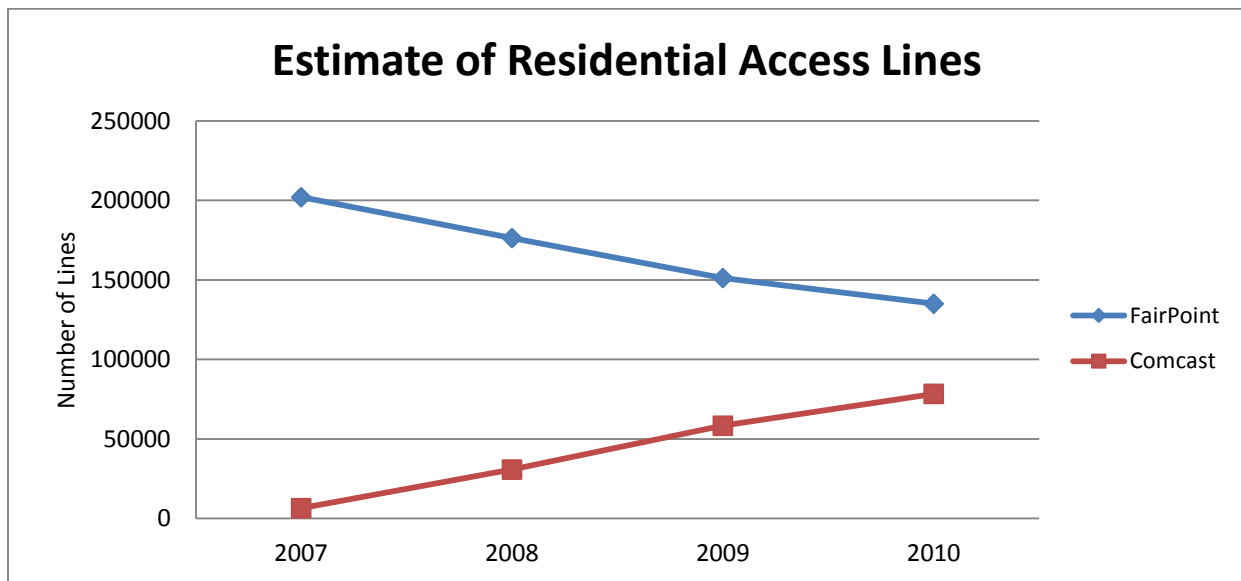
Source: Wireless Subscriber figures: FCC Wireline Competition Bureau, Local Telephone Competition Report, released March 2011; Subscriber Percentage figures: Based upon Wireless Subscribers divided by population from the U.S. Census Bureau's annual estimates.



¹¹ FCC Wireline Competition Bureau, Local Telephone Competition Report, March, 2011.

¹² Vantage Market Analysis at 19.

Cable Telephone Service: While the Department and the cable providers may disagree as to whether the telephone service provided via cable is subject to state regulation, from a consumer point of view, the telephone service cable companies provide is an almost identical and direct replacement for FairPoint telephone service. Since Comcast began offering its telephone service in Vermont in 2007, the Department estimates that it has garnered approximately 80,000 access lines.¹³ This chart illustrates the growth of telephone service provided by Comcast in just the past five years:



It is not surprising that Vermont's urban population centers have the greatest amount of competition and the rural areas have the least amount.¹⁴ Competitors to FairPoint tend to invest in the urban areas where it is profitable to invest, and choose not to invest in the rural areas that

¹³ As stated in footnote 5, Based upon the annual reports of Comcast Phone of Vermont, the Department estimates that Comcast IP Phone II has gained approximately 80,000 customers since it launched its voice service in 2007, while FairPoint lost 67,000 customers over the same period.

¹⁴ Vantage Market Analysis at p. 36.

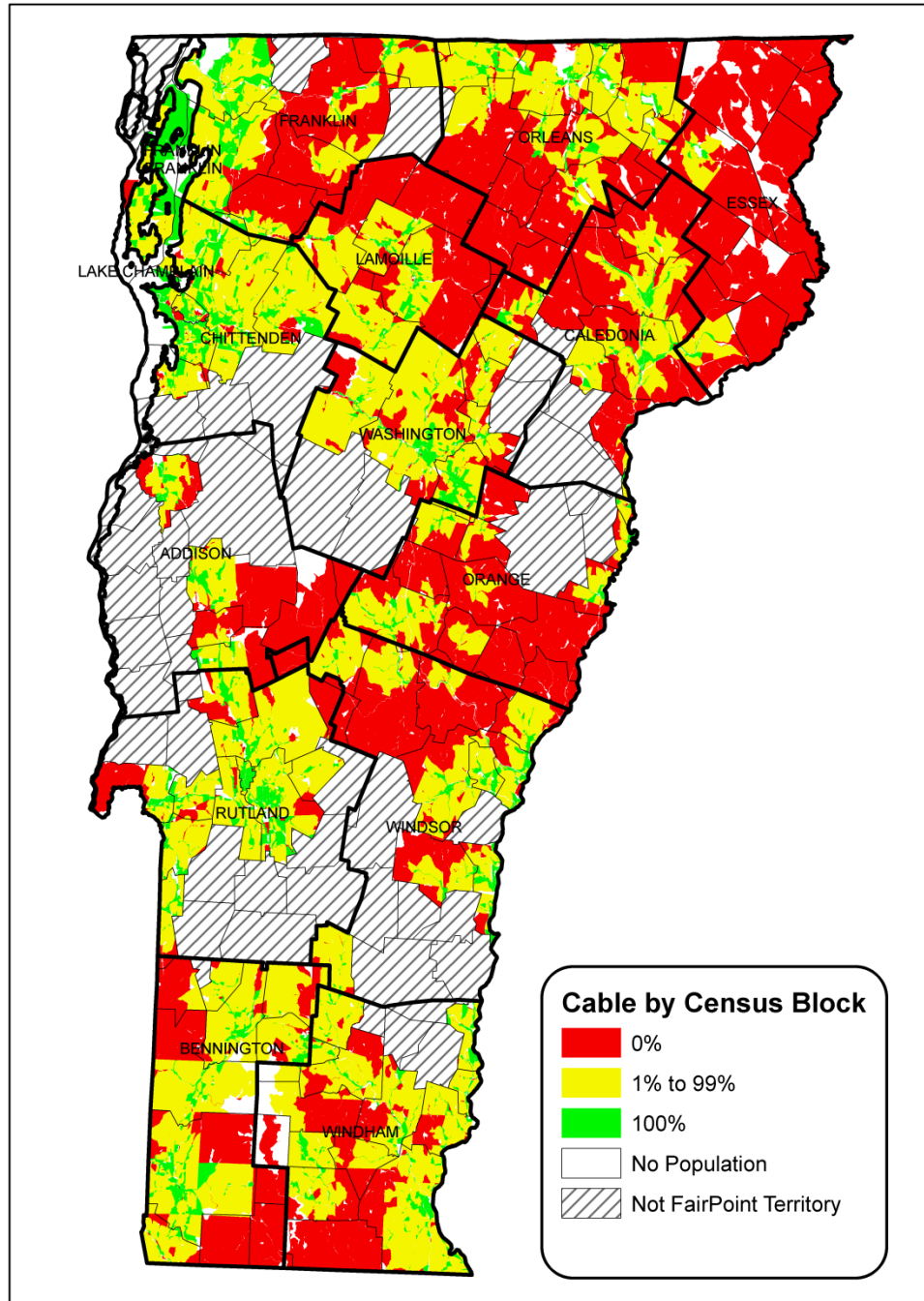
require greater infrastructure costs and yield fewer customers per mile. Within FairPoint's Burlington wire center, 98.7% of its customers can receive telephone service from a cable provider and 100% of its customers can receive telephone service from a cellular provider.¹⁵ In contrast, in FairPoint's Bethel wire center, only 25.4% of its customers can receive telephone service from a cable provider and only 45.3% of its customers can receive telephone service from a cellular provider.¹⁶ In FairPoint's overall service territory in Vermont, over 71% of its customers can receive telephone service from a cable provider and over 87% of its customers can receive telephone service from a cellular provider.¹⁷ Thus, while a great majority of Vermonters may have service alternatives to FairPoint, a substantial minority does not. The maps on the following two pages illustrate cable and wireless availability in FairPoint's service territory:

¹⁵ Vantage Market Analysis at p. 84.

¹⁶ Vantage Market Analysis at p. 84.

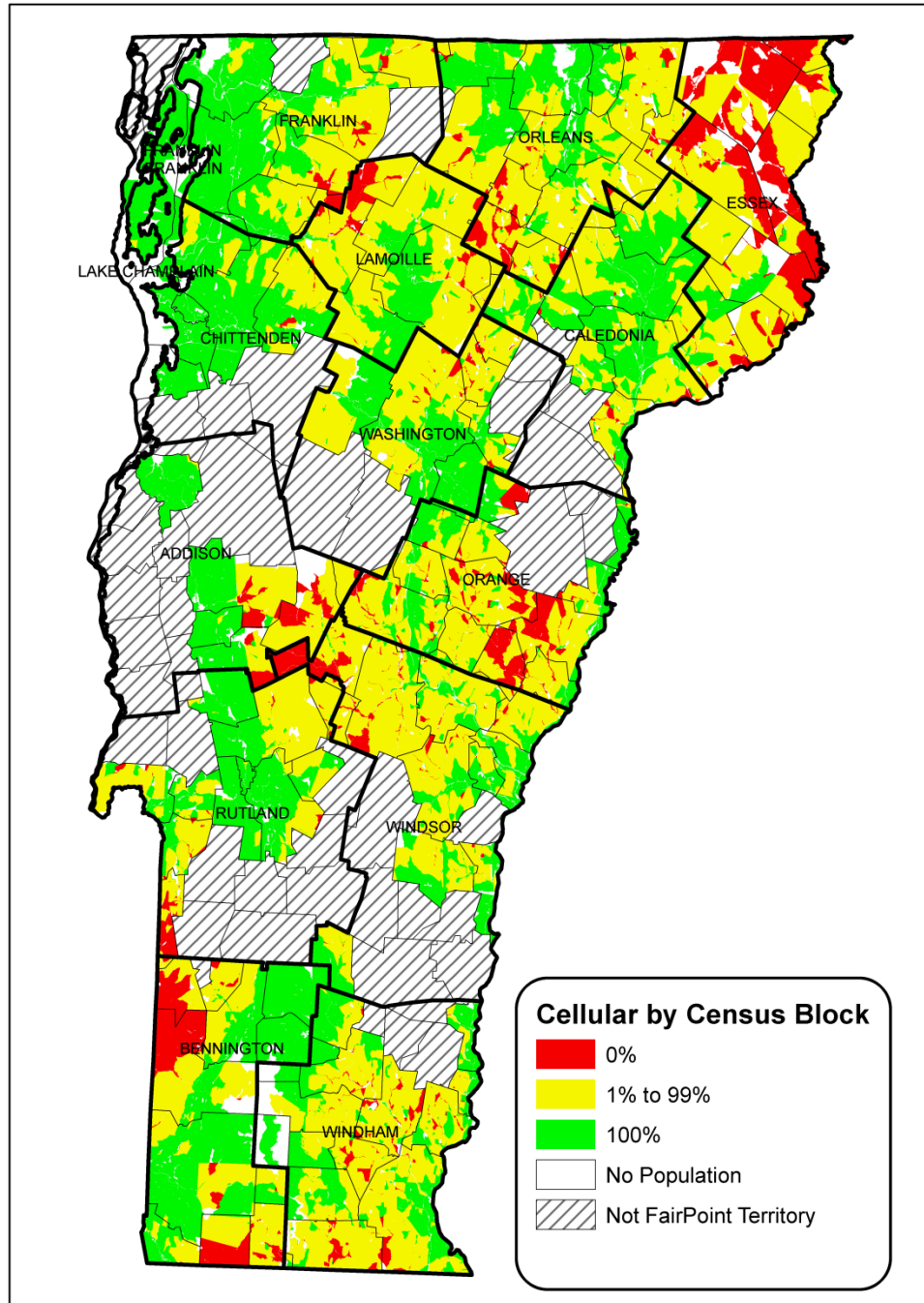
¹⁷ Vantage Market Analysis at p. 6.

Vermont 2010 Cable Availability in FairPoint territory



This map was created by the Department of Public Service using data provided in cable operator annual reports. The map depicts the percentage of business and residential addresses with estimated cable availability in the FairPoint service territory.

Vermont 2010 Cellular Availability in FairPoint territory



This map was created by the Department of Public Service using data provided by Pericle. The map depicts the percentage of business and residential addresses with estimated cellular availability in the FairPoint service territory.

Federal Regulatory Trends

On November 28, 2011, the FCC issued an order (“FCC Order”) that calls for sweeping changes to Intercarrier Compensation (“ICC”) and the federal Universal Service Fund (“USF”). For many years, telephone companies that operate in rural and high cost areas have relied upon money from the federal USF to defray the cost of providing telephone service in high-cost areas. The new FCC Order mandates that over a period of five years, federal USF monies will be directed away from supporting voice service and toward provision of broadband.

The FCC Order is voluminous, subject to appeal from multiple parties, and will not go into effect, whatever its final form may be, for several months. Nevertheless, an initial analysis indicates that the FCC Order will not be favorable for rural states like Vermont.¹⁸ It likely will negatively impact all of the Vermont ILECs. The Independents currently receive substantial federal USF support; a shift away from voice service support likely will harm the Independents. For FairPoint, it appears that the FCC Order may not provide enough cost support for the required broadband infrastructure and service. This is because the FCC Order would provide federal USF support for broadband only if FairPoint expands broadband of certain higher speeds to customers—and the amount of support would be limited to only \$750 per address. While the exact cost to FairPoint for providing broadband at speeds called for in the federal plan is not yet known, it almost certainly will exceed \$750 per address. If the FCC Order were to take effect as issued, FairPoint may have no incentive to accept the federal USF support.

This is important for two reasons: first, it would negatively affect the revenue that FairPoint has available for capital expenditures; second, if FairPoint determines that it should forgo federal USF monies due to the strings attached, FairPoint’s COLR obligations to provide telephone service to captive customers would be in jeopardy.¹⁹ It is extremely important, the Department believes, that Vermonters continue to have universal access to traditional telephone

¹⁸ It should be noted that Vermont, through both the Department and the Public Service Board, filed comments in the FCC Order process and will be participating in the clarification and appeals processes.

¹⁹ Federal law defines certain criteria that a telecommunications provider must meet in order to become what is known as an Eligible Telecommunications Carrier (“ETC”). Only an ETC may receive federal USF money. To qualify as an ETC, a carrier must assume the COLR obligation of providing service to every person in its service territory. In Vermont, COLR obligations are enforced in orders of the Board.

service unless and until all Vermonters have reliable, adequate, and meaningful access to alternative voice services.

Northern New England Regulatory Trends

The competitive pressures FairPoint faces in Vermont are also present in New Hampshire and Maine. Regulatory changes for FairPoint are currently under review at the New Hampshire Legislature.²⁰ Maine appears to have chosen a regulatory structure that substantially mirrors the incentive regulation plan the Department has negotiated with FairPoint in Vermont.

Last year, the Maine Legislature directed the Maine Public Utilities Commission (“Maine PUC”) to draft a plan that would significantly reduce the extent of regulation applied to telecommunications carriers in Maine.²¹ The Maine PUC has recently issued its draft plan on November 1, 2011 and it may be found at the Maine PUC website at <http://www.maine.gov/mpuc/>. It proposes to eliminate the Maine PUC’s jurisdiction over rates and conditions for all telecommunications services other than Basic Local Exchange Service (“BLES,” basic dial tone service) offered by FairPoint. Rates for BLES would be fixed under a price cap, and would have to be provided at that rate throughout the company’s service territory. The plan also calls for a mechanism whereby FairPoint would be eligible for subsidies from the Maine Universal Service Fund for providing COLR services in high-cost areas, similar to proposed legislation pending at the Vermont Legislature this session.²²

²⁰ House Bill 1295, NH General Court, 2012 Session.

²¹ 125th Maine State Legislature in Resolves 2011, Ch. 69.

²² Senate Bill 180, pending at the Vermont Legislature this session, seeks a similar result here. The Department believes that it is appropriate to consider allowing all COLRS (FairPoint, as well as the Independents) to receive high-cost support from the Vermont USF, in light of the recent FCC Order. The criteria for and level of funding from the Vermont USF, particularly in light of the evolving federal situation, require further investigation beyond the scope of this report.

Regulation of FairPoint in Vermont

1. The 2000 and 2005 Incentive Regulation Plans

ILECs such as FairPoint and its predecessor, Verizon, were traditionally subject to state rate regulation based upon cost of service, rate base, and rate of return. In the mid 1990s, the Vermont Legislature offered an alternative to this traditional regulatory environment through 30 V.S.A. § 226b, which allows an ILEC to elect to operate under a less formal incentive regulation plan ("IRP"). IRPs, which still require significant investigation and Board approval, can offer much greater flexibility for a utility than traditional rate regulation. Verizon elected Section 226b treatment; its first IRP was approved by the Board in 2000 ("2000 IRP").²³ A successor IRP was approved by the Board in 2005 ("2005 IRP").²⁴ FairPoint assumed the obligations of 2005 IRP when it acquired the Verizon network in Vermont.

The 2005 IRP established price caps for all services that were offered as of 2000. Pricing for new services, or bundles of new and old services, were at the company's discretion. Moreover, the company retained the discretion to reduce its rates for any service. The 2005 IRP also contained a service quality plan that measured 18 different metrics related to the service quality provided to retail customers. If a metric was not met, the company was subject to automatic penalties. These penalties could amount to as much as \$10.65 million per year if the company missed a certain amount of metrics by certain percentages.

For Verizon, given the size and market power of the company, the 2005 IRP under which it operated in Vermont was appropriate, particularly given Verizon's decision not to invest more in its network in Vermont and northern New England. The 2005 IRP, in the opinion of the Department, is no longer appropriate for FairPoint, a much smaller company than Verizon and one that committed to, and has, invest heavily in its network in Vermont. Accordingly, in 2011, the Department and FairPoint negotiated a successor IRP ("2011 IRP").

²³ PSB Docket Nos. 6167/6189.

²⁴ PSB Docket Nos. 6959/7142.

2. The 2011 Incentive Regulation Plan

The 2011 IRP is currently awaiting approval by the Board. The 2011 IRP, in the view of the Department, provides a level playing field for FairPoint while protecting those captive customers of FairPoint who have no competitive alternative for telephone service. The table below sets forth the key provisions of the 2011 IRP, comparing and contrasting it to the prior 2005 IRP and to Section 227d’s protections for small carriers.

COMPARISON OF 2005 IRP, 2011 IRP, and 30 VSA § 227d

2005 IRP	2011 IRP	30 VSA 227d
Required FairPoint to refund most of its \$7 million per year federal USF money as customer bill credits	Allows FairPoint to invest all of \$7 million in federal USF money in infrastructure.	Same relief as the 2011 IRP.
Mandated price caps for all services that were in effect as of 2001.	Removes price caps for all services except basic local exchange service (“BLES”).	Same relief as the 2011 IRP.
Mandated that tariffs for retail services be filed and be approved by the Board.	Removes the obligation to file tariffs for retail services.	Same relief as the 2011 IRP.
Allowed promotional offerings for only up to 180 days.	Allows promotional offerings for up to one year.	Same relief as the 2011 IRP.
Required that a price floor analysis be filed for new retail services.	Removes the price floor analysis requirement in favor of requiring only that retail pricing is not more advantageous than the wholesale pricing offered in its Statement of Generally Available Terms and Conditions (“SGAT”).	Same relief as the 2011 IRP.
Provided for automatic service quality penalties in an amount up to \$10.65 million per year.	Reduces the automatic penalties for service quality to \$1.65 per year and ultimately allows its service quality to be measured like that of the Independent ILECs.	Same relief as the 2011 IRP.

Fundamentally, therefore, the 2011 IRP offers FairPoint every competitive advantage that Section 227d would offer. The 2011 IRP, authorized by Section 226b, offers exemptions from Sections 225, 226, 227 and 229 of Title 30. These same four exemptions are offered under Section 227d. As shown in the above chart, through incentive regulation FairPoint can receive the regulatory benefits offered under Section 277d, while remaining subject to an approval and review process that, in the Department’s view, is better suited to a company that remains the dominant carrier in Vermont, relied upon by a still significant number of Vermonters.

There are, moreover, certain statutory exemptions available to small carriers under Section 227d that the Legislature may find are not appropriate to extend to FairPoint at this time. Specifically, Section 277d offer exemptions from §§ 104, 105, 108 and 230 of Title 30. Neither Section 226b nor the 2011 IRP offer FairPoint those exemptions.

SECTION 227d EXEMPTIONS NOT PROVIDED BY 2011 IRP

Statute	Text
30 V.S.A. § 104	Provides that a company shall not amend its articles of incorporation unless the Board approves such amendment by a finding that it is in the public good.
30 V.S.A. § 105	Provides that when a company issues stock for property other than cash, the value affixed to that property must be approved by the Board.
30 V.S.A. § 108	Provides that under certain circumstances a company must receive Board approval before mortgaging or pledging corporate property or before issuing stocks or bonds or other indebtedness.
30 V.S.A. § 230	Provides for the imposition of civil penalties for an officer or employee of a company to grant a special rebate or knowingly consent to such special rate or rebate.

Section 227d is, by definition, designed for *small* eligible telecommunications carriers; the Legislature found it appropriate to provide small carriers with the above exemptions to provide greater financial flexibility, judging the risk of reduced regulation appropriate in light of the size of the companies. FairPoint, while now a smaller company than it was when it acquired Verizon’s Vermont assets, nevertheless remains the dominant wire line telecommunications provider in Vermont. As the successor RBOC, it remains subject to federal requirements that the smaller Independents need not fulfill. A significant number of Vermonters continue to rely upon the company to provide telephone service. Therefore, the health of the company continues to be

of great importance, and the review and approval conditions required by Sections 104, 105, 108, and 230 should, in the view of the Department, continue to apply.

Accordingly, the Department finds that the disadvantages to Vermont consumers of allowing FairPoint to elect Section 227d treatment outweigh the advantages. Section 226b allows for an incentive regulation plan that can foster a level playing field for FairPoint, while maintaining approval and review processes that offer better protection to the substantial number of Vermonters who still rely upon FairPoint for service. The 2011 IRP strikes that balance.

Conclusion

The telecommunications industry has moved far away from the days when a single company offered local and long-distance telephone service and, as a monopoly, was the only game in town. Competition for telephone service has grown immensely in the past twenty years. Moreover, the convergence of technology and the explosion in the use of and reliance upon broadband and data are making telephone service less relevant with each passing year.

FairPoint, a successor to the old Bell monopoly system, finds itself in the unenviable position of losing its dominant market share in the more profitable urban areas of its service territory while maintaining the dominant market share only in the higher cost, rural areas where it has an absolute obligation to continue to provide service.

Accordingly, it is appropriate to ensure that FairPoint is permitted to compete on a level playing field by reducing state regulatory obligations that have traditionally applied. However, it is equally appropriate to ensure that captive Vermont customers are protected, and that the state retains its ability to oversee FairPoint because it continues to be the dominant provider of telecommunications service in Vermont.

Incentive regulation plans allowed by Section 226b of Title 30, such as the 2011 IRP negotiated between the Department and FairPoint, offer both the necessary flexibility and protections. FairPoint's large territory, extensive infrastructure, and significant number of captive customers all weigh in favor of continuing the approval and review processes offered by Section 226b IRPs, rather than permitting FairPoint to elect all of the exemptions allowed to small telecommunications carriers under Section 227d.

While the Department does not recommend that the legislature offer FairPoint the exemptions allowed under Section 227d, the Department nevertheless notes that the competitive realities in the telecommunications industry, the convergence of technology, and the shifting federal regulatory role require continued vigilance and careful review at the state level to ensure that all Vermonters have meaningful, reliable, and affordable access to those communications services necessary to life in the 21st century. The Department recommends that the legislature prioritize addressing the use and amount of the Vermont Universal Service Fund, particularly in light of the pending FCC Order.