Orig.

AGENDA DATES: 12/22/92, 4/14/93

State of New Jersey
Board of Regulatory Commissioners
CN 350
Trenton, N.J. 08625-0350

TELECOMMUNICATIONS

IN THE MATTER OF THE APPLICATION OF NEW JERSEY BELL TELEPHONE COMPANY FOR APPROVAL OF ITS PLAN FOR AN ALTERNATIVE FORM OF REGULATION	)	DECISION AND ORDER DOCKET NO. TO92030358

(SERVICE LIST ATTACHED)

BY THE BOARD:

I. INTRODUCTION

In accordance with the Telecommunications Act of 1992 (Act), N.J.S.A. 48:2-21.16 et seq., this matter was initiated by the filing on March 31, 1992 of a petition by New Jersey Bell Telephone Company (NJ Bell) requesting approval by the Board of Regulatory Commissioners (Board) of a plan for an alternative form of regulation (plan), which proposed to substitute a form of incentive, formula - based rate regulation for traditional rate base, rate of return regulation. The petition was accompanied by the plan, itself, as well as four supporting affidavits (P-2; P-4; P-5; P-6). Additionally, the petition indicated that the plan would enable NJ Bell to invest in the accelerated deployment of advanced switching and transmission technologies for its communications network. The accelerated deployment, referred to by NJ Bell as Opportunity New Jersey (ONJ), was described in an attachment to one of the supporting affidavits (P-3). NJ Bell subsequently filed a revised plan for an alternative form of regulation on May 21, 1992 (P-1)[1] but continued to rely on the previously filed petition and supporting affidavits.

---

1 Unless otherwise noted, references hereinafter to NJ Bell's plan refer to the revised plan filed on May 21, 1992. Although the plan was marked as Exhibit P-1, citations herein refer to the plan, itself. Citations to all other documents admitted into evidence, including witnesses' prefiled testimony, are to the designated exhibit number.

A. TELECOMMUNICATIONS ACT OF 1992

By way of background, on January 17, 1992, the Telecommunications Act of 1992, N.J.S.A. 48:2-21.16 et seq., became effective. In the Act, the Legislature found and declared that it is State policy to, among other things, permit the Board "the authority to approve alternative forms of regulation to address changes in technology and the structure of the telecommunications industry; to modify the regulation of competitive services; and to promote economic development." N.J.S.A. 48:2-21.16(a)(5). Consistent with this declaration of State policy, the Act permits a local exchange telecommunications company (LEC) to petition the Board to be regulated under a plan for an alternative form of regulation. N.J.S.A. 48:2-21.18. An "alternative form of regulation" is defined by the Act as "a form of regulation of telecommunications services other than traditional rate base, rate of return regulation to be determined by the Board and may include, but not be limited to, the use of an index, formula, price caps or zone of rate freedom. N.J.S.A. 48:2-21.17. The Board is empowered to review a plan for an alternative form of regulation and may approve such a plan, or approve it with modifications, if it finds, after notice and hearing, that certain specifically enunciated criteria have been met. Specifically, pursuant to N.J.S.A. 48:2-21.18(a), to approve a plan for an alternative form of regulation, the Board must find that the plan:

(1) will ensure the affordability of protected telephone services;

(2) will produce just and reasonable rates for telecommunications services;

(3) will not unduly or unreasonably prejudice or disadvantage a customer class or providers of competitive services;

(4) will reduce regulatory delay and costs;

(5) is in the public interest;

(6) will enhance economic development in the State while maintaining affordable rates;

(7) contains a comprehensive program of service quality standards, with procedures for Board monitoring and review; and

(8) specifically identifies the benefits to be derived from the alternative form of regulation.

Although in making a determination as to whether to approve a plan for an alternative form of regulation, the Board must consider whether the plan will produce just and reasonable rates, the Act expressly provides that, notwithstanding the provisions of any law to the contrary, the Board is no longer bound to determine whether rates are just and reasonable by traditional rate base, rate of return regulation, pursuant to which the Board has regulated the rates via a determination of a utility's costs and expenses, including an allowance for a fair return on the utility's property used and useful in the provision of utility service. N.J.S.A. 48:2-21.18(b). In particular, in authorizing the Board to approve a plan for an alternative form of regulation, the Legislature specifically exempted the Board from the statutory requirements pertaining to traditional rate base, rate of return regulation, including N.J.S.A. 48:2-18, which authorizes the Board after hearing to set adequate and proper depreciation rates; N.J.S.A. 48:2-21, which sets forth the Board's general ratemaking authority; N.J.S.A. 48:2-21.2 which describes the circumstances under which the Board is not required to find a rate base; and N.J.S.A. 48:3-1[2], which prohibits unjust or unreasonable discriminations or classifications of rates. The Act provides in N.J.S.A. 48:2-21.18(b) that notwithstanding these statutory requirements, or any other law to the contrary, in determining just and reasonable rates, the Board may authorize a local exchange telecommunications company to set rates based on an alternative form of regulation pursuant to a plan approved by the Board in accordance with the provisions of N.J.S.A. 48:2-21.18(a).

The Act also provides that no local exchange telecommunications company may use revenues earned or expenses incurred in conjunction with noncompetitive services to subsidize competitive services. N.J.S.A. 48:2-21.18(c). The Act further empowers the Board to require an independent audit or such accounting and reporting systems from local exchange carriers as may be necessary to allow a proper allocation of investments, costs or expenses for all telecommunications services, competitive or noncompetitive, subject to the Board's jurisdiction. N.J.S.A. 48:2-21.18(d).

The Act expressly prohibits the Board from regulating the rates of competitive services. N.J.S.A. 48:2-21.19(a). The Board may, however, require telecommunications companies to file and maintain tariffs for competitive telecommunications services. Ibid. The

---

2 N.J.S.A. 48:2-21.18(b) refers to N.J.S.A. 48:3-1.1; however, because there is no such provision presently in effect, it appears that this reference was intended to be N.J.S.A. 48:3-1. The Board notes that, in fact, a similar provision in N.J.S.A. 48:2-21.19(a) refers to N.J.S.A. 48:3-1.

Board is authorized to determine, after notice and hearing, whether a telecommunications service is a competitive service. The Act requires that in making such a determination, the Board shall develop standards of competitive service which, at a minimum, shall include evidence of ease of market entry; presence of other competitors; and the availability of like or substitute services in the relevant geographic area. N.J.S.A. 48:2-21.19(b). Services provided by interexchange telecommunications carriers (IXCs) are deemed to be competitive services. N.J.S.A. 48:2-21.20(a).

The Act authorizes the Board to determine what reports are necessary to monitor the competitiveness of any telecommunications service. N.J.S.A. 48:2-21.19(c). The Act further authorizes the Board to reclassify any telecommunications service that it has previously found to be competitive if, after notice and hearing, it determines that sufficient competition is no longer present, based upon application of the above enunciated criteria. N.J.S.A. 48:2-21.19(d).

The Act in N.J.S.A. 48:2-21.19(e) also sets forth certain safeguards which apply to the offering of any competitive service by a local exchange telecommunications company:

> (1) a local exchange telecommunications company must unbundle each noncompetitive service which is incorporated in a competitive service and make all such noncompetitive services separately available to any customer under tariffed terms and conditions, including price, that are identical to those used by the local exchange company in providing its competitive service;
>
> (2) the rate which a local exchange telecommunications company charges for a competitive service must exceed the rates charged to others for any noncompetitive services used by the local exchange telecommunications company to provide the competitive service;
>
> (3) tariffs for competitive services filed with the Board are to be in the public record unless they are determined by the Board to be proprietary, in which case they shall be filed under seal and made available under the terms of an appropriate protective agreement; and
>
> (4) the Board retains the authority to ensure that local exchange telecommunications companies do not make or impose unjust preferences, discriminations, or classifications for noncompetitive services.

The Act also requires the Board to submit a report to the Governor and the Legislature reviewing the implementation of the Act, including an evaluation of any alternative form of regulation approved by the Board, any plan of such alternative form of regulation and the success of the deregulation of competitive services. The Board may include in the report any proposals for legislative or other changes which it deems appropriate. L. 1991, c.428, §7.

B. NJ BELL'S PLAN FOR AN ALTERNATIVE FORM OF REGULATION (AS REVISED ON MAY 21, 1992)

NJ Bell's proposed plan for an alternative form of regulation provides that it shall be in effect from the date of its approval through December 31, 1999, and that no later than January 1, 1999, NJ Bell shall file with the Board for an extension or modification of the plan (Plan, §I(A)). NJ Bell's plan declares that its approval by the Board would provide the foundation for NJ Bell's acceleration of an information age network in New Jersey described in Exhibit P-3 and referred to by NJ Bell as "Opportunity New Jersey" (Plan, Summary). Opportunity New Jersey would accelerate the deployment of key network technologies to make available advanced intelligent network, narrowband digital, wideband digital, and broadband digital service capabilities in the public switched network, and thereby accelerate the transformation of NJ Bell's public switched network, which today transports voiceband services (voice, facsimile and low speed data), to a public switched network, which transports video and high speed data services in addition to voiceband services (P-3, at 3).

Pursuant to NJ Bell's plan, no increases in the tariffed rates for rate regulated services would be permitted before January 1, 1996, except as otherwise provided with regard to exogenous events and revenue neutral rate restructures (Plan, §§I(B)(1)(a), I(B)(4) and (5)). The monthly rates for Low Use Message Rate Residence service would not be increased under the plan and the Link-Up America program for low-income subscribers[3] would not be affected (Plan, §I(B)(1)(b)).

---

3 Low Use Message service is a basic exchange telecommunications service furnished to individual exchange access line residence customers within a specified geographical area for the purpose of local calling on a measured basis. It is offered at a reduced monthly rate and includes 20 local message units. Low Use Message, NJ Bell Network & Exchange Services Tariff, A5 at 26-27

Link Up America is a program designed to promote universal service among residential telecommunications service customers by providing a discount on service connection charges to low income customers who meet certain eligibility criteria. Link Up America, NJ Bell Network & Exchange Services Tariff, A3 at 2.

On or after January 1, 1996, NJ Bell would, under the plan, be permitted to increase the individual rates for its rate regulated services in an amount limited to 50% of the annual increase in the prior year's Consumer Price Index (CPI). The monthly rates for all classes of residential basic exchange service, however, could not increase by more than $0.25 in any one year, regardless of the change in the CPI (Plan, §I(B)(2)(a)). No CPI-based rate increases would be permitted on protected telephone services[4] if the average intrastate return on equity for NJ Bell's rate regulated services for the applicable 12 month period exceeds 11.9% and no CPI-based rate increases on any rate regulated services would be permitted if the average intrastate return on equity for its rate regulated services for the applicable 12 month period exceeds 13.9% (Plan, §I(B)(2)(b)). Additionally, the plan provides that if NJ Bell's intrastate return on equity for its rate regulated services exceeds 13.9%, those excess earnings would be shared equally between NJ Bell and its customers (Plan, §I(B)(3)). The plan would require NJ Bell to submit certain data and calculations by October 31 of the year prior to any CPI increase for rate regulated services (Plan §II(B)) or any required sharing of earnings (Plan, §II(E)). The plan proposes that the Board must rule on any earnings sharing proposal by NJ Bell within 60 days of the filing (Plan, §II(E)).

The plan also provides that NJ Bell would be permitted to increase rates for its rate regulated services if there occurs a major, unexpected extraordinary or exogenous event beyond its control. The plan specifies that such an extraordinary or exogenous event would include significant matters such as natural disasters, tax, separations and/or accounting changes, regulatory or other governmental actions, and changes in the terms and conditions which govern the provision of intraLATA services (Plan, §§I(B)(4) and II(C)). As to the provision of intraLATA services, the plan expressly provides that nothing therein would affect the Board's authority to determine whether and under what terms and conditions it will permit interexchange telecommunications carriers or any other entities to offer intraLATA services within the

---

4 "Protected telephone services" are defined in the Act as any of the following telecommunications services provided by a local exchange telecommunications company, unless the Board determines, after notice and hearing, that any of these services is competitive or should no longer be a protected telephone service: telecommunications services provided to business or residential customers for the purpose of completing local calls; touch-tone service or similar service; access services other than those services that the Board has previously found to be competitive; toll service provided by a local exchange telecommunications company; and the ordering, installation and restoration of these services. N.J.S.A. 48:2-21.17.

State (Plan, §I(F)). The plan would require NJ Bell to make its rate adjustment filing resulting from an exogenous event within 60 days of the date on which the effects of that event are known and calculated, and would require the Board to rule on the filing within 60 days (Plan, §II(C)). The filing would be required to include a description of the exogenous event with an explanation as to why it was unexpected, data quantifying the financial impact to NJ Bell, and a proposed rate design to reflect associated rate changes (Plan, §II(C)).

Throughout its term, the plan also would permit NJ Bell to propose for the Board's review and approval revenue neutral rate restructures to its rate regulated services (Plan, §I(B)(5)). Such proposals would be required to be filed 60 days before the proposed effective date, and any such filing would be required to include a description of the service(s) affected, an explanation as to why the restructure is proposed, calculations demonstrating the proposed restructure's revenue neutral effect, and a description of the impact of the proposed restructure on all classes of affected customers (Plan, §II(D)).

The plan further proposes that NJ Bell would have flexibility to adjust its depreciation rates in accordance with generally accepted accounting principles (GAAP). NJ Bell, however, would not be permitted to set the depreciation rates at an effective composite level less than the composite level resulting from the rates last approved by the Board in Docket No. TR88121324 (Plan, §I(C)).

The plan also proposes a series of consumer and competitive safeguards that would be applicable to all NJ Bell competitive telecommunications services and those that NJ Bell seeks to classify or reclassify as competitive. The safeguards are described by the plan as ensuring that NJ Bell's ratepayers will not bear any of the costs of competitive services and that NJ Bell's competitors will have access to NJ Bell's network services on the same terms and conditions as NJ Bell (Plan §III). The safeguards include imputation of noncompetitive charges, tariffs for competitive services, unbundling and open network architecture (ONA) considerations, notice provisions, attribution and enhanced services rates.

With regard to the imputation of noncompetitive charges, to the extent that NJ Bell charges others for noncompetitive services necessary to compete with competitive services that it offers, the plan would require that the rates that NJ Bell charges for its own competitive service shall exceed the rates charged to others for the noncompetitive services on which the competitive service depends (Plan, §III(A)).

For services that the Board deems to be competitive, the plan provides that NJ Bell would file tariffs with rates, except that the plan proposes that tariffs need not be filed for any service 1) for which NJ Bell is not required to file as of the date NJ Bell filed the plan, 2) that the Board detariffs, or 3) which, in the future, NJ Bell offers without a tariff being required by the Board (Plan, §III(B)). To ensure that rate regulated services do not cross-subsidize competitive services, NJ Bell would continue to provide Embedded Analysis System (EAS) reports to the Board's Staff on an annual basis as approved by the Board in Docket No. TO87050398, and in connection with any filing to make a service competitive, NJ Bell would file with the Board fully distributed, embedded and direct cost allocation data consistent with the methodology approved by the Board in its June 22, 1987 and January 19, 1989 Orders in Docket No. TO87050398 (Plan, §III(D)). The plan would require NJ Bell to provide 30 days notice to interested parties of its intent to make a filing with the Board to propose the reclassification of an existing rate regulated service as competitive (Plan, §III(F)(2)). The plan also would require NJ Bell to file notice with the Board and to provide notice to interested parties of new proposed competitive telecommunications services no less than 14 days in advance of their introduction or as otherwise required by the Board as a result of the pending rulemaking in Docket No. TX92020201 (Plan, §III(F)(1)).

With regard to unbundling, in connection with any filing to make a service competitive, the plan would require NJ Bell to identify each noncompetitive service, if any, which is incorporated in its competitive service and to make all such noncompetitive services separately available to any customer under tariffed terms and conditions, including price, identical to those used by NJ Bell in providing its competitive service (Plan, §III(C)).

With regard to attribution, the plan provides that upon its adoption, to the extent the Board uses revenues from access charges paid by interexchange telecommunications carriers to support the cost of local exchange or any other noncompetitive service, the equivalent access charges would be attributed to NJ Bell and would be treated in the same way (Plan, §III(G)).

Additionally, the plan provides that nothing therein is intended to supersede the Board's final decision in the Open Network Architecture (ONA) rulemaking proceeding in Docket No. TX91061131 (Plan, §III(E)). The plan also provides with regard to enhanced services that the rates NJ Bell charges for enhanced services in New Jersey would exceed the rates for NJ Bell's noncompetitive basic service elements (BSEs) or basic service arrangements (BSAs) or their successors, upon which the enhanced service is based (Plan, §III(I)).

The plan also sets forth reporting requirements obligating NJ Bell to file financial, service quality and infrastructure deployment reports, as well as annual reports of the status of the plan (Plan, §IV). With regard to financial reports, the plan provides that NJ Bell will continue to file with the Board quarterly financial monitoring reports for NJ Bell's rate regulated services, which will provide the intrastate return on equity figures for those services for the most recent quarter and most recent four quarters available, and be in a form consistent with the methodology approved by the Board in Docket No. TO87050398 (Plan, §IV(A)). With regard to service quality, the plan would require NJ Bell to continue to file with the Board on a quarterly basis the service quality reports it currently provides to demonstrate its compliance with the service quality benchmarks established by the Board in Docket No. TO87050398 (Plan, §IV(B)). With regard to infrastructure deployment, the plan would require NJ Bell to provide the Board with an annual report to serve as an update on the status of the network and to specifically address service capability and technology deployment levels, as well as pending or planned market, technical, and operational trials. The report also would identify critical technology issues related to infrastructure deployment and describe deployment objectives for the forthcoming year (Plan, §IV(C)).

II. PROCEDURAL HISTORY

As noted above, along with its March 31, 1992 petition, NJ Bell filed several supporting affidavits. One affidavit, that of William J. Doherty, Jr., included a request that the Board expedite its review of this matter (P-2, at 21). By letter dated April 6, 1992, NJ Bell reiterated its request for expedited review and asked that a prehearing conference be scheduled. The Board considered NJ Bell's request and determined to schedule a prehearing conference for April 30, 1992. Notice of the conference was sent to various persons who had previously expressed interest in telecommunications matters. The Board also entered a written Order Scheduling Prehearing Conference dated April 27, 1992.

A prehearing conference chaired by the Board's counsel was held on April 30, 1992, at which time procedural matters were discussed. At the conference, NJ Bell stated its intention to file a revised plan by May 21, 1992, and therefore, the prehearing conference was continued until June 3, 1992. The conference was followed by a letter from the Board's counsel to the potential parties setting forth the matters discussed at the conference, including the procedure for motions for intervention, the publication by NJ Bell of notice of its revised plan, the submission of prehearing memoranda in accordance with N.J.A.C. 1:1-13.2(a), and a preliminary discovery schedule ending July 20, 1992. The letter confirmed that there would be a further conference on June 3, 1992 and that thereafter the matter would be placed on the Board's agenda for consideration of the issuance of a Prehearing Order.

NJ Bell filed a revised plan on May 21, 1992 (P-1). On or about May 28, 1992, NJ Bell, Board Staff and various prospective parties submitted prehearing memoranda setting forth their respective positions on the nature of the issues to be considered as part of the proceeding, as well as positions on other matters required to be addressed in prehearing memoranda.

At the June 3, 1992 prehearing conference, various procedural matters were discussed including the possibility of NJ Bell adding one or two additonal witnesses. In light of this development, the preliminary discovery schedule was extended to August 14, 1992. A consensus could not be reached as to the framing of appropriate issues. As agreed at the conference, the next day, a proposed issues list was circulated by the Board's counsel for consideration and comment by the prospective parties. Between June 9 and 18, 1992, NJ Bell, Board Staff and various prospective parties submitted positions on the proposed issues list.

At the June 3, 1992, prehearing conference, NJ Bell consented to intervention by all potential intervenors, which had filed motions for intervention, except for that of the Communications Workers of America (CWA). By letter dated June 9, 1992, NJ Bell opposed the CWA's motion. The CWA filed a response thereto on June 16, 1992.

Various submissions requesting that the matter be transmitted to the Office of Administrative Law (OAL) for hearing were filed by the CWA, the Department of the Public Advocate, Division of Rate Counsel (Rate Counsel), MCI Telecommunications Corporation (MCI), the New Jersey Cable Television Association (NJCTA), and the New Jersey Press Association (NJ Press Association). These entities generally contended that the proceeding should be transmitted to the OAL due to the complexity of the matter and the anticipated time which would be required to hear the matter. The CWA further alleged that because of testimony given on December 10, 1991 before the Senate Transportation and Public Utilities Committee by Board Chairman, Dr. Edward H. Salmon, in support of the Telecommunications Act of 1992, the Board was "favorably predisposed towards a plan for alternate regulation" and the "perception of partiality" could be substantially mitigated by transferring the case to the OAL. The NJCTA also supported transmittal to the OAL, alleging that on June 11, 1992, at a public meeting of the New Jersey Utilities Association, an "ex parte" presentation was made "to an effective majority of the Board" by Mr. William J. Doherty, Jr., a witness in this case for NJ Bell. All parties acknowledged that even if the case were transmitted to the OAL for hearings, the Board, as the regulatory administrative agency, would retain final authority to accept, reject, or modify any Initial Decision issued by an Administrative Law Judge. N.J.S.A. 52:14B-10. No party sought recusal of any member of the Board from deciding this case. NJ Bell took the position that this case presents broad policy matters which are suitable for adjudication by the Board itself. Board Staff took the position that the decision whether or not to transfer the case to the OAL is a matter within the Board's discretion.

On June 10, 1992, NJ Bell filed a motion requesting that the Board order that discovery be completed by July

20, 1992 and set an expedited hearing schedule before the Board. NJ Bell indicated that it would not be offering any additional witnesses. NJ Bell noted that it had already received over 1,000 interrogatories and that the July 20, 1992 date provided a reasonable opportunity for all legitimate discovery to be answered. NJ Bell further contended that expeditious approval of the plan would allow the public benefit attendant to its proposed acceleration of technology deployment to begin and that this would benefit the economy of the State. Various prospective parties opposed NJ Bell's motion for expedition, arguing that the importance and complexity of the case required more discovery time than that proposed by NJ Bell. Several prospective parties suggested August 14, 1992 as the completion date for discovery. The NJCTA indicated its opposition to an August 14, 1992 discovery deadline.

The Board considered these matters at its June 24, 1992 agenda meeting and its determinations were memorialized in a written Prehearing Order dated July 22, 1992. As a threshold matter, because NJ Bell's petition involves the first opportunity for the Board to review a proposed plan to be regulated under an alternative form of regulation filed pursuant to the Telecommunications Act of 1992, N.J.S.A. 48:2-21.16 et seq., and because of the possible significant policy decisions which could potentially be involved, the Board determined that it would hear this matter directly. The Board considered and rejected the arguments of the CWA and the NJCTA for transmittal to the OAL. The Board found that, contrary to the assertions of the CWA, the transcript of Chairman Salmon's testimony before the Senate Transportation and Public Utilities Committee clearly demonstrated his objectivity. The Board also rejected the NJCTA's contention that the presentation by NJ Bell witness Doherty at the New Jersey Utilities Association conference rendered it necessary to transfer the matter to the OAL. The Board noted that the presentation was made in a public forum and that two of the Commissioners were not in attendance at the time of the presentation. The Board stated that this matter would be decided on the record herein, that the presentation at the Utilities Association Conference had not influenced any Commissioner regarding NJ Bell's petition, and that NJ Bell would provide copies of the materials from the presentation to all parties, who would then be able to point out any contrary views to the Board during the course of the proceedings.

In the Prehearing Order, the Board granted the CWA's motion to intervene as well as all of the uncontested motions to intervene. Thus, the Prehearing Order identified the following parties and intervenors in this matter:

New Jersey Bell Telephone Company (NJ Bell)
Board Staff (Staff)
Department of the Public Advocate, Division of Rate Counsel (Rate Counsel)
Atlantic Communications Enterprises (Atlantic)
AT&T Communications of New Jersey, Inc. (AT&T)

Communications Workers of America, AFL-CIO (CWA)
MCI Telecommunications Corporation (MCI)
MH Lightnet, Inc. (Lightnet)
New Jersey Cable Television Association (NJCTA)
New Jersey Payphone Association, Inc.[5]
New Jersey Press Association (NJ Press Association)
Sprint Communications Company, L.P. (Sprint)
Teleport Communications (Teleport)
United Telephone Company of New Jersey, Inc. (United)
WilTel Inc. and WTG-East, Inc. (WTG)

In the Prehearing Order, the Board also addressed the nature of the proceeding and the issues to be resolved. The Board defined the essential question to be whether the Board should approve, approve with modifications, or reject NJ Bell's plan for an alternative form of regulation filed with its petition pursuant to the Act and as amended on May 21, 1992. The Board set forth the following list of particular issues and subissues to be addressed in the proceeding:

1. Does the plan satisfy the criteria set forth in N.J.S.A. 48:2-21.18(a)?

   (a) Will the plan provide for the affordability of protected telephone services?

   (b) Will the plan provide for just and reasonable rates for telecommunications services?

   i. Is the rate of return/rate cap formula and mechanism, including the use of a CPI index and earnings sharing, reasonable and in the public interest?

   ii. Does the plan incorporate sufficient and understandable reporting requirements to ensure that earnings are properly reviewable?

   iii. Is the exogenous events provision in the plan properly defined, reasonable and in the public interest?

   iv. Is the depreciation provision in the plan reasonable and in the public interest?

   v. Is the revenue neutral provision within the plan reasonable and in the public interest?

---

5 The New Jersey Payphone Association subsequently withdrew from this matter on October 15, 1992.

(c) Will the plan not unduly or unreasonably prejudice or disadvantage a customer class?

(d) Will the plan not unduly or unreasonably prejudice or disadvantage providers of competitive services?

(e) Will the plan reduce regulatory delay and costs?

(f) Is the plan in the public interest?

(g) Will the plan enhance economic development in New Jersey while maintaining affordable rates?

i. Will the plan and the proposed network deployment (Opportunity New Jersey) provide diversity in the supply of telecommunications services and products and otherwise meet the intent and policies of the Act?

(h) Does the plan contain a comprehensive program of service quality standards with procedures for Board monitoring and review to ensure the provision of safe, adequate and proper service?

(i) Does the plan specifically identify benefits to be derived from the alternative form of regulation?

2. Does the plan incorporate sufficient safeguards to prevent revenues earned or expenses incurred in conjunction with noncompetitive services from subsidizing competitive services as prohibited by N.J.S.A. 48:2-21.18(c)?

   a. Does the plan incorporate sufficient and understandable reporting requirements to enable the monitoring and review of any cross-subsidization?

3. Does the plan include compliance with all of the safeguards set forth in N.J.S.A. 48:2-21.19(e), including the unbundling of each noncompetitive service which is incorporated in any competitive service and the separate availability of such noncompetitive service to any customer under tariffed terms and conditions, including price, that are identical to those used by NJ Bell in providing its competitive service?

4. Does the plan include sufficient

safeguards and reporting requirements to enable the monitoring and review by the Board of the appropriateness of any reclassification of services?

The Board also commented upon some of the matters raised by various submissions in response to the proposed list of issues that had been circulated by its counsel. The Board noted that this proceeding is not to be used as a forum for a full review of other possible plans, but rather is limited to a review of the plan which is the subject of the petition herein. In addition, the Board noted that this proceeding is not a comprehensive evaluation of the current Rate Stability Plan (RSP), which was approved by Board Order in In the Matter of the Petition of New Jersey Bell Telephone Company for Approval of a Proposal for a Rate Stability Plan and Relaxed Earnings Surveillance for Certain Competitive Services (RSP Order), Docket No. TO87050398 (June 22, 1987) (NJCTA-1-0101), but rather is a proceeding to determine whether, under the new legislation, NJ Bell's newly petitioned-for plan for an alternative form of regulation should be approved and that the parties, therefore, should approach this proceeding from the viewpoint articulated throughout the legislation, namely: What will the proposed plan do? Will the proposed plan result in just and reasonable rates? Will the proposed plan enhance economic development?

In response to some parties' proposals that the Board in this proceeding should determine the guidelines for competitive versus noncompetitive services, the Board indicated that it would permit the parties to address the issue of guidelines for the determination of competitive and noncompetitive services as to NJ Bell, but reserved the right to determine whether to consider and address the record established on this issue in the proposed rulemaking proceeding in Docket No. TX92020201. See, 24 N.J.R. 1868 (May 18, 1992).

The Board also responded to various parties' requests for a review of the Board's policy on intraLATA competition. The Board noted that while the Act does not preclude the Board from considering this issue in reviewing a plan, the Act does not require the Board to consider this issue in reviewing a plan and that, because pursuant to the Board-approved intraLATA compensation settlements, certain interexchange carriers could file requests after September 1, 1992 for review of intraLATA compensation, the Board anticipated that there would be another forum for consideration of intraLATA competition in the near future. Therefore, the Board found that consideration of intraLATA competition in the within proceeding would likely cause delay and unduly complicate the review of the plan. Therefore, the Board permitted consideration of the potential impact of allowing intraLATA competition to the limited extent that it is included in the exogenous events provision in NJ Bell's plan.

Various parties had indicated beliefs that the issues set forth in their prehearing memoranda were incorporated in the proposed issues list which list was approved by the Board and included in the Prehearing Order. Except as specifically addressed in the Prehearing Order, the Board informed the parties that they should not construe the Prehearing Order as a ruling by the Board that issues in their prehearing memoranda were encompassed within the list set forth therein. The Board reserved the right to specifically address any such contentions as may be necessary during or following the development of the factual record.

In the Prehearing Order, the Board also set August 14, 1992 as the completion date for all discovery, established an evidentiary hearing schedule beginning on August 31, 1992, and scheduled two public hearings on September 8 and 15, 1992, in Hackensack and Trenton, respectively.[6]

Hearings on NJ Bell's direct case were held on August 31 and September 1, 2, 3, 4, 8, 9 and 10, 1992, at which time the witnesses whose affidavits had been filed by NJ Bell with its petition, William J. Doherty, Jr., Francis Cronin, Sharon B. Megdal and Robert Willig, testified and were cross-examined. Additionally, oral argument on disclosure of certain information alleged to be proprietary by NJ Bell and its witness Cronin was heard on September 17, 1992.

Thereafter, testimony of Rate Counsel and certain of the intervenors was prefiled. Rate Counsel prefiled testimony of Richard W. LeLash, Charles W. King, Michael D. Dirmeier, David C. Newton, Glenn D. Meyers, Buckner A. Wallingford, II, Horace J. DePodwin, Stephen E. Siwek and Jamshed K. Madan. The CWA prefiled testimony of Scott J. Rafferty and George Kohl; MCI prefiled testimony of Nina W. Cornell and Randy R. Klaus; the NJ Press Association prefiled testimony of Richard Bilotti, Robert C. Cole and John O'Brien; the NJCTA prefiled testimony of Patricia D. Kravtin, David J. Roddy, Susan M. Baldwin and Lee L. Selwyn; AT&T prefiled testimony of John D. Schell, Jr.; and Sprint prefiled testimony of Kenneth M. Prohoniak. Hearings on Rate Counsel's and the intervenors' direct cases were held on September 30 and October 1, 2 and 5, 1992.

---

6 A motion for leave to appeal the Board's Prehearing Order was filed on August 6, 1992 with the Superior Court of New Jersey, Appellate Division by the NJCTA, the CWA, and the NJ Press Association, and Rate Counsel subsequently moved to join the appeal. The movants also requested the Board to stay the proceeding herein pending the determination of their motion for leave to appeal. The motion for a stay was denied by the Board by Order Denying Motion for Stay entered on August 20, 1992. The Appellate Division denied the motion for leave to appeal on August 28, 1992.

NJ Bell filed rebuttal testimony of three additional witnesses, Jennifer Taylor, James H. Vander Weide and Joseph H. Weber, along with the rebuttal testimony of three of its original witnesses; and Company rebuttal was heard and cross-examined on October 9, 13 and 14, 1992. Surrebuttal of Rate Counsel witnesses Dirmeier, Newton, Siwek, Wallingford, DePodwin, and Madan, and NJCTA witness Kravtin was heard and cross-examined on October 14 and 15, 1992.

Public hearings also were held as scheduled in the Prehearing Order on September 8, 1992 in Trenton and on September 15, 1992 in Hackensack, and in order to provide a full opportunity for the public to comment in diverse parts of the State, an additional public hearing was held in Millville on October 29, 1992.[7]

Initial and reply briefs were ordered to be filed by November 6, 1992 and November 23, 1992, respectively. Initial briefs were filed by NJ Bell, Board Staff, Rate Counsel, the NJCTA, the CWA, the NJ Press Association, MCI, and AT&T. Reply briefs were filed by NJ Bell, Board Staff, Rate Counsel, the NJCTA, the NJ Press Association, MCI, Sprint and AT&T, and the CWA filed a one page letter in reply.[8]

---

7 Subsequent to the conclusion of the hearings, various motions were filed, which have been addressed by the Board by Decision and Order on Motion of New Jersey Cable Television Association to Reopen Record, entered December 9, 1992; Decision and Order on Motions of New Jersey Cable Television Association, entered December 15, 1992; Decision and Order on Motion of New Jersey Cable Television Association to Strike a Portion of Reply Brief of Staff of Board Regulatory Commissioners, entered February 17, 1993; Decision and Order on Motion of Division of Rate Counsel to Strike a Portion of Reply Brief of New Jersey Bell Telephone Company, entered February 17, 1993; and Decision and Order on Motion of New Jersey Cable Television Association to Reopen Record, entered February 23, 1993. The motions and the Board's rulings are not repeated at length herein, and reference may be made to these Decisions and Orders for further details regarding the motions and the Board's rulings with regard thereto.

8 Citations herein to the parties' briefs are as follows:

Party:	Citation to Initial/Reply Brief:
NJ Bell	NJBb/NJBrb
Board Staff	STb/STrb
Rate Counsel	RCb/RCrb
AT&T	AT&Tb/AT&Trb
CWA	CWAb/(Not applicable)
MCI	MCIb/MCIrb

The Board has carefully reviewed and considered the testimony, including direct, cross-examination, rebuttal, surrebuttal, and testimony presented at the public hearings, the exhibits admitted into evidence, and the initial and reply briefs.[9] Having carefully reviewed and considered the record in its entirety and the briefs of the parties, the Board sets forth below its determination regarding each of the issues listed in the Prehearing Order, although for cohesiveness and ease of discussion in a somewhat different sequence.

In addition, subsequent to the Board's consideration of this matter at its December 22, 1992 agenda meeting but prior to issuance of the Board's written Decision and Order, NJ Bell and the NJ Press Association, by letter dated March 23, 1993, filed a proposed modification to NJ Bell's plan for an alternative form of regulation. The proposed modification would prohibit NJ Bell from engaging in electronic publishing except through a separate corporate affiliate. "Electronic publishing" is defined by the proposed modification to include the dissemination, provision, publication or sale, using NJ Bell's telecommunications network, of newspaper - type information but does not include the transmission of information as a common carrier. Following service of the proposed modification upon other counsel of record and notice that the Board would consider the proposed modification at its April 14, 1993 agenda meeting, the NJCTA and MCI filed letters with regard thereto, and NJ Bell filed a response to the NJCTA's letter. The Board thereafter considered the proposed modification and the letters submitted with regard thereto at its April 14, 1993 agenda meeting. The Board's determination regarding the modification to the plan proposed by NJ Bell and the NJ Press Association also is addressed in this Decision and Order.

III. DISCUSSION AND ANALYSIS

A. WILL THE PLAN PROVIDE FOR JUST AND REASONABLE RATES FOR TELECOMMUNICATIONS SERVICES?

(Footnote 8 continued from previous page)

NJCTA	NJCTAb/NJCTArb
NJ Press Association	NJPAb/NJPArb
Sprint	(Not applicable)/SPrb

9 The Board notes that although pursuant to N.J.S.A. 48:2-32, Chairman Salmon at times during the course of this proceeding sat singly for the purpose of taking testimony, transcripts of the hearings and copies of exhibits were provided to and reviewed by Commissioners O'Connor and Armenti on an on-going basis throughout this proceeding.

In the Telecommunications Act of 1992, the Legislature declared that it is the policy of the State to, among other things, "[e]nsure that customers pay only reasonable charges for local exchange telecommunications services..." N.J.S.A. 48:2-21.16(a)(2). To this end, the Act permits the Board to approve a plan for an alternative form of regulation if it finds that the plan, among other things, "will produce just and reasonable rates for telecommunications services." N.J.S.A. 48:2-21.18(a)(2). Related to the issue of whether the plan will provide for just and reasonable rates for telecommunications services, are the five sub-issues identified in the Prehearing Order, which pertain to the reasonableness of provisions in the plan involving the rate of return/rate cap formula and mechanism, earnings reporting, exogenous events, depreciation and revenue neutral rate restructures. Each of these is discussed separately below.

NJ Bell's plan provides that there will be no increase in rate regulated services prior to January 1, 1996 except with regard to exogenous events or revenue neutral rate restructures (Plan, §§I(B)(1)(a), I(B)(4) and I(B)(5)). Thereafter, for the remainder of the plan, adjustments to rate regulated services would be based on one-half of the Consumer Price Index (CPI) with certain qualifications more fully discussed below (Plan, §I(B)(2)). The plan also provides for earnings sharing discussed more fully below as well (Plan, §I(B)(3)).

NJ Bell cites to authority granted by the Act in N.J.S.A.48:2-21.18(b), which enables the Board in determining just and reasonable rates to depart from rate base, rate of return regulation and to authorize a local exchange telecommunications company to set rates based on an alternative form of regulation, and to the definition of an "alternative form of regulation" in N.J.S.A. 48:2-21.17 as meaning "a form of regulation of telecommunications services other than traditional rate base, rate of return regulation to be determined by the Board and may include, but not be limited to, the use of an index, formula, price caps, or zone of rate freedom" (NJBb9 to NJBb10). Having cited to these statutory provisions, NJ Bell asserts that the Act "specifically authorizes the formula - based ratemaking form of regulation" it proposed in the plan and that the proposed CPI-based formula will ensure just and reasonable rates exist throughout the plan (NJBb10). In its view, four other provisions of the plan provide additional assurances that NJ Bell's rates are just and reasonable: 1) increases to the monthly rate for residential basic exchange services are limited to $0.25; 2) CPI-based rate adjustments will be allowed on protected telephone services only if earnings on rate regulated services are 11.9% return on equity (ROE) or less and if earnings on rate regulated services exceed 13.9% ROE, the plan provides for a sharing with customers; 3) the filing of quarterly earnings surveillance reports; and 4) the revenue neutral and exogenous events rate adjustment provisions, which provide flexibility, subject to Board approval, to "address inconsistencies that may arise over time between current rate design and the effects of future competitive, technological, and regulatory changes" and to recognize significant, unanticipated events that might affect the Company's financial health (NJBb11 to NJBb13). In evaluating revenue neutral or exogenous events proposals, NJ Bell agrees that the Board may consider whether the resulting rates will continue to be just and reasonable (NJBb13). Accordingly, NJ Bell submits that the rates for its telecommunications services will remain just and reasonable throughout the life of the plan (NJBb13).

In response to claims that its current rates are not just and reasonable, NJ Bell argues that its basic services rates are the lowest of the former Bell operating companies and more than 40% below the national average and that its intraLATA message toll service rates and intrastate switched access rates are among the lowest in the country (NJBb10 n.36; P-2, at 8-9). Its witness Doherty testified that since rates set by the Board in 1985 (Docket No. 848-856) were capped under the RSP (Docket No. TO87050398) (NJCTA-1-0101), and will continue to be capped under the plan until 1996, "customers will have experienced a zero percent increase in the cost of rate regulated telephone services for over ten years, while the costs of other consumer goods and services will reflect a cumulative inflation effect of approximately 60 percent" (P-2, at 2-3). He further testified that "[r]ate stability since 1985 has been accomplished in a period when NJ Bell's overall costs have continued to increase," and under the RSP, NJ Bell absorbed normal and extraordinary expense increases, including the direct effects of inflation, through "aggressive new service development and improved operating efficiencies" (P-2, at 2-3, 13-15). NJ Bell argues that the claim that its costs are declining is false. "[W]hile some technology costs are decreasing, others are increasing," and it maintains that its total operating costs per access line increased from $415.92 in 1988 to $443.95 in 1991 (NJBb40; P-48; CWA-9). It argues that the CWA's claim that the cost of providing telephone service has dropped by over 33% is based upon a mischaracterization of Exhibit P-21, which shows the incremental cost of a message unit in 1984 as compared to its cost in 1992 (NJBb15). NJ Bell argues that no valid comparison can be made between the two figures because they were not adjusted for underlying cost analysis changes including changes in cost methodology (NJBb15 to NJBb16). Secondly, NJ Bell argues that the principal cost component of basic telephone service is not the cost per message unit relied on by the CWA, but rather the cost of a local loop, which has changed insignificantly (NJBrb16). It further argues that the average basic telephone service rate nationwide has increased by almost $1 since 1985 and is about 60 percent higher than NJ Bell's average basic telephone services rate (NJBrb16 to NJBrb17), and the business service rate also has increased nationwide while NJ Bell's has remained unchanged since 1985 (NJBrb17 to NJBrb18). It contends that nationwide rate reductions relied upon by Rate Counsel and the NJCTA were in large measure due to the Tax Reform Act of 1986, which also caused a $48.2 million reduction in NJ Bell's rates on July

1, 1987 (NJBrb18). NJ Bell further argues a 1992 cost study for its basic residence service shows that the cost of basic exchange telephone service is still substantially above its price (NJBrb19).

Citing Exhibit P-27, a summary of NJ Bell's Group II (noncompetitive services) quarterly earnings surveillance reports (NJBrb19), NJ Bell further argues that its earnings have been below 12.9%, the Group II return on equity target established by Board Order in In the Matter of the Petition of New Jersey Bell Telephone Company for Approval of a Proposal for a Rate Stability Plan and Relaxed Earnings Surveillance for Certain Competitive Services, Docket No. TO8750398 (January 19, 1989) (NJCTA-1-0101). According to NJ Bell, Rate Counsel witness Dirmeier's claim that its earnings in 1988 - 1991 were excessive is based on erroneous use of 12.9% as applicable to NJ Bell's total intrastate return on equity, rather than to the return on equity on Group II services only, which the 12.9% return on equity target established by the Board was designed to measure (NJBrb11 to NJBrb12).

NJ Bell contends that the foregoing demonstrates that its current rates are just and reasonable and that its rates under the plan will continue to be just and reasonable. In response to arguments of other parties, it asserts that because the Act changed the regulatory framework under which regulation is to take place, empowers the Board to consider alternative forms of regulation, and permits it not to be bound by rate base, rate of return regulation, to require a finding on whether the "going-in" rate is reasonable using a rate base, rate of return analysis is not in keeping with the clear language of the Act, nor is rate base, rate of return regulation constitutionally required (NJBrb8 to NJBrb11). In opposition to an argument by the NJCTA that "just and reasonable" is a term which calls into play anti-confiscation protections afforded by the United States Constitution's Fifth and Fourteenth Amendments (NJCTAb41), NJ Bell argues that rates set under a voluntarily submitted plan cannot constitute an unconstitutional taking of property, which requires coercion to have occurred (NJBrb6 to NJBrb8).

NJ Bell also observes that consistent with the principle that there is no constitutional requirement to rely on traditional regulation to set rates, many jurisdictions have adopted, or are pursuing alternate rate regulation plans which incorporate rate methodologies other than rate base, rate of return and cites as "first and foremost" the Federal Communication Commission's (FCC) 1988 price cap decision for local exchange carriers. NJ Bell notes that the interstate rates being capped in that decision were required to be "just and reasonable" pursuant to the Communications Act of 1934 (NJBrb10), and that in its initial approval of price cap regulation for major carriers, the FCC stated:

> The Communications Act mandates that rates for interstate telecommunications common carrier services be just, reasonable, and non-discriminatory. However, while the statute requires that "we execute and enforce [its] provisions," and provides us with an array of regulatory powers, both specific and broad, it does not compel this Commission to utilize a rate-of-return methodology or any other particular regulatory model in fulfilling our statutory obligations. Rather, courts have consistently found in the Act a congressional intent to grant this Commission broad discretion in selecting regulatory tools. Our "broad discretion" specifically includes "selecting methods...to make and oversee rates...." In doing so, we may make any "reasonable selection from the available alternatives." Moreover, upon an appropriate administrative record we may amend existing regulatory methods to implement statutory objectives "either with or without a change in circumstances." [NJrb10 to NJrb11, quoting In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket 87-313, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3296-3297 (May 23, 1988); footnotes omitted]

NJ Bell argues that similarly, the broad discretion provided to the Board by the Act is not circumscribed by state or federal law and the Board is free to approve an alternative regulation plan not premised upon a rate base, rate of return analysis (NJBr11).

Rate Counsel, the NJCTA, the CWA and MCI all contend that the Board cannot find that rates under the plan will be just and reasonable because there has not been a full evaluation of the "going-in" rates and there is insufficient evidence in the record to find that the "going-in" rates are just and reasonable. Rate Counsel argues that an objective analysis of NJ Bell's current return on intrastate services would, in Rate Counsel's view, show an excessive overall return (RCb19; RCT-3, Sch.7, at 6). Rate Counsel further argues that since the RSP was experimental, no conclusions on the reasonability of rates can be drawn without an overall evaluation of the RSP, which it alleges was precluded by the Prehearing Order in this matter (RCb19; to RCb20). Rate Counsel contends that the Board cannot find that the plan will produce just and reasonable rates without an evaluation of existing rates (RCb60; RCrb22). Rate Counsel also relies upon the claim that nationwide, for virtually the entire period 1987 through the present, telecommunications rates were being decreased (RCb22; RCb60 to RCb61; RC-12). Rate Counsel further asserts that NJ Bell has proffered no standard for assessing the reasonableness of rates to substitute for the traditional cost-of-service methodology; "affordability" and "reasonableness" are two separate standards under the Act (RCb61); and the most recent data available should be used in setting rates because the use of a recent test year is regulatory policy in New Jersey (RCb61).

Like Rate Counsel, the NJCTA argues that absent an evaluation of today's rates against recent conditions, there is no basis for a Board determination that rates are presently just and reasonable. It claims that NJ Bell's position improperly assumes that rates based on a 1984 test year are per se just and reasonable as the initial rates of an indexed rate plan for the years 1993-2000 (NJCTAb48), and argues that rates set at a time of uncertainty following divestiture cannot be irrebuttably presumed to be just and reasonable seven or eight years later (NJCTAb51; NJCTAb53). It also contends that the Board declared analysis or review of existing rates and recent conditions to be "off limits to this proceeding as improper 'retroactive analysis'" (NJCTAb50). Again like Rate Counsel, the NJCTA points to rollbacks in telephone rates that have occurred elsewhere in the country since 1985 and argues that this suggests that the perpetuation of NJ Bell's rates at 1984 levels may have denied its ratepayers the benefits of cost savings as a result of industry and network changes (NJCTAb52). It further argues that NJ Bell did not present any consideration of its recent actual cost and revenue experience (NJCTAb54). While NJ Bell relies on its Embedded Analysis System (EAS) reports, the NJCTA asserts that there has to be an investigation into the total costs subjected to allocation, which was prohibited by the Prehearing Order, and that the lack of a review of the present NJ Bell books of account precludes a finding that its rates will be just and reasonable at the outset of the plan or at any subsequent time (NJCTAb67 to NJCTAb69).

The NJCTA also contends that "just and reasonable" is a term of constitutional significance calling into play anti-confiscation constitutional provisions (NJCTAb41 to NJCTAb48). The NJCTA claims that under case law, rates must be high enough to avoid confiscation but low enough to protect the public from unreasonable exactions, and this determination as to whether rates under a proposed plan satisfy this test should be based on the utility's status at the time a plan goes into effect and be made in light of the utility's costs, risks and investment levels as they exist at the plan's outset (NJCTAb55 to NJCTAb57).

The CWA also argues that the use of 1985 rates based on 1984 test year data as a starting point for a plan for rates from 1993-1999 is arbitrary and that rates grounded in a 1984 test year have little relation to present expenses or revenue requirement. Changes cited by the CWA as having occurred since 1985 include: a 30% decrease in NJ Bell's workforce (CWAb15); a reduction in central office switching expense (CWAb18; CWA-5, at 2; CWA-6); a decline in the cost of digital switching and fiber optic cable (CWAb18); a decrease in the market cost of capital (CWAb19); and a decrease in the basic cost to the Company of providing telephone service (CWAb20 to CWAb21).

The CWA also argues that the services to be provided from investment in narrowband, wideband and broadband capabilities are unrelated to basic telephone service, and it is "improper to compel ratepayers to underwrite the bulk of investments when they will not utilize the new services that result from these investments" (CWAb26 to CWAb28). It further speculates that these services ultimately will be categorized as competitive and that the revenues therefrom will not be available to reduce the cost of basic telephone service or to the plan's sharing mechanism (CWAb29 to CWAb31).

MCI argues that the Act's separate "affordability" and "just and reasonable" criteria each must be satisfied at all times during the operation of the plan including the first day the plan is in effect, and therefore, the "going-in" rates themselves must be just and reasonable and not solely the adjustment mechanisms (MCIb37 to MCIb38). MCI does not dispute that since a plan for alternative regulation is authorized by the Act not to use rate base, rate of return regulation, the Act's "just and reasonable" criterion should not be construed to require traditional regulation; however, MCI argues that the use of the term "just and reasonable" indicates that the Board must find that the rates to be charged under a plan "cannot differ materially from what would have resulted under traditional regulation" (MCIb39). MCI argues that the Board cannot determine whether NJ Bell's plan satisfies the just and reasonable criteria because the parties were precluded from testing the current rates under the traditional test (MCIb40). MCI contends that the only proof in the record that the initial rates under the plan will be just and reasonable is that they were so found in 1985 and that NJ Bell has not demonstrated that factors considered in 1985 have not changed (MCIb40 to MCIb42). With particular regard to access rates paid by MCI, MCI argues that the rates are above NJ Bell's costs and that NJ Bell's witness Doherty admitted that switching costs are declining, and therefore, MCI argues that the rate/cost relationship with respect to access has become distorted over time as rates have been frozen while costs have declined (MCIb42). MCI contends that NJ Bell's reference in its initial brief to earnings reports as support for its claim that its current rates are just and reasonable is improper in view of alleged attempts by NJ Bell to "prevent scrutiny of its earnings and the Board's sanctioning of that position in its [P]rehearing [O]rder," and it argues that the Board cannot rely on the quarterly RSP reports without suitable investigation (MCIrb12 to MCIrb13).

Board Staff argues that with certain modifications which it has proposed, the rates for telecommunications services under the plan will be just and reasonable (STb160). Staff argues that the Act does not require the Board to set just and reasonable rates based on traditional rate base, rate of return analysis and that neither a test year nor the used and useful standard needs to be utilized (STrb2 to STrb13). Indeed, Board Staff asserts that the contention that the Board is required to set rates based on the traditional rate base, rate of return methodology is inconsistent with the Act's plain language, which clearly empowers the Board to approve an alternative form of regulation using a methodology other than the traditional rate base, rate of return methodology (STrb3). Noting that in defining "alternative form of regulation," the Legislature used the words "other than" in reference to traditional rate base, rate of return, and significantly did not use words such as "in conjunction with" or "after considering," Board Staff submits that the Act thus is clear that an "alternative form of regulation" is a form "other than" traditional rate base, rate of return regulation (STrb3). Staff further notes that in authorizing the Board to approve a plan for an alternative form of regulation, the Legislature specifically excluded statutory requirements pertaining to traditional rate base, rate of return regulation, and thereby clearly indicated that the requirements of these statutory provisions have, with regard to the setting of rates for LECs, been replaced with new criteria set forth in N.J.S.A. 48:2-21.18(STrb4).

Board Staff further suggests that "[i]t is not surprising that the Legislature would intend that an alternative form of regulation is appropriate to replace the traditional rate base - rate of return method" for LECs in light of certain difficulties and disincentives associated with the traditional rate base, rate of return approach, which, Staff notes, have been referenced in this proceeding as well as by other jurisdictions, including the California Public Utilities Commission, the FCC, the United States Department of Commerce's National Telecommunications and Information Administration (NTIA), and more recently in the context of the electric and gas industries by the Federal Energy Regulatory Commission (STrb6 to STrb10). Criticisms of traditional rate base, rate of return regulation noted by Staff include that any cost savings benefit a utility only until the next rate case when they are passed on to ratepayers; that absent detection and action by the regulatory agency, uneconomic actions are picked up in a utility's next rate case and reflected in updated cost levels; and since profit level is tied to investment level, there is an incentive to invest in plant at greater than optimal levels (STrb6 to STrb12). Thus, Staff notes that traditional rate base, rate of return regulation for LECs has been viewed as not resulting in efficient management or cost containment while, in contrast, non-traditional incentive regulation rewards efficiency and innovation by allowing a regulated firm to keep at least a portion of any improved earnings (STrb6 to STrb10; P-4, at 2). In view of the difficulties and disincentives associated with traditional rate base, rate of return regulation and given the extent of the Legislature's revisions of the statutory scheme for telecommunications utilities, "[i]t is unreasonable to assume the Legislature intended to continue the negative impacts of traditional regulatory theory by requiring the institution of a full base rate case prior to approval of a plan for alternative regulation" (STrb10).

In addition, Staff argues that those parties that claim that under the plan users of plain old telephone service (POTS) will be required to pay for a network and capabilities they do not want, need or will use, take too narrow a view of the benefits to be derived from Opportunity New Jersey and an advanced telecommunications network (STrb18). Staff submits that the view that POTS is static and should be examined in terms of existing uses does not properly consider the benefits of advanced technology, which include possibilities for telecommuting applications, distance learning applications, video transport and the high speed transport of computer data (STrb18). In Staff's view "[t]here is no reason to assume that users of the network will not benefit from the capabilities developed by ONJ" (STrb18). Furthermore, Staff submits that in the event that these ratepayers do not use the advanced capabilities, Staff's proposed modifications will protect the affordability of rates (STrb18). Staff asserts that it is not unreasonable that revenues from new services will lag the investment needed to provide those services (STrb19 to STrb24). Staff also refutes that the plan will exact a penalty from ratepayers as premised upon an improper review of total company intrastate earnings, rather than Group II earnings only, which thereby incorrectly combines competitive and noncompetitive operations and applies a rate regulated return to competitive operations (STrb28).

The Board's analysis of the parties' arguments begins with N.J.S.A. 48:2-21.18(b), which expressly provides:

> Nothwithstanding the provisions of R.S. 48:2-18, R.S. 48:2-21, R.S. 48:3-1.1 and [N.J.S.A. 48:2-21.1] or any other law to the contrary, in determining just and reasonable rates, the Board may authorize a local exchange telecommunications company to set rates based on an alternative form of regulation pursuant to a plan approved under subsection a. of this section.

Additionally, "alternative form of regulation" is defined by the Act in N.J.S.A. 48:2-21.17 as:

> a form of regulation of telecommunications services other than traditional rate base, rate of return regulation to be determined by the board and may include, but not be limited to, the use of an index, formula, price caps, or zone of rate freedom.

From N.J.S.A. 48:2-21.18(b) and the definition of "alternative form of regulation" in N.J.S.A. 48:2-21.17, it is manifest that the rates under a plan for an alternative form of regulation need not be based upon a traditional rate base, rate of return analysis. Nor is such an analysis constitutionally required. In Duquesne Light Co. v. Barasch, 488 U.S. 299, 109 S.Ct. 609, 102 L.Ed. 2d 646 (1989), the Supreme Court of the United States emphasized that no one ratemaking methodology is constitutionally required:

> The adoption of a single theory of valuation as a constitutional requirement would be inconsistent with the view of the Constitution this Court has taken since [Federal Power Comm'n v.] Hope Natural Gas [Co., 320 U.S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944)]. As demonstrated in Wisconsin v. FPC [373 U.S. 294, 83 S.Ct. 1266, 10 L.Ed. 2d 357 (1963)], circumstances may favor the use of one rate making procedure over another. The designation of a single theory of rate making as a constitutional requirement would unnecessarily foreclose alternatives which could benefit both consumers and investors. The Constitution within broad limits leaves the States free to decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public. [Id., 102 L.Ed. 2d at 662-663; footnote omitted]

In Wisconsin v. FPC, 373 U.S. 294, 83 S.Ct. 1266, 10 L.Ed. 2d 357 (1963), referred to in Duquesne Light Co. v. Barasch, supra, the Supreme Court of the United States upheld the Federal Power Commission's rejection of the use of an individual company specific cost-of-service method based on theories of original cost and prudent investment, and its determination to instead base rates upon an area rate approach premised upon the financial requirements of the industry. The Court therein observed: "It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates." Id., 373 U.S. at 309. See also, FERC v. Pennzoil Producing Co., 439 U.S. 508, 517, 99 S.Ct. 765, 58 L.Ed. 2d 773 (1979); FPC v. Texaco, 417 U.S. 380, 387-390, 94 S.Ct. 2315, 41 L.Ed. 2d 141 (1974); Mobil Oil Corp. v. FPC, 417 U.S. 283, 316-318, 94 S.Ct. 2328, 41 L.Ed. 2d 72 (1974); Permian Basin Area Rate Cases, 390 U.S. 747, 776-777, 88 S.Ct. 1344, 20 L.Ed. 2d 312 (1968).

The Supreme Court in Duquesne Light Co. v. Barasch, supra, also reiterated that "an otherwise reasonable rate is not subject to constitutional attack by questioning the theoretical consistency of the method that produced it. 'It is not theory, but the impact of the rate order which counts.' The economic judgments required in rate proceedings are often hopelessly complex and do not admit of a single correct result." Id., 102 L.Ed. 2d at 661, quoting FPC v. Hope Natural Gas Co., 320 U.S. 591, 602, 64 S.Ct 281, 88 L.Ed. 333 (1944). Thus, whether or not proposed rates are just and reasonable depends upon whether the end result constitutes a reasonable balancing of the investor interest against confiscation in maintaining financial integrity and access to capital markets and the consumer interest in being charged non-exorbitant rates. Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1178 (D.C. Cir. 1987).

In light of the decisions of the Supreme Court of the United States cited above, the Board rejects as without merit arguments of the NJCTA, premised upon its interpretation of a 1908 decision in Knoxville v. Knoxville Water Co., 212 U.S. 1, 29 S.Ct 148, 53 L.Ed. 371 (1908), that rate base, rate of return must be utilized in setting rates and in evaluating whether rates are unconstitutionally confiscatory (NJCTAb43 to NJCTAb45). Indeed, while the NJCTA concedes that Hope Natural Gas "does not require any specific approach to setting rate base" (NJCTAb47), it contends that any subsequent constitutional challenge to rates set pursuant to NJ Bell's plan will require a rate base, rate of return analysis to ascertain whether the rates are confiscatory and that if the alternative regulation plan ever results in rates too low to raise capital on reasonable terms, NJ Bell would be able to have the plan set aside as confiscatory (NJCTAb45; NJCTAb47 to NJCTAb48; NJCTAb59 to NJCTAb61). The Board concurs with NJ Bell that an unconstitutional taking of property, i.e., a finding that rates are confiscatory, requires a coercion by a governmental authority, which is not the case with a plan voluntarily proposed by a utility pursuant to the Telecommunications Act of 1992 (NJBrb6 to NJBrb7). See, Whitney v. Heckler, 780 F.2d 963, 972 (11th Cir. 1986); Minn. Ass'n of Health Care Facilities, Inc. v. Minn. Dept. of Public Welfare, 342 F.2d 442, 446 (8th Cir. 1984), cert. denied 469 U.S. 1215, 105 S.Ct. 1191, 84 L.Ed. 2d 337 (1986); Garelick v. Sullivan, 784 F. Supp. 108, 113-114 (S.D. N.Y. 1992). NJ Bell, itself, has stated, "[b]y submitting a plan, New Jersey Bell has implicitly agreed to waive the constitutional floor to its rates and bear the attendant financial risk" (NJBrb7 to NJBrb8). Moreover, even if NJ Bell were not precluded from raising claims of confiscation, the Board finds that the NJCTA's fear that NJ Bell might one day be able to have the plan set aside as confiscatory is extremely speculative and not a basis for disapproval of the plan as modified. As discussed further below, the rate adjustment mechanism will provide NJ Bell with adequate revenues, and the plan provides an additional safeguard against any undue substantial financial impact in the event of an exogenous event. Therefore, the Board rejects as ill-founded the NJCTA's speculative confiscation argument.

Thus, contrary to suggestions of various parties herein, neither the Act, the Constitution nor any other law requires the Board to conduct a traditional rate proceeding using the traditional rate base, rate of return methodology prior to approving a plan for an alternative form of regulation. In N.J.S.A. 48:2-21.18(b) and in defining "alternative form of regulation" in N.J.S.A. 48:2-21.17, the Legislature very plainly empowered the Board to determine whether rates are just and reasonable using a methodology "other than traditional rate base, rate of return regulation," including the use of an index, formula, price caps or zone of rate freedom.

The Board believes that the issue of whether the plan will produce just and reasonable rates should be viewed with regard to the plan in its entirety over the life of the plan, rather than on an isolated, piecemeal basis. In viewing the plan in its entirety and considering its net effect, factors in favor of one party may be compensated by countervailing factors in some other respect. Cf., Duquesne Light Co. v. Barasch, supra, 102 L.Ed. 2d at 661. In this way, the justness and reasonableness of rates under the plan can be judged with due regard for the risks borne by the Company in agreeing in 1993 to a plan for its rate structure which, if approved, would be in place until the end of this century, the benefits to ratepayers of the stability associated therewith, and all other pertinent factors, including ONJ, so as to determine whether the overall effect of the plan constitutes a just and reasonable balancing of the interests of NJ Bell's shareholder and its ratepayers.

Nevertheless, even considering the initial rates under the plan in isolation as various parties argue is required, the Board FINDS that NJ Bell's earnings reports and operating cost information reflect that the plan as modified herein will provide for rates in effect prior to any index-based adjustments, which will be just and reasonable. The Board rejects contentions that the initial rates under NJ Bell's plan cannot be found to be just and reasonable because they are rates set as part of NJ Bell's last full rate case, which was premised upon a 1984 test year, and not based upon a current test year. Such contentions ignore both the Act, itself, and the regulatory treatment of NJ Bell since its last rate case. A test year is a tool of the traditional ratemaking approach used to develop a proxy of the utility's anticipated costs, sales, revenues, etc., over the life of the proposed rates in order to set a fair level of prospective rates. The point of incentive regulation is not the proper choice of a test year, and under the Act no test year is required to be reviewed. As to NJ Bell, this is especially relevant in that NJ Bell has been operating under an incentive approach with a rate cap since the Board's 1987 RSP Order. To superimpose traditional rate base, rate of return concepts onto incentive or alternative approaches would destroy the very incentive of the alternative scheme. Nevertheless, given that the plan under review proposes to continue and, absent exogenous events or revenue neutral rate restructures, to not increase until at least 1996, rates found just and reasonable by the Board after a review of NJ Bell's revenues, costs and expenses (See Decision and Order, In the Matter of the Petition of New Jersey Bell Telephone Company, Docket No. 848-856 (May 1, 1985); RSP Order), the Board rejects contentions that if the plan is approved rates would be set without any regard for NJ Bell's costs.

Moreover, reports submitted by NJ Bell under the Rate Stability Plan employing three cost methodologies, direct, embedded, and fully distributed, show that since the inception of the RSP, NJ Bell has not exceeded its authorized return on equity of 12.9% for Group II services (P-27; S-15, at 19). See Order, In the Matter of the Petition of New Jersey Bell Telephone Company for Approval of a Proposal for a Rate Stability Plan and Relaxed Earnings Surveillance for Certain Competitive Services, Docket No. TO87050398 (January 19, 1989)(NJCTA-1-0101). The highest reported return has been 11.07% in the first quarter of 1992. A review of current Board authorized returns using recent costs of capital reveals returns in the range of 11.4% to 12.5%. Therefore, even using the lowest of these, 11.4%, NJ Bell has not overearned. In this regard, the Board has carefully considered but rejects the argument of MCI and others that they were precluded by the Prehearing Order from testing the current rates, and that the Board cannot rely upon the quarterly earnings reports. This argument is based upon a misinterpretation of the Prehearing Order.

In the Prehearing Order, in response to various parties' contentions that a full evaluation of the RSP is required before NJ Bell's current plan could be considered, the Board stated:

> [T]his proceeding is not a comprehensive evaluation of the current Rate Stability Plan (RSP), but rather is a proceeding to determine whether, under the new legislation, NJB's newly petitioned for plan for an alternative form of regulation should be approved. The parties, therefore, are to approach this proceeding from the viewpoint articulated throughout the legislation, namely: What <u>will</u> the proposed plan do? Will the proposed plan result in just and reasonable rates? Will the proposed plan enhance economic development? The guiding principle is a forward looking approach without the requirement to conduct any retroactive analysis. We find this to be the clear mandate of the legislation. Some parties have argued that a full evaluation of existing rates is necessary to the Board's decision in this proceeding. The Board disagrees. <u>N.J.S.A</u>. 48:2-21.18(a)(2) clearly requires as a prerequisite for Board approval of the plan that the Board find that the plan "will produce just and reasonable rates for telecommunications services." Therefore, the issue in this proceeding is whether or not the plan will meet the legislative mandate of ensuring on a prospective basis the affordability, justness, and reasonableness of various telecommunications services. This analysis does not require a finding by the Board that the current RSP has produced just and reasonable rates, but rather an analysis of the prospective effects of NJB's proposed plan on rates over the life of the proposed plan.

This provision of the Prehearing Order made clear that this proceeding was to be a proceeding to determine whether NJ Bell's plan for an alternative form of regulation should be approved. The Board thus rejected the argument that the Board could not act on NJ Bell's plan until it had performed a comprehensive analysis of the RSP. Premised upon language in the RSP Order and the subsequent January 19, 1989 Order indicating that the RSP was experimental in nature and the Board would consider it as regulatory policy only after a conclusion of the experiment, this argument failed to recognize that the RSP was approved as part of the then existing regulatory structure, and that the regulatory structure was altered by the enactment of the Telecommunications Act of 1992. It was the incentive regulatory approach which was considered by the Board to be experimental in 1987, and with the passage of the Act, it became explicit State policy to permit the Board to approve alternative forms of regulation provided that the Act's criteria are satisfied. N.J.S.A. 48:2-21.16(a)(5).

While the proceeding was not to be a comprehensive evaluation of the RSP, *per se*, to the extent that rates established under the RSP were proposed to be continued under the plan, parties were not precluded from presenting evidence as to the justness and reasonableness of these rates under the plan. Indeed, the claims that the parties were so precluded ignores and is contradicted by the fact that earnings issues and other issues relevant to the existing rates established under the RSP were, in fact, explored by the parties during discovery and the hearing, as is reflected in various exhibits admitted into evidence, *e.g*. P-27 (summaries of Groups I and II quarterly surveillance reports); P-48 (costs of providing service); S-15, at 19 (summaries of Groups I and II quarterly surveillance reports); MCI-7 (intrastate results related to surveilled services for quarter ended March 31, 1992); CWA-2 (employment); CWA-5 (how 1985 just and reasonable rates continue to be so through 1996); CWA-6 (switch expenditures); CWA-7 (captital expenditures); RCT-3 (Dirmeier), at 11, 25-27 (analysis of earnings during the RSP); RCT-1 (Lelash), at 15-16 (cost of capital). Moreover, in addition to the RSP reports demonstrating that NJ Bell has not exceeded its authorized return on equity, the record effectively counters the arguments that the Company's costs are declining and demonstrates that NJ Bell's overall operating costs have been increasing (P-2, at 2-3, 3-15; P-48; CWA-5).

As discussed more fully below, the argument raised by some that protected services ratepayers will subsidize competitive service offerings, would be detected by an analysis of the rate stability reports, which the Board will require to be continued. Notwithstanding the EAS showing and as a further safeguard to ensure the accuracy of these reports, the Board will order an operations review of the EAS, as discussed further below. Furthermore, the sharing mechanism in the plan, as modified, will provide an additional level of protection for ensuring the continuation of just and reasonable rates.

The Board has considered but rejects MCI's argument that the rate/cost relationship with respect to access charges has become distorted since switching costs have been declining over time and that therefore access charges must be reduced before the commencement of the plan. Were the Board to reduce every service rate that is above cost, there would be no subsidy from any service to basic exchange service and universal service would be jeopardized. The Board has historically priced basic residential service on a residual basis, that is, after a revenue requirement has been quantified, rates have been increased for all services other than basic to the extent possible, and then basic has been increased as a last resort. This is a policy that has created affordable rates (in fact among the lowest in the nation) and universal service. This Board policy and the accomplishmments derived from it would be eliminated if all services were priced precisely at cost.

In light of the foregoing, although the Board believes that the Act does not require it to determine whether the initial rates under the plan will be just and reasonable on an isolated basis, the Board FINDS that even if such an analysis is performed, the initial rates under the plan will be just and reasonable.

The Board next turns to an analysis of the plan's other provisions pertaining to the rates to be effective thereunder. As indicated earlier, the Board's Prehearing Order identified five subissues related to the issue of whether the plan will produce just and reasonable rates. The first subissue is:

1. Is the rate of return/rate cap formula and mechanism including the use of a CPI index and earnings sharing, reasonable and in the public interest?

Under NJ Bell's proposed plan, absent revenue neutral rate restructures or exogenous events changes, rates would be frozen through 1995. For the remainder of the plan, 1996 through 1999, adjustments to rate regulated services would be based on one-half of the Consumer Price Index (CPI) with the following qualifications:

1. The monthly rates for Low Use Message Rate Residence service and the Link-Up America Plan would not be affected;

2. The monthly rates for all classes of residential basic exchange service could not increase by more than $0.25 in any one year, regardless of the change in the CPI; however, the $0.25 annual rate adjustment cap on residential basic service would not include additional message units above a basic allowance, touch-tone service, toll, directory assistance and other services that make up an average customer's monthly bill;

3. No CPI-based rate increases would be permitted on protected services during any year in which NJ Bell's average intrastate return on equity (ROE) for its rate

regulated services exceeds 11.9%;

4. No CPI-based rate increases would be permitted on any rate regulated service during any year in which NJ Bell's average intrastate return on equity for its rate regulated services exceeds 13.9%;

5. In no case would the rate for any service be increased by more than the CPI increase applicable to that category of service (Plan, §§I(B)(2), II(B)).

By October 31 of the year prior to which NJ Bell would invoke a CPI-based increase of any rate regulated service effective the following January 1, the plan as proposed would require NJ Bell to provide the following information:

1. Data showing the CPI for the preceding twelve months ended September 30th and the CPI percentage change for that twelve-month period;

2. Calculations showing the rates to be adjusted based on 50% of the CPI;

3. Calculations showing the average intrastate return on equity over the most recent four quarters available, as reflected in the quarterly financial monitoring reports for NJ Bell's rate regulated services. The average return on equity figure would be calculated based on the 3rd and 4th quarters of the year preceding the filing and the 1st and 2nd quarters of the year in which the filing is made; and

4. Tariff pages to reflect the revised tariff rates (Plan, §II(B)).

During the proceeding, NJ Bell offered several clarifications to this proposal. First, CPI index-based rate adjustments would work in both directions, that is, positive and negative for rate changes (P-8). However, while index-based decreases would be mandatory, they would not be applicable if NJ Bell's average intrastate return on equity for its rate regulated services fell below 11.9% (P-10).

As to sharing, the plan provides that if earnings exceed 13.9% ROE for rate regulated services, customers will share equally in those earnings above 13.9% (Plan, §I(B)(3)). The plan provides that by October 31 of the year prior to which NJ Bell must share earnings with its customers, it must submit to the Board calculations showing the average intrastate ROE for its rate regulated services for four quarters, including the third and fourth quarters of the previous calendar year and the first two quarters of the current year as reflected in its quarterly financial monitoring reports; data showing the dollars associated with the portion for customer sharing; and a description of the manner of sharing (Plan, §II(E)).

The Board will first consider the proposed rate adjustment thresholds and sharing levels and thereafter the proposed use of the CPI index in particular and arguments as to a productivity offset.

Proposed rate adjustment and sharing thresholds

NJ Bell argues that the "earnings thresholds operate as a reasonableness check and provide a balance among: (1) the desire to provide reasonable customer prices, (2) the need to provide incentives for business efficiency and marketing innovation; and (3) the need to eliminate inefficiencies and expense of traditional rate base, rate of return regulation" (NJBb12). To determine the thresholds, NJ Bell started with the 12.9% target return authorized by the Board in the January 19, 1989 Order in the rate stability case, Docket No. TO87050398 (NJCTA-1/0101). NJ Bell determined that a 200 basis points range was a reasonable threshold range and therefore it added and subtracted 100 basis points, thereby deriving thresholds of 11.9% and 13.9% (T112; T4296 to T4297). The plan's earnings thresholds, according to NJ Bell, are conservative when compared with the sixteen year range of rates approved by the Board for gas, electric and telephone utilities (12.4% to 17%). The 11.9% is below both the overall average (14.2%) and the average for telephone rates over this period (14.1%) (S-1, at 5). NJ Bell proposes that the earnings thresholds be approved as an additional consumer safeguard in the form of a reasonableness check on prices for rate regulated services without determining the specific cost of capital for NJ Bell's rate regulated services (S-1, at 6).

NJ Bell contends that Opportunity New Jersey will require a significant capital commitment on the part of the Company and its parent company, Bell Atlantic Corporation, and the plan allows for significant risk. In NJ Bell's view, the 50/50 sharing threshold for earnings on rate regulated services above 13.9% provides incentive for capital commitment, and also provides a continuing incentive to accomplish accelerated deployment and continued high quality service in as economically efficient a manner as possible. As set forth in the plan, the 50/50 sharing provision is a component of the framework to accelerate technology deployment because it provides NJ Bell with incentives to achieve new revenues and remove non-essential costs. A provision returning 100% of earnings to customers above the threshold does not provide such an incentive, according to the Company (S-1, at 6).

NJ Bell witness Dr. Megdal rebuts other witnesses' testimony regarding the appropriate earnings/sharing thresholds and states that the thresholds for determining when price adjustments allowed are reasonable. In response to suggestions that the sharing threshold is not significant because NJ Bell does not forecast earnings on rate regulated services to exceed the threshold during the life of the plan, NJ Bell argues, through its witness Dr. Megdal, that the earnings estimated by the Company are only forecasted earnings, and that forecasting the future is difficult particularly with a longer forecast period (P-59, at 9). Dr. Megdal further argues that even if one considers the threshold for protected service price adjustments in the context of traditional rate base, rate of return proceedings, the 11.9% threshold appears reasonable when compared to recent Board action. She cites certain returns authorized in 1992, for example, 11.9% ROE is less than the returns authorized for Rockland Electric Company and South Jersey Gas Company, and slightly higher than those authorized in 1992 for three water companies (P-59, at 9). Dr. Megdal also argues that the 13.9% threshold is reasonable in that it provides NJ Bell a financial incentive to operate more efficiently and introduce new products and services. Earnings above the 11.9% level should be retained by the Company as a reward for efficiently conducting business according to Dr. Megdal, and if earnings reach the 13.9% threshold, ratepayers would begin sharing in NJ Bell's success (P-59, at 9-10).

A second rebuttal witness, Dr. Vander Weide, argues that it would not be consistent with prior reporting methodology, and not appropriate to use a different capital structure as recommended by Rate Counsel witness Lelash for calculating the experienced ROE for the rate regulated services. He suggests that the use of the Company's actual capital structure is appropriate because it underlies and supports NJ Bell's ubiquitous network. Whatever services the Company provides must rely on that same source for investment, according to Dr. Vander Weide (P-61, at 8).

Further, in response to arguments that the plan's thresholds are too high because historical allowed returns are irrelevant and interest rates and inflation are at a record low (RCb31), NJ Bell argues that this implicitly assumes a continuation of traditional rate regulation and that under such rate base, rate of return regulation, a utility could seek a rate increase if it thought its cost of capital was out of line with current rates. However, under the plan, rates would not be tied to a particular cost of capital , and NJ Bell would not have the option of seeking higher rates or thresholds if the costs of capital increase. The thresholds in the plan would be fixed and therefore, in NJ Bell's view, should take into account a range of expected capital costs over the life of the plan (NJBrb21 to NJBrb22).

Rate Counsel objects to the proposed adjustment mechanism as not being tied to actual expense increases or to any showing that particular services are not generating sufficient revenues, and asserts that as a result, the plan would allow index-based rate increases without any assessment of base prices, productivity offsets, or future volume forecasts (RCb25; RCT-1, at 11). Rate Counsel claims that revenues from CPI increases would produce a major portion of the overearnings, which Rate Counsel claims will result from the plan (RCb27). Rate Counsel also argues that NJ Bell's proposal for sharing earnings is unreasonable and "a mirage" (RCb30). Rate Counsel contends that reliance in setting the 13.9% return figure on average returns awarded in the past is inappropriate since utilities generally seek rate relief in periods of high inflation and poor economic conditions, and that at the present time, interest rates are at a record low for the past two decades and inflation also is low (RCb31).

Rate Counsel witness Lelash maintains that if any alternative regulatory plan is to incorporate safeguards based on return levels, then those return levels must represent reasonable limits based on the applicable required return for the entity and that return levels used in any pricing mechanism must be relevant to current economic conditions. While NJ Bell has established a two hundred basis point range with the Board's last authorized benchmark return of 12.9% as the mid-point of its proposed thresholds and alternatively justified its thresholds based on a sixteen year range of Board authorized returns, these conceptual bases for the pricing thresholds are inappropriate in Mr. Lelash's view (RCT-1, at 7). The use of a 16 year history of return levels is, in Mr. Lelash's opinion, inappropriate because economic conditions in the past are not anticipated to repeat during the foreseeable future, and prime rates in excess of 20.0% during the early 1980's are in sharp contrast to the current 6.0% level. Therefore, Mr. Lelash argues that NJ Bell's use of 11.9% and 13.9% as threshold levels in its pricing mechanism is arbitrary and without support (RCT-1, at 8). Mr. Lelash suggests that current cost of capital calculations show that telephone operations have a cost of equity of about 11.50%. Therefore, current market data would indicate that the thresholds would be reasonable if they were established at 10.50% and 12.50% for total Company operations (RCT-1, at 8). For Group II services only, Rate Counsel contends that a 6.5% return would be required to generate the 13.7% average return on intrastate equity over 20 years as calculated by NJ Bell and that if income sharing is to be based solely on returns earned by Group II services, as proposed by NJ Bell, then the range of thresholds should center around 6.5% (RCb35; RCT-9, at 33).

Mr. Lelash also argues that NJ Bell's proposed return thresholds are unreasonable because they are not based on a specified capital structure and that the resultant return on equity associated with any earnings level is directly affected by the capital structure employed in the calculation (RCT-1, at 10). Mr. Lelash therefore argues that, in effect, by using a capital structure heavily weighted with common equity, NJ Bell could retain earnings which, under a more reasonable capital structure, would be shared with ratepayers (RCT-1, at 10). As a result, Rate Counsel argues that the pricing mechanism could be manipulated and would be unable to protect the public interest (RCb33; RCT-1, at 16). Rate Counsel also alleges that under the plan as proposed, NJ

Bell could unilaterally change its depreciation rate and thereby control its return level to obtain rate increases or limit the ratepayers' sharing of earnings (RCb34).

MCI also contends that a sharing of overearnings as proposed by NJ Bell will never occur (MCIb18). It argues that by focusing on Group II earnings that will be determined according to the "Bell-controlled" embedded analysis system and by the plan's depreciation proposal, NJ Bell will have the incentive and means to maintain its Group II earnings below any established threshold (MCIb48). MCI submits that overall Company earnings should be considered in any sharing formula (MCIb49; MCIrb16). Furthermore, although it takes no position with respect to what a fair return on equity would be (MCIb65; MCIrb16), based on testimony of its witness Dr. Cornell, MCI argues that NJ Bell's sharing proposal should be rejected and replaced by a "reverse taper," which would return to ratepayers the cost savings that are easiest to achieve and allow NJ Bell to retain a greater and greater portion of the cost savings that are more difficult to achieve. Thus, for example, the first 100 basis points might belong all to the ratepayer, the next 200 basis points could be shared 50/50, and anything over 300 basis points could be kept entirely by NJ Bell (MCIb65; MCI-T-1, at 10-11).

MCI also argues, based on testimony of its witness Klaus, that overearnings should be computed on a calendar year basis (MCI-T-2, at 11-12), rather than as proposed by NJ Bell to determine overearnings according to a 12-month period ending June 30 and to thereby utilize EAS factors developed in a prior calendar year. MCI contends that applying one year's factors to a different 12-month period is an "apples-to-oranges" proposal and also would create the phenomenon of year-end accounting adjustments occurring mid-way through the year. When coupled with NJ Bell's depreciation proposal, the use of interim earnings could be subject to abuse according to MCI. MCI argues that in contrast, its proposal would permit overearnings to be determined according to the annual EAS studies, which unlike the quarterly studies, use factors and financial data related to a single period, including all year-end adjustments (MCIb66; MCIrb16).

Sprint witness Prohoniak contends that although NJ Bell's plan refers to a return on equity it does not state the targeted overall rate-of-return on investment (ROR) for either the target ROR for initial rates or before application of the sharing mechanism. If the intrastate target ROR is higher than the interstate target set at 11.25% by the FCC, Sprint argues that the Board should consider whether it is appropriate to allow NJ Bell an opportunity to target a higher ROR for NJ Bell's intrastate regulated services than it is currently authorized to target for its interstate regulated services, prior to application of the sharing mechanism (SPT-1, at 16-17; SPrb16). Because the FCC has determined that an 11.25% ROR, coupled with a sharing mechanism as reflected in the FCC's Price Cap Plan, provides the appropriate incentive for NJ Bell to engage in cost effective measures in the interstate jurisdiction, Sprint argues that these elements should be incorporated into NJ Bell's plan to provide the appropriate incentives to encourage NJ Bell to achieve efficiencies in the intrastate jurisdiction. Sprint further argues that the 50/50 sharing mechanism should begin at 1% above the 11.25% ROR so as to match the sharing mechanism in NJ Bell's plan for intrastate regulated services with the mechanism which already is in place for NJ Bell's interstate regulated services. Also, under the FCC's Price Cap plan, NJ Bell is required to "refund" or "share" 100% of earnings in excess of 5% of the target ROR. Therefore, at 16.25% ROR, NJ Bell is required to refund all excess earnings to ratepayers. NJ Bell has proposed no ceiling on intrastate earnings and Sprint contends that its plan should be modified to match the FCC's plan in this regard (SPT-1, at 27-28; SPrb16). Sprint also argues that the plan does not identify whether NJ Bell's IXC access customers will be included in the sharing of any excess earnings and that IXCs must be allowed to participate in any sharing of excess earnings from intrastate access services (SPrb15 to SPrb16).

The CWA contends that the plan's sharing mechanism will never become effective (CWAb33). Its witness Kohl suggests that ratepayers will not share in any cost savings despite NJ Bell's proposal that earnings over 13.9% will be shared with ratepayers, because 13.9% is a very high rate of return in this economic climate, and NJ Bell's own calculations show that it does not expect to come close to earning 13.9% throughout the life of the plan. The CWA also argues that as new services become profitable, NJ Bell will petition to reclassify them as competitive, thereby lowering the return on equity for rate regulated services and foreclosing any possibility of sharing (CWAb31). Therefore, the CWA contends that NJ Bell ratepayers will not benefit from any sharing (CWAT-2, at 31).

The NJCTA's witness Baldwin disagrees with NJ Bell's earnings thresholds, stating that although NJ Bell has proposed two distinct earnings thresholds which, if not met or exceeded, would trigger permissible rate increases beginning January 1, 1996, i.e., a threshold of 11.9% for protected services and a threshold of 13.9% for all other rate-regulated services, based on NJ Bell's own projections it is highly probable that NJ Bell's earnings would be less than 11.9% until 1999. Therefore, the fact that NJ Bell has proposed two earnings thresholds is a virtually meaningless distinction according to Ms. Baldwin. In order for this distinction to take on meaning, NJ Bell would, in Ms. Baldwin's view, need to lower the earnings threshold for protected services, thus increasing the probability of protection for basic residence and business telephone services (CTAT-3, at 8).

NJCTA's witness Dr. Selwyn further disputes the proposed sharing mechanism, and offers specific modifications to NJ Bell's plan. Under his proposed modifications to the sharing mechanism, NJ Bell's earnings would be measured with respect to its overall return on rate base, rather than on the return on equity standard.

Secondly, Dr. Selwyn recommends that the Board establish a benchmark rate of return (BROR) to use as the basis for determining the level of earnings that may be shared between NJ Bell and its ratepayers. Sharing would occur when NJ Bell's earnings level has exceeded the BROR by 100 basis points. In addition, he proposes that shared earnings be returned to ratepayers in the form of a "Sharing Credit" spread over the earliest feasible three-month period in proportion to the billed amounts for monopoly services, exclusive of access services furnished to interexchange carriers (CTAT-4, at 44).

Dr. Selwyn argues that measuring earnings with respect to the total return on rate base reduces the opportunity for NJ Bell to manipulate its reported earnings. Second, by establishing a benchmark rate of return at the outset of the plan, in Dr. Selwyn's opinion, the Board would be able to explicitly reflect the favorable reaction in the capital markets that can be expected to result from the expanded earnings opportunities that NJ Bell will receive operating under the plan relative to what would otherwise apply under rate of return regulation. In addition, by limiting the sharing credit to monopoly services furnished directly to end users, Dr. Selwyn contends that basic ratepayers would be assured the benefits of any sharing that may occur and that since prices for competitive services are determined by market conditions at the time of the purchase transaction without any expectation of receiving a subsequent adjustment, it is appropriate that they be excluded from the sharing credit (CTAT-4, at 45-46).

Although the NJCTA did not expressly address the proposed threshold levels in its initial brief, in its reply brief it appears to concur with Rate Counsel's contention that a 6.5% return on equity target should be utilized for Group II services for sharing purposes (NJCTArb28 to NJCTArb30).

Staff argues that a sharing mechanism is appropriate and provides incentives for the deployment of an enhanced telecommunications network, and that the inclusion of a mechanism that would not permit increases in prices when earnings are above a certain authorized level is reasonable (STb104). In addition, Staff contends that the 50/50 sharing mechanism would continue the incentive for NJ Bell to contain costs and be as efficient as possible even when the sharing threshold is achieved and that a requirement that NJ Bell return 100% of earnings above a certain threshold would eliminate the incentive (STb104). However, in order to take into account current economic conditions, Staff recommends adjustments be made to the plan's threshold levels (STb104 to STb105). Staff recommends that a lower threshold applicable to protected services be set at 11.0%, a median threshold applicable to other rate-regulated services be set at 12.0%, and the upper threshold for sharing purposes be set at 13.0% (STb106; STb145). The thresholds would continue to be based upon return on equity and not overall return on rate base (STb107). Staff submits that the Board currently reviews and measures NJ Bell's earnings based on ROE and there has been no demonstration that use of ROE as a measurement mechanism is inappropriate (STb107). In addition, Staff submits that the use of ROE is more appropriate for an alternative form of regulation because it does not base earnings on overall investment which is the measurement technique in a rate base, rate of return regulatory environment. The levels suggested by Staff would, in its view, create a more reasonable level of protection for basic ratepayers by keeping rates affordable while at the same time permitting NJ Bell to raise rates for necessary increased costs. Sharing above its proposed 13% threshold would, in Staff's view, provide adequate safeguards to customers as well as incentive for NJ Bell to continue to achieve cost savings when earnings exceed this level of return, and would also increase the likelihood of sharing (STb106 to STb107). Staff submits that these levels are reasonable in light of NJ Bell's forecast, which projects that it will not earn above 11.8% until 1999 (when it forecasts 13.08%) and will not reach the 13.9% proposed sharing threshold during the life of the plan (STb106; S-1, at 1).

Having considered the record and all of the arguments regarding this issue, the Board FINDS that earnings thresholds for index-based rate adjustments and for earnings sharing are reasonable and appropriate means of establishing and maintaining over the life of the plan a balance between providing reasonable and affordable prices for NJ Bell's customers, without the inefficiency, expense and delay of traditional rate base, rate of return regulation, and providing NJ Bell with the incentive to contain costs and to commit capital and accomplish accelerated deployment of an enhanced telecommunications network in as efficient a manner as possible.

Various aspects of the traditional rate base, rate of return approach with regard to telecommunications carriers have been discussed and criticized in this case as well as by other jurisdictions. As described by Dr. Megdal, a former member of the Arizona Corporation Commission, "Incentive regulation rewards efficiency and innovations in production and marketing by allowing a regulated firm to keep at least a portion of its improved earnings... Moreover, the cost-plus nature of traditional regulation, coupled with basing profit levels on the amount of invested capital, provides limited incentives for companies to produce their output in the most efficient way" (P-3, at 2).

The Federal Communications Commission has found "that price caps represent a regulatory approach that is superior to rate of return because price caps are better suited to encouraging efficiency and innovation in the provision of services..." In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 2881 (April 17, 1989). The FCC's discussion of the problems inherent with the traditional approach for telecommunications carriers is instructive:

> In theory, rate of return is intended to replicate competitive market results. However, there are many differences in the manner in which rate of return regulation and competitive forces operate. Competition holds each firm to "normal" profit levels as a result of a dynamic process that operates over time -- a firm strives to maximize profits and secure advantage over other firms by responding to consumer demand effectively. Under rate of return, however, "normal" profit levels are established in advance by regulatory fiat. The dynamic process that produces socially beneficial results in a competitive environment is strongly suppressed. In fact, rather than encourage socially beneficial behavior by the regulated firm, rate of return actually discourages it.
>
> The distorted incentives created by rate of return regulation are easily illustrated. In a competitive environment, where prices are dictated by the market, a company's unit costs and profits generally are related inversely. If one goes up, the other goes down. Rate of return regulation stands this relationship on its head. Although carriers subject to such regulation are limited to earning a particular percentage return on investment during a fixed period, a carrier seeking to increase its dollar earnings often can do so merely by increasing its aggregate investment. In other words, under a rate of return regime, profits (i.e., dollar earnings) can go up when investment goes up. This creates a powerful incentive for carriers to "pad" their costs, regardless of whether additional investment is necessary or efficient. And, because a carrier's operating expenses generally are recovered from ratepayers on a dollar-for-dollar basis, and do not affect shareholder profits, management has little incentive to conserve on such expenses. This creates an additional incentive to operate inefficiently. Moreover, in situations in which carriers providing more than one service face competition for one or more of such services, rate of return regulation enables carriers to distort the competitive process by manipulating their reported cost allocations.
> ....
>
> Our experiences administering rate of return regulation lead us to conclude that this methodology has certain inherent flaws. As explained above, this type of regulation presents carriers with certain incentives -- to pad their rates and forgo efficient

> innovation, for example -- that are perverse when viewed from a public interest perspective. These incentives would exist even if technology and industry boundaries were to remain stable and the existence of such incentives alone provides sufficient justification to seek alternative regulatory approaches that are better suited than rate of return to achieving the consumer-oriented goals of the Communications Act.
>
> We have every reason to expect, moreover, that the telecommunications industry will continue to be marked in the future by the same steady technological advancement it has demonstrated in the past. This will lead to greater competition than at present and a continuing shift in the boundaries between the competitive and less competitive segments of the telecommunications marketplace. Notwithstanding this technological change and growing competition, we could continue our current practice of implementing cost allocation systems that present strong deterrents to anticompetitive activity associated with those boundaries, but it will become increasingly difficult to obtain these benefits while concomitantly holding to a minimum the costs such deterrents impose on society. We conclude, therefore, that it is prudent to implement regulatory systems that are better able than rate of return to operate effectively in an environment marked by competition and technological change. [Id. at 2889-2891; footnote omitted]

In its Second Report and Order, the FCC again explained:

> In making the judgment that incentive regulation is superior to rate of return, we do not find that rate of return is necessarily a bankrupt regulatory practice, but only that it is not the best. Previous orders in this docket have contained lengthy discussions of the tendency of rate of return regulation to produce inefficiencies, as documented by various scholars. Commenters in this proceeding have extensively debated whether the inefficiencies attributed to rate of return in the form of rate base padding or the padding of expenses actually occur in practice. Our own experience with administering a rate of return system convinces us that carriers in fact attribute unnecessary costs to their operations in an effort to generate more revenue. Our experience also reveals, however, that rate of return oversight is a responsible, functional method of correcting for these tendencies.

> Unfortunately, a regulatory system that simply corrects for a tendency to pad investments or expenses is not a system that can also drive LECs to become more efficient and productive. But incentive regulation, by limiting the amount carriers can charge for their services and continually exerting downward pressure on those price ceilings, can. The downward pressure on price ceilings requires LECs to share the benefits of increased productivity with ratepayers in the form of lower rates. Both carriers and customers will be better off.
>
> We do not subscribe to the view, attributed to this Commission by several parties on the basis of statements made in earlier orders in this proceeding, that our rate of return system necessarily discourages innovation. Our view is that rate of return does not provide sufficient incentives for broad innovations in the way firms do business. Incentive regulation, by creating incentives for carriers to become more productive, generates powerful motives to innovate, and is a better way of regulating. [5 FCC Rcd 6786, 6790 (October 4, 1990)]

Additionally, the National Telecommunications and Information Administration (NTIA) also has considered the appropriate regulatory treatment for telecommunications carriers. "NTIA strongly supports the continued replacement by states of rate of return regulation with some form of incentive regulation. Because incentive regulation generally induces firms to operate more efficiently, [NTIA] believe[s] that it will ensure that regulated services are provided at lower prices and at a lower cost than is the case under rate of return regulation" (P-42, at 248).

As outlined by the State of California Public Utilities Commission (PUC), in its order in Alternative Regulatory Frameworks for Local Exchange Carriers, Decision 81-10-031, 107 PUR 4th 1 (Ca. P.U.C. 1989):

> The shortfalls of the traditional rate of return regulatory approach are well documented. One of the most commonly voiced criticisms is that traditonal regulation creates a set of incentives which do not result in efficient management and cost containment. First, both the risk and the reward attached to management actions are dampened by the rate setting process. Because it would be almost impossible for a regulatory agency to determine the reasonableness of all of a utility's activities, this approach shields management to some extent from a bottom line accountability for its actions. While shareholders are at risk for possible

> revenue shortfalls between general rate cases, absent detection and action by the regulatory agency uneconomic actions are simply picked up in the next examination of the utility's expenses and operations and are reflected in updated revenue levels. At the same time, cost reductions due to successful management are detected and passed on to ratepayers when rates are updated; the fact that shareholders receive direct benefits of these actions only until that time reduces incentives to operate efficiently or to implement new cost cutting measures.
>
> Another perverse incentive arises from the regulatory formula which ties a utility's profit directly to the amount of its investment, or rate base. [Id. at 84]

In light of the Telecommunications Act of 1992 and the record in this proceeding, the Board FINDS these discussions are persuasive and that a change in the regulatory model for NJ Bell is appropriate. The Board concurs with NJ Bell and FINDS that rate adjustment and sharing thresholds will operate as a reasonableness check and provide a balance among reasonable customer prices; incentives for business efficiency and marketing innovation; and elimination of inefficiencies and the expense of traditional rate base, rate of return regulation.

The Board concurs with NJ Bell and Staff that a sharing mechanism is appropriate and provides incentives for the deployment of an enhanced telecommunications network in as efficient and cost effective a manner possible even after the sharing threshold level has been achieved, while at the same time, insofar as earnings over the threshold may not all be retained by NJ Bell and must be shared with ratepayers, a sharing mechanism serves as an additional level of protection to ensure that rates paid by NJ Bell's customers are just and reasonable. Likewise, an earnings threshold level beyond which index-based rate increases cannot be imposed also serves as an additional safeguard to ensure that rates are just and reasonable. The Board has considered MCI's "reverse taper" proposal but finds that NJ Bell's proposal to retain earnings up to a certain level and to thereafter share earnings with its ratepayers on a 50/50 basis is reasonable given the overall context of the plan before the Board, including, in particular, ONJ. There needs to be some assurance for the Company that earnings will be sufficient to sustain the ONJ investment.

Concern has been raised by parties during this proceeding about the level of accelerated investment in Opportunity New Jersey that will allegedly be financed by ratepayers. The funds to construct ONJ are to come from reduced dividend payments to Bell Atlantic, retained earnings, debt issuance and new services revenues (S-17, at 47). Under NJ Bell's proposal, rates for Low Use Message Rate Residence service customers as well as Link-Up America customers would be frozen for the life of the plan, and rates for rate regulated services would be frozen until January 1, 1996, except that the Board may consider revenue neutral or exogenous events rate changes over the life of the plan. Index-based rate adjustments under the plan are not intended to fund network acceleration but rather are intended to cover increases in general operating expenses due to inflation. Nevertheless, to assure that monthly residential basic rates are not required to shoulder any additional burden to fund Opportunity New Jersey, the Board HEREBY MODIFIES the plan to eliminate any index-based rate increase adjustments on all monthly residential basic rates through the term of the plan, regardless of the earnings level. If there are negative adjustments, which translate to lower rates, residential ratepayers would receive that benefit.

While the Board concurs with NJ Bell that in judging the levels of the thresholds it should take into consideration that the thresholds will be fixed and that NJ Bell will not have the option of seeking higher rates or thresholds if the costs of capital increase, the Board FINDS that NJ Bell's proposed levels should, however, be modified somewhat in view of the current economic climate as well as NJ Bell's own earnings projections, tempered by the fact that pursuant to this Decision and Order, residential basic exchange rates will not be increased during the plan other than for Board approved revenue neutral rate restructures or exogenous events rate changes. The Board further FINDS that, as Staff suggested, an intermediate threshold for adjustments for rate regulated services should be included. Therefore, the Board FINDS that a lower threshold of 11.7% for protected services, an intermediate threshold of 12.7% for rate regulated services, and a sharing threshold of 13.7% are reasonable. These return on equity thresholds (11.7%, 12.7% and 13.7%) are consistent with the legislative intent that a plan will produce just and reasonable rates, be in the public interest, and at the same time balance the need to enhance economic development in the State. The need to enhance economic development while maintaining affordable rates is a key element of the Act, an element that has required this Board to carefully construct a plan that meets this two-edged mandate. Indeed, the Act has placed a considerable emphasis on the need to maintain affordable rates and at the same time provide a means to enhance economic development. The Board believes this balance is met by the rate adjustment and sharing mechanism described herein. Thus, the Board MODIFIES the plan to provide that:

1. NJ Bell cannot request or seek rate formula increases for protected services if its verified rate of return on equity exceeds 11.7%;

2. NJ Bell cannot request or seek rate formula increases for rate regulated services if its verified rate of return on equity exceeds

12.7%; and

3. NJ Bell will share on a 50/50 basis with all customer service groups, as determined by a rate design to be reviewed and approved by the Board, earnings above a 13.7% verified rate of return on equity.

With regard to the submission of reports by NJ Bell to enable the Board's review of earnings levels, the Board is satisfied, at this time, with NJ Bell's proposal. While the Board has considered MCI's suggestion that earnings should be measured on a calendar year basis, it finds that this revision to the plan is not necessary. The Board's review of the quarterly financial surveillance reports is not limited to a single three month period. The report also contains a running total of year to date data. This allows for all year end adjustments to be reflected in the report that contains the total year information. The Board, therefore, does not view one quarter in isolation. Instead, the Board looks for trends over several quarters in its earnings review, thereby eliminating any incentive to shift earnings between periods. In this way, the Board can monitor the quarterly reports and investigate any inappropriate earnings shifts. While the Board notes MCI's concern, it has not found cause to modify the plan to provide for a calendar year determination of earnings. However, the Board reserves the right to require a revision to the time period for earnings analysis should it be found to be appropriate to do so in the future.

Proposed use of Consumer Price Index

Also to be considered in determining whether the rate of return/rate cap formula and mechanism is reasonable and in the public interest is the plan's proposed use of the United States Bureau of Labor Statistics' New York - Northeastern New Jersey Consumer Price Index for Urban Wage Earners (CPI) in allowing for increases in rates (Plan, Summary n.2; P-4, at 4). NJ Bell contends that the CPI is the index best understood by consumers, is specific for a local geographic area, and is the best measurement of general inflation to NJ Bell's consumers (NJBrb20; P-4, at 4).

Regarding the appropriate measure of a formula based price adjustment, the NJCTA's witness Selwyn favors the Gross Domestic Product Price Index (GDP-PI), which is supplied by the United States Department of Commerce and measures the total output produced domestically. The GDP-PI thus is a measure of price changes weighted by national output rather than by consumer level purchases. Dr. Selwyn testified that although not specific to the telecommunications industry, the GDP-PI is a superior index of the price level changes in input factors acquired by producers of goods and services and is a variant of the Gross National Product Price Index (GNP-PI) which the FCC and the California PUC have adopted for their price cap indices (CTA-T-4, at 11-12). Dr. Selwyn testified that the CPI should be rejected because:

> CPI measures changes in the price of such commodities as housing, automobiles, food, fuel, entertainment, education, and other normal elements of a typical consumer's "market basket." The telephone company, by contrast, does not purchase this particular household mix of commodities. Instead, the telephone company tends to purchase labor and highly sophisticated telecommunications switching and transmission equipment, computers and various miscellaneous items...[T]he aggregate labor cost is rising far more slowly than the overall inflation rate, even if the CPI is considered a reasonable index of overall inflation. The costs of electronic switching and transmission equipment have been experiencing rapid and pervasive <u>decreases</u> over time... The costs of fiber optic transmission systems, digital carrier systems, electronic digital switching, have all decreased and that trend is expected to persist for the anticipated future. Thus, there is no reason to expect that the CPI or any percentage of the CPI will even remotely resemble the cost changes that will confront New Jersey Bell. [CTA-T-4, at 10-11]

Sprint also disagrees with the use of the CPI and relies on the FCC's rationale for rejecting use of the CPI in its price cap proceeding in <u>In the Matter of Policy and Rules Concerning Rates for Dominant Carriers</u>, Second Report and Order, CC Docket No. 87-313, 5 <u>FCC</u> <u>Rcd</u> 6786, 6793 (October 4, 1990). Sprint notes that the FCC concluded: "While the CPI summarizes price changes that occur in goods and services that consumers purchase, the GNP-PI summarizes price changes that occur in all sectors of the economy, not just consumer items. The expenditure categories and the weights within CPI, based on consumer items, cover only about 65 percent of the changes considered by the GNP-PI. This is because the CPI includes nothing but final sales to consumers, while most of the LECs' purchases are of intermediate and capital goods. While the GNP-PI does not mirror the LECs' expenditures exactly, it does encompass investment goods as well as consumption expenditures." <u>Ibid</u>. Sprint further notes that the FCC also rejected the CPI because it was found to be far more volatile than the GNP-PI, due in part to its emphasis on categories that have larger weights on consumers' budgets than their importance on the economy as a whole, such as large increases for energy and medical care. Sprint also asserts that NJ Bell's parent company, Bell Atlantic, supported the use of the GNP-PI as proposed by the FCC (SP-T-1, at 25). Sprint thus urges the use of the GNP-PI because it would prevent a jurisdictionally different treatment for the same cost element of NJ Bell between the State and the FCC, and it argues that it is not an index that LECs could easily influence or manipulate (SPrb12 to SPrb14).

Staff proposes the use of the GNP-PI in place of the CPI. In its view, the GNP-PI is understandable and is based on a mix of inputs which more closely track NJ Bell's costs than the CPI. In addition, Staff notes that several other jurisdictions, including the FCC and the California PUC, have determined that the GNP-PI is an appropriate measure of costs for telecommunications carriers in a price cap context (STb100 to STb104). Staff argues that NJ Bell's witness Doherty acknowledged that the CPI would result in the highest percentage change when compared to other indices, such as the GNP-PI or the Telephone Price Index, with GNP-PI posting the lowest level of change (STb100; T152; T1214).

Staff also submits that the FCC's experience with price caps is revelant (STb100). The FCC found that in contrast to the GNP-PI, the CPI reflects fewer sectors of economic activity and thus, by its very nature, is volatile and is less likely to reflect the costs faced by carriers. The FCC further found that the broad-based nature of the GNP-PI means that changes to such index cannot be substantially influenced by inflationary pressures experienced by only one or two economic sectors and that the carriers themselves can do little to influence changes to the GNP-PI. <u>In the Matter of Policy and Rules Concerning Rates for Dominant Carriers</u>, CC Docket No. 87-313, Report and Order, 4 <u>FCC Rcd</u> 2873, 3073 (April 17, 1989). Staff argues that these findings indicate that a CPI based mechanism is not an appropriate measure of costs for a company such as NJ Bell (STb100).

As to the use of GNP-PI or GDP-PI, Staff notes that the GNP-PI includes United States products made in foreign countries as well as foreign companies presiding in the United States, while the GDP-PI ignores these foreign factors, and that it is reasonable to assume that NJ Bell and Bell Atlantic are influenced in some manner by the production, purchases, or use of goods or services by United States firms that are located in foreign lands (STb101). Staff argues that although NJCTA's witness Dr. Selwyn stated that the GNP-PI and the GDP-PI are simply variances of one another, no testimony clearly explains why the GDP-PI is a more appropriate representation of NJ Bell's costs than the GNP-PI (STb101). In Staff's view, the GDP-PI does not sufficiently recognize the purchasing patterns that NJ Bell has and will experience through the plan's term, while the GNP-PI, on the other hand, provides an inflationary index that incorporates this broader selection of goods and services. Therefore, Staff recommends that the plan be modified to replace the CPI with the GNP-PI (STb100 to STb101).

Having carefully considered the record and briefs regarding an appropriate index to utilize for purposes of a rate adjustment mechanism, the Board <u>FINDS</u> that the use of a GNP-PI based pricing mechanism is superior to the plan's proposed use of the CPI. The FCC experience is noteworthy and persuasive in this regard. The FCC found, among other things, that in contrast with the GNP-PI, the CPI reflects fewer sectors of the economy, is more volatile and less likely to reflect local exchange carrier costs, and is more easily influenced by inflationary changes in one or two sectors of the economy. The Board concurs with these findings and FINDS that a CPI based mechanism is not the appropriate measure of NJ Bell's costs for the purposes of a rate adjustment mechanism to be utilized in an alternative form of regulation for NJ Bell. In addition, the Board concurs with Staff that the GNP-PI incorporates a broader selection of goods and services and therefore is a more appropriate index for NJ Bell's plan than the GDP-PI. Accordingly, the Board MODIFIES the plan so as to substitute the GNP-PI for the CPI as the appropriate pricing measure for the purposes of this plan. Further, the Board incorporates the record adjustments which provide that index based rate adjustments work for both increases and decreases except that no decreases would be required in any year that NJ Bell's average intrastate return on equity for rate regulated services falls below 11.7%. Finally, the Board agrees with Staff that the tariff design aspects of any formula based or other rate changes must be reviewed and approved by the Board.

Productivity offset

The Board also has considered various parties' arguments that if a price index is utilized, there should be an explicit fixed offset factor to account for any productivity gains. Although the plan, itself, contains no express productivity offset and instead would limit rate adjustments to only one half of the Consumer Price Index, the Board has carefully considered parties' arguments that there should be a specific productivity offset included in the rate adjustment mechanism.

NJ Bell contends that its plan already incorporates productivity offsets in three ways: 1) by absorbing all cost increases through 1995; 2) by continuing to absorb 50% of CPI increases thereafter, and 3) by restricting basic residential rates to a maximum $0.25 increase (NJBrb21; P-4, at 5). It further claims that a fixed productivity offset is no more likely to exactly equal NJ Bell's actual productivity than is the plan's one-half CPI provision (NJBrb 21; P-59, at 8). Accordingly, NJ Bell opposes proposals calling for a fixed productivity offset (NJBrb21).

According to the NJCTA's witness Dr. Selwyn, an incentive based regulatory plan, such as NJ Bell's, is intended to stimulate even greater efficiency and productivity improvements than were expected under rate of return regulation (CTA-T-4, at 9). In his view, NJ Bell's proposed 50% of CPI rate indexing formula fails to reflect overall productivity improvements (CTA-T-4, at 10). In Dr. Selwyn's view, "[t]he productivity offset should...exist independently of the specific rate of inflation. NJ Bell is proposing to base its offset on the inflation rate itself. That is, as the CPI increases, the offset, which is a fraction of the CPI, also increases. Productivity does not vary with inflation per se, and should be established as a fixed offset" (CTA-T-4, at 4). As explained by Dr. Selwyn, productivity offsets should be expressed as a "target" to be achieved by the utility in return for the benefits of incentive-based regulation, rather than merely as a reflection of historical productivity trends (CTA-T-4, at 12). He notes that the FCC Price Cap plans for AT&T and the Bell Operating Companies also incorporate a productivity offset to reflect the expected improvement in aggregate productivity and efficiency that will presumably result from incentive regulation (CTA-T-4, at 9).

Dr. Selwyn recommends that the Board adopt the 4.5% productivity target that has been adopted by the California PUC for Pacific Bell and GTE California Incorporated (CTA-T-4, at 12). He notes that the California PUC has had nearly three years of experience with its price cap system operating under a GNP-PI minus 4.5% formula, and that this target has proven to be workable for the LECs and beneficial to consumers (CTA-T-4, at 13).

MCI witness Dr. Cornell testified that although, in her view, an automatic rate increase mechanism should not be implemented because inflation has not posed a problem and, in fact, the costs in this industry are declining, not increasing, if the Board does find a rate increase mechanism necessary, "it should alter the one-half CPI-based rate increase proposal so that it incorporates a productivity offset instead" (MCI-T-1, at 4). While MCI prefers that the Board institute a productivity offset in the range of 4.0% to 4.5%, it submits that the Board should adopt a productivity offset no less than the 2.5%-3.0% proposed by Staff (MCIrb15).

Staff agrees with the NJCTA that incentive regulation plans tend to stimulate greater efficiency and productivity than is generally expected under traditional regulatory approaches and notes that, in fact, it has been a major tenet of NJ Bell witness Dr. Megdal's testimony that incentive regulation approaches provide incentives for production efficiencies (STb103). Staff notes that several price adjustment mechanisms that have been implemented by the FCC and other regulatory agencies provide offsets for productivity gains, and that the purpose of a productivity offset is to ensure that changes in prices for telecommunications services closely match anticipated changes in the costs of providing those services (Ibid). Staff submits that a 50% automatic offset as proposed by the plan would provide NJ Bell with added revenue, while a specific productivity offset would require the Company to meet a static target as part of receiving a revenue increase (STb102). Staff believes that the use of a productivity offset is reasonable and workable and the setting of a fixed value would give the Company a known target (STb103). The use of a reasonable factor would, in Staff's view, protect NJ Bell from rising costs and provide stable or reduced rates if costs are fixed or declining. Therefore, Staff recommends that the plan be modified so as to require that any adjustments in rate regulated rates be by the GNP-PI minus a fixed value as a productivity offset (STb103).

With regard to Dr. Selwyn's reference to the California plan and its productivity offset requirement of 4.5%, Staff contends that the network acceleration proposed by NJ Bell differs from the situation surrounding the California companies. Because of the added responsibility associated with NJ Bell's plan to accelerate the deployment of technology, Staff submits that it would be appropriate for the Board to consider adopting a percentage similar to that used and adopted by the FCC, and Staff thus suggests that the Board use a productivity factor of between 2.5% and 3.0% (STb103). While recognizing that NJ Bell may be able to achieve a higher degree of productivity as a result of its added investment, Staff submits that a set productivity offset would be a known factor familiar to the parties and workable, and that given the differences between NJ Bell's plan and that in California, Staff does not believe that the factor utilized in California represents a reasonable surrogate for this case (STb103). Accordingly, Staff recommends that the plan be modified so as to require that any adjustments in rate regulated rates be by the GNP-PI minus a productivity factor of between 2.5% and 3.0% (STb144).

Having carefully reviewed the record and arguments on the issue of a productivity offset, the Board <u>FINDS</u> that a static productivity offset should be employed instead of the 50% CPI proposal of NJ Bell. A static productivity offset of the index employed is preferable to a percentage offset since static offsets hold the promise of possible rate decrease adjustments not possible under percentage offsets, absent a negative index change. Although productivity offsets as high as 4.5% have been suggested, the Board <u>FINDS</u> that a static offset of a lower value in recognition of NJ Bell's acceleration of technology is appropriate. Therefore, the Board <u>MODIFIES</u> the plan to include a 2% offset for productivity gains, in conjunction with the GNP-PI for rate adjustments. Further, NJ Bell shall not be permitted to forego any decreases resulting from application of the GNP-PI less 2% formula. In addition, while the plan indicates that NJ Bell has the option to forego formula based increases, in the event that it does forego increases for some services, it shall not be permitted to make up lost revenues from other services. The Board <u>MODIFIES</u> the plan to incorporate the modifications set forth herein.

The next subissue under the topic of just and reasonable rates is:

2. Does the plan incorporate sufficient and understandable reporting requirements to ensure that earnings are properly reviewable?

Because of the plan's proposal, discussed above, to allow increases in rates after 1995 if certain earnings levels have not been exceeded and its proposal to share earnings in excess of a specified level (Plan, §I(B)(2) and

(3)), this issue was included in the Prehearing Order in order to consider whether the plan includes sufficient and understandable reporting requirements to enable a review of earnings for purposes of ensuring proper compliance with the plan's rate adjustment and earnings sharing provisions. The plan provides that NJ Bell would continue to file with the Board quarterly financial monitoring reports for NJ Bell's rate regulated services. These reports provide the intrastate return on equity figures for those services for the most recent quarter and most recent four quarters available (Plan, §§II(B); II(E); IV(A)). The quarterly reports would be in a form consistent with the methodology approved by the Board in Docket No. TO87050398 (Plan, §IV(A)).

The Prehearing Order also listed as an issue whether the plan incorporates sufficient and understandable reporting requirements to enable the monitoring and review of any cross-subsidization. Because consideration of the plan's proposed reporting requirements for earnings review purposes and for cross-subsidization review purposes are interrelated, the Board at this juncture, notes that it FINDS that the plan does incorporate sufficient and understandable reporting requirements to ensure that earnings are properly reviewable, but that it will more fully address the issue of the adequacy of the plan's reporting requirements for earnings review purposes further below in conjunction with considering the adequacy of the plan's reporting requirements for cross-subsidization review.

The next subissue related to whether the plan will produce just and reasonable rates is:

3. Is the exogenous events provision in the plan properly defined, reasonable and in the public interest?

As an exception to the plan's provision not allowing any increases in rates for rate regulated services prior to January 1, 1996 and in addition to the index-based rate adjustments allowed on and after January 1, 1996, the plan would permit NJ Bell to increase rates for its regulated services "if there occurs a major, unexpected extraordinary or exogenous event that is beyond [the Company's] control" (Plan, §I(B)(1) and (4)). An "unexpected event" is defined in the plan as an event "that is not specifically recognized at the time the plan is submitted to the Board." (Plan, §I(B)(4) n.9). The plan states that extraordinary or exogenous events include significant matters such as natural disasters, tax, separations and/or accounting changes, regulatory or other governmental actions, and changes in the terms and conditions which govern the provision of intraLATA services. The plan states that the exogenous events provision is "not intended as a mechanism to permit routine requests for rate relief" but "[r]ather, it is intended to be exercised sparingly and only in circumstances presenting serious financial implications to the rate regulated side of New Jersey Bell's business" (Plan, §I(B)(4) n.10).

Under the plan, NJ Bell would have to make a rate adjustment filing resulting from a significant exogenous event within 60 days of the date on which the effects of the event are known and calculated, and Board review would be required to conclude within 60 days of the filing. As part of a request pursuant to the exogenous events provision, the plan would require NJ Bell to submit a description of the exogenous event and an explanation as to why the event was unexpected; data which describes and quantifies the estimated financial impact to NJ Bell; and a proposed rate design to reflect required changes in rates of the rate regulated services (Plan, §II(C)). Under the terms of the plan, NJ Bell would be given the discretion to forego rate increases for certain services, where appropriate to protect low income subscribers, for market reasons, or for other reasons (Plan, §II(C)n.15).

NJ Bell agreed during the hearings to amend the exogenous events clause to clarify that changes could occur in either direction, i.e., events could produce either rate increases or decreases (T128; P-11). It also agreed that the Board would not be limited to 60 days to consider an exogenous events filing and that the Company's proposal would not take effect until the Board approved it (T34; T95). In addition, NJ Bell witness Doherty explained that while the plan provides for adjustments for rates for rate regulated services in the event of an exogenous event, the Company's intention is to allocate exogenous events in the same manner as it does for its investments, revenues and costs, i.e., to allocate exogenous events on a total Company basis, between interstate and intrastate jurisdictions and between competitive and non-competitive services (T1219). However, no additional clarifying language was offered to memorialize this intention in the plan.

NJ Bell contends that the requirement of Board approval of any proposed exogenous event filing gives the Board vast authority to approve or deny any such proposal, and it, therefore, objects to suggested amendments to this section of the plan (NJBrb26). In NJ Bell's view, "changing the definition of 'unexpected' or eliminating certain categories of events could leave the Board unable to react when a future event triggers a need for a rate adjustment, up or down" (NJBrb26). From NJ Bell's perspective, the changes and limitations proposed by Staff and other parties add "unacceptable risk" given the Company's long term financial commitment under Opportunity New Jersey (NJBrb26 to NJBrb27).

Rate Counsel argues that NJ Bell's proposal that exogenous events be compensated by ratepayers, in addition to the automatic rate increase feature of its plan, provides "a one way loophole" (RCb38). Rate Counsel contends that there are significant unanswered questions regarding various aspects of the exogenous events provision (RCrb38). In this regard, Rate Counsel asserts that although the exogenous events provision requires Board approval, it is not clear what authority the Board would have in case there is a dispute between NJ Bell and the

Board with regard to the interpretation of various exogenous events; it is not clear whether, in addition to NJ Bell, the Board or interested parties could initiate a request to consider an exogenous event; there are no standards concerning the identification of an exogenous event nor for financial relief related to the event and although an exogenous event is defined as an event that was not anticipated at the time of this filing, it is not clear on this record what was known and anticipated within the context of exogenous events (RCb38).

NJCTA's witness Dr. Selwyn proposes to limit the flow- through of exogenous cost changes to major, unexpected events that are beyond NJ Bell's control or ability to reasonably anticipate at the outset of the plan, and directly and uniquely impact NJ Bell or telecommunications utilities (CTA-T-4, at 20; CTA-T-4, Appendix 2, at 5). Examples of such changes as cited by the witness would be changes in FCC jurisdictional separations rules, FCC accounting requirements or special conditions the impact of which is direct and limited to regulated companies (CTA-T-4, at 20). In his view, changes not unique to telephone companies vis-a-vis the remainder of the economy generally, would affect the overall inflation index used for index-based rate adjustments and would not need to be included within the scope of an exogenous events provision (Ibid.).

MCI principally opposes that part of the proposed exogenous events provision which would include intraLATA competition as a potentially eligible exogenous event (MCIb47). In its view, because such competition already has been authorized in other jurisdictions and several IXCs have the right to initiate such a proceeding before the Board, it is not appropriate to include the allowance of intraLATA competition as an unexpected event, falling within the exogenous event provision (MCIb48). MCI also asserts that a disadvantage to an exogenous event provision is its focus on only a single event without other possible countervailing considerations being brought before the Board at the same time (MCIb48).

AT&T does not oppose inclusion of an exogenous events provision in the plan, but argues, based on testimony of its witness Schell, that NJ Bell's proposed definition of "unexpected" is too vague to offer any guidance to the Board. Citing the definition of an "unexpected" event in footnote 9 of the plan as one that is "not specifically recognized at the time the plan is submitted to the Board," AT&T questions specifically "what and by whom an event must be 'recognized' in order to qualify as unexpected" and argues that no additional guidance or clarification on the precise meaning of the term unexpected were offered by NJ Bell's witness Doherty under cross examination. Accordingly, AT&T recommends that footnote 9 of the plan be deleted and the term "unexpected" be accorded its ordinary meaning of "unforeseen" or "coming without notice" (AT&Tb14 to AT&Tb15).

Sprint proposes that the Board adopt the FCC's definition of "exogenous events" in order to prevent jurisdictionally different treatment of this issue and to avoid disadvantaging IXCs. The FCC's definition of exogenous costs in 47 C.F.R. §61.44 provides that such cost changes are limited to those cost changes that the FCC shall permit or require and include those caused by: the completion of the amortization of depreciation reserve deficiencies; changes in the Uniform System of Accounts; changes in the Separations Manual; the reallocation of investment from regulated to non-regulated activities pursuant to part 64.901; and such tax law changes and other extraordinary exogenous cost changes as the Commission shall permit or require (SP-T-1, at 21 to 22; SPrb10). Sprint additionally notes that in further defining the issue of exogenous tax law changes, the FCC found that tax law changes are presumptively exogenous and already taken into account by use of the GNP-PI index, and Sprint submits that tax consequences likewise should be excluded from NJ Bell's plan as potential exogenous events (SP-T-1, at 22; SPrb10 to SPrb11, citing In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, CC Docket No. 87-313, 5 FCC Rcd 6786, 6808 (October 4, 1990)). Sprint's witness Prohoniak also urges that intraLATA regulation changes be retained as an exogenous event to provide NJ Bell an adequate incentive to support change, i.e., allow for intraLATA toll competition and to enable NJ Bell to have rate flexibility to adapt to a competitive intraLATA toll environment (SP-T-1, at 30 to 31).

The NJ Press Association proposes three adjustments to NJ Bell's plan with regard to exogenous events. The first change would insert language to allow the Board the authority not to approve any rate adjustment under this section that has an adverse impact on any customers or competitors (NJPA-T-2, Appendix). The second adjustment would make two specific changes to §I (B)(4) of the plan so as to change the first sentence of this section to reflect that NJ Bell may propose exogenous event increases for the Board's review and approval; and to obligate NJ Bell to decrease rates for regulated services for positive exogenous events (NJPA-T-2, Appendix). The third change proposed would add a requirement that NJ Bell describe the impact of proposed rate adjustments on all classes of affected customers and competitors (NJPA-T-2, Appendix).

Staff recommends that the Board adopt NJ Bell's record clarifications and thereby modify the plan to provide that the exogenous events clause works for both negative and positive events, and may result in increases and decreases in rates; that the Board is not limited to 60 days to consider an exogenous events filing; that no request to implement exogenous events rate changes shall take effect before Board approval; and that the effects of an exogenous event will be allocated on a total Company basis, between intrastate and interstate jurisdictions, and rate regulated and competitive services (T134; T1094; T1219).

In addition to the changes agreed to by NJ Bell, Staff proposes that specific references to intraLATA rule changes as an eligible event be deleted, and that the plan be modified to incorporate a revised definition of "unexpected" to mean events that are unforeseen or coming without notice. Staff also proposes that the exogenous events provision in the plan be modified so as to limit the timeframe for recognition of events to 12 months preceding the filing in order to avoid rate shock; preclude or eliminate known, anticipated or foreseeable events, e.g., changes in cable/telecommunications cross-ownership provisions or Open Network Architecture (ONA) requirements, absent a strong showing by NJ Bell of a substantial material effect; require rate decrease filings for positive events and make upward adjustments optional; include language reserving rate design determinations to the Board; add language that does not allow NJ Bell to terminate the plan or lessen accelerated investment if the Board denies a request for exogenous recovery; and clearly state that the exogenous events provision should be invoked sparingly and only under extreme conditions (STb108 to STb109).

Having carefully considered the record and arguments pertaining to the plan's exogenous events provision, the Board FINDS that it is reasonable to include a provision to enable rate recognition of events during the life of the plan which have a material, substantial and demonstrable impact on NJ Bell's financial condition so as to warrant an increase or a decrease in rates. Such a provision is appropriate and reasonable to include in a plan which will extend through 1999 in order for the plan to endure major unexpected events and at the same time to provide appropriate rate recognition of any such events. The Board emphasizes that, as the plan already states, this provision is to be exercised sparingly and is not to be utilized as a mechanism to permit routine requests for rate relief. The Board FINDS, however, that the proposed exogenous events provision is generally properly defined, but that certain modifications are necessary. First, the clause is MODIFIED for those clarifications agreed to during the hearings; that is, exogenous adjustments shall work for both increases and decreases in rates; the impacts of any adjustment shall be allocated on a total Company basis, between intrastate and interstate jurisdictions, and rate regulated and competitive services; the Board is not limited to 60 days to consider a particular exogenous events filing; and no Company proposal shall take effect until Board approval. To the extent that an exogenous event filing seeks to increase rates, NJ Bell shall give notice to its customers of the filing and a statement of the proposed effect on customers of various classes by publication in newspapers published and circulated in NJ Bell's service area. In this way, competitors also will be on notice of the filing. Board approval shall include the right to determine the appropriate rate design. NJ Bell shall be required to file for any rate decreases resulting from exogenous events and may, at its option, file for any rate increases resulting therefrom. References to specific events shall be deleted, and NJ Bell shall bear the burden of proof to demonstrate a material, substantial and demonstrable impact on the

Company's financial condition for any proposed increase claimed to be attributable to an exogenous event. In this way, any countervailing considerations may be taken into account by the Board, if appropriate. The Board shall retain its flexibility to not only determine if an event should be recognized under this section, but for the Board itself to propose an exogenous events change that is necessary and in the public interest. Moreover, in order to preserve the integrity of the plan, should the Board modify or reject a request under this clause, NJ Bell shall be prohibited from terminating the plan or lessening its investment in Opportunity New Jersey. Finally, events qualifying under this clause must not contain items which occurred more than 12 months prior to the filing for a change. The Board MODIFIES the plan to incorporate the modifications described herein.

An additional subissue related to whether the plan will produce just and reasonable rates is:

4. Is the depreciation provision in the plan reasonable and in the public interest?

With regard to depreciation, the plan proposes:

> Consistent with the Board's recognition that NJ Bell's depreciation rates should more closely match the service lives of its equipment, and notwithstanding the provisions of N.J.S.A. 48:2-18 and N.J.A.C. 14:11-1.12, NJ Bell shall have the flexibility to adjust its depreciation rates in accordance with generally accepted accounting principles. NJ Bell, however, shall not be permitted to set depreciation rates at an effective composite level less than the composite level resulting from the rates last approved by the Board in Docket No. TR88121324. [Plan, §I(C); footnote omitted]

NJ Bell submits that it has presented its depreciation proposal pursuant to N.J.S.A. 48:2-21.18(b), which gives the Board authority to depart from pre-existing statutory requirements for the regulation of depreciation rates, and pursuant to N.J.S.A. 48:2-21.18(a)(4), which mandates that an alternative regulatory plan reduce regulatory delay and costs (NJBrb49). Referring to "today's rapidly changing telecommunications environment," NJ Bell asserts that it needs regulatory flexibility to reexamine depreciation rates annually and to make timely adjustments to its depreciation rates so that depreciation adjustments will match the changing service lives of its equipment and in order to minimize regulatory costs, delay and uncertainty (NJBb41). It maintains that certainty is needed so that technology deployment decisions can incorporate all relevant costs, including depreciation (NJBb41; NJBrb49; S-14, at 39). Thus, NJ Bell further contends that the proposed depreciation process warrants approval even without consideration of Opportunity New Jersey but that the need for the proposed reforms are even more compelling in view of the substantial acceleration of technology deployment associated with Opportunity New Jersey (NJBb41). NJ Bell believes that adherence to generally accepted accounting principles (GAAP) would not permit arbitrary changes to depreciation and would require changes to the estimates of the economic useful life of the plant to be timely, consistent, rational, and systematic (NJBb41; NJBrb50).

NJ Bell also cites to its commitment set forth in discovery responses admitted into evidence to use the same depreciation methods and techniques as previously approved by the Board (S-14, at 3,43) and the plan's provision that the effective composite level of depreciation rates will not be less than that resulting from the rates last approved in Docket No. TR88121324 as placing further limitations on the process used for depreciation adjustments (NJBb42; NJBrb50). It also points to discovery responses admitted into evidence in which it indicated that it will submit annual reports to the Board, along with supporting documentation, and it explains in its briefs that the depreciation rate study will identify all accounts that experienced a depreciation rate change and will describe in detail the reason for the change (NJBb42; NJBrb51; S-14, at 33, 43). It asserts that the study will enable Board Staff to analyze the underlying data and to verify that any depreciation changes are consistent with ONJ, in conformity with GAAP, and based upon depreciation methods and techniques approved by the Board (NJBrb51). NJ Bell insists that its depreciation proposal continues appropriate Board oversight and that through a review of the annual depreciation reports and responses by NJ Bell to any issues raised by the Board, the Board would be able to detect any possible abuse and take appropriate action, including requiring a special audit, initiating a formal investigation, and ultimately, if found necessary, requiring a change in the depreciation rates (NJBb42; NJBrb51; T189; T1390). It further contends that due to the controls and limitations in its proposal, claims by other parties that earnings could be manipulated so as to avoid any earnings sharing are baseless (NJBb42).

Rate Counsel opposes the plan's proposed depreciation provision and asserts that the plan proposes that the Board disregard or relinquish its authority under N.J.S.A. 48:2-18, which requires the Board to fix proper rates for depreciation, and N.J.A.C. 14:11-1.12, which prohibits utilities from changing depreciation rates without Board approval (RCb40; RCb50 to RCb54; RCrb10). Rate Counsel contends that by constraining NJ Bell's discretion only by requiring conformance to GAAP and by requiring that rates not be set any lower than the existing composite rate, the plan's proposed depreciation provision "essentially deregulates depreciation and allows the company to manipulate, to its benefit, the non-cash depreciation expense to avoid sharing any earnings"; "will permit New Jersey Bell to implement depreciation expense increases related to Opportunity New Jersey between 1993 and 1999 even though no material benefits will be realized before 1997 or 1998"; and "effectively extracts from regulated services added depreciation expense for plant that is designed to provide unregulated services" (RCb41; RCrb10 to RCrb11). Rate Counsel contends that with regard to depreciation, GAAP is loosely drawn and permits a company to depreciate plant in a "systematic and rational" manner over its service life, and in Rate Counsel's view, GAAP is "therefore quite permissive as to the structure and even the level of depreciation charges" and enables a company to control service lives and in turn depreciation rates (RCb41 to RCb44; RCT-2, at 5). It also asserts that there is no official or formal means of enforcing GAAP and that the industry relies on reports to it by outside auditors to point out any deviations from acceptable depreciation techniques (RCb43; RCT-2, at 5-6). Claiming that depreciation is the largest single expense and hence the largest single determinant of telephone service prices, Rate Counsel argues that, therefore, "telephone businesses must have an external source of control on depreciation expense to insure that its regulated rates are just and reasonable" (RCb42 to RCb43; RCT-2, at 6). Rate Counsel concludes that if NJ Bell is allowed to set depreciation rates with only GAAP as a guideline, it "will not be effectively constrained against unfair pricing" (RCb43).

Rate Counsel further contends that the plan provides no other effective controls over NJ Bell's discretion to change depreciation rates (RCb44). It asserts that the plan's provision precluding NJ Bell from setting depreciation rates at an effective composite level less than that resulting from the rates approved by the Board in Docket No. TR88121324 means that depreciation rates can only go up, not down, and that the proposal to submit depreciation changes to the Board for review provides no procedure by which the Board can require any appropriate revisions to be made (RCb44 to RCb45). In Rate Counsel's view, the plan thus grants NJ Bell discretion over its depreciation rates and, since net income can be reduced by increasing depreciation expense or conversely net income can be increased by reducing depreciation expense, the plan thereby enables NJ Bell to control its net income and, in turn, to manipulate its return on equity to avoid the plan's sharing provision (RCb46; RCT-2, at 7-8).

Rate Counsel also objects that if the plan is approved as proposed, NJ Bell has indicated it anticipates booking depreciation expense increases for ONJ between 1993 and 1999 over and above the amount which would be charged under a business as usual scenario, and that this increased depreciation expense would occur prior to any benefits or revenues accruing from the associated plant (RCb47; RCT-3, Sch.8, at 3; RCT-2, at 9-11). In this way, Rate Counsel maintains that present monopoly ratepayers would be required to pay for the investment associated with competitive services that may not be available until the year 2000 (RCb47). Rate Counsel further argues that this is in conflict with GAAP's requirement that depreciation expense be spread over the facility's useful life according to the period during which services are obtained therefrom (RCb47; RCT-2, at 9-11). Rate Counsel further asserts that unless the Board is able to modify historical usage-based allocations and require the attribution of the increased depreciation resulting from ONJ to competitive and unregulated services, most of the depreciation will, in Rate Counsel's view, be inappropriately allocated to regulated monopoly services (RCb48 to RCb50; RCT-2, at 12).

Through testimony its witnesses Kravtin and Selwyn, the NJCTA similarly claims that NJ Bell's proposal to utilize GAAP imposes no limit on the amount of depreciation accruals NJ Bell could book and that NJ Bell could effectively reduce its realized return by targeting depreciation accruals for the coming year at levels high enough to offset any added earnings shown by internal business forecasts, thereby enabling it to receive index-based increases and avoid having to share earnings (CTA-T-1, at 36, 37, 43; CTA-T-4, at 24). NJCTA witness Kravtin notes that a reduction in the Board's oversight could have a significant financial effect, citing that the FCC drastically reduced the annual depreciation accruals that it allowed under the 1991 depreciation represcription study and eliminated about 69% of NJ Bell's request, to achieve an average composite rate of 7.01% (CTA-T-1, at 39-40). Dr. Selwyn recommends that NJ Bell should be required to write off the value of plant that has been retired before it was fully depreciated and to simultaneously lower NJ Bell's prices to account for the write off. However, speculating that NJ Bell would probably claim that this would be too costly and time consuming, Dr. Selwyn argues that depreciation accruals should be tied to the same service life estimate that NJ Bell relied upon when it first acquired the asset, thereby providing an incentive for the consistent treatment of assets between NJ Bell's initial capital budgeting process and its depreciation practices (CTA-T-4, at 25-27).

MCI also objects to the plan's depreciation provision as placing the setting of depreciation rates solely within NJ Bell's discretion, with little, if any, Board oversight (MCIb12 to MCIb13; MCIb49 to MCIb50; MCIrb17 to MCIrb18). MCI maintains that the depreciation provision would allow NJ Bell "to manipulate its earnings so as to guarantee that it receives all automatic rate increases under the Plan and that ratepayers never share in any overearnings" (MCIrb18). Based on testimony of its witness Dr. Cornell, MCI claims that the plan would allow essentially deregulated depreciation, thereby permitting the return on equity to be whatever NJ Bell wants it to be. Thus, in any year in which NJ Bell believes it might have to share funds and does not want to do so, MCI argues that it could increase the depreciation rate to prevent that outcome, and in any year NJ Bell wants to increase rate regulated rates, MCI argues that it can adopt a depreciation rate that ensures that it comes within one or both of the required ceilings on return on equity to permit such an increase (MCIrb18; MCI-T-1, at 9).

Referring to the plan's depreciation provision as a "blank check to accelerate depreciation," the CWA claims that the provision enables NJ Bell to "assign an unnecessarily short life to its existing network assets and still accrue full depreciation expense for everything it replaces - whether the assets require replacement or not" (CWAb31 to CWAb32). The CWA asserts that this will result in average ratepayers bearing the depreciation expense "even though investment in new plant was not necessary to provide basic telephone service" (CWAb32). It further objects that the plan creates incentives for NJ Bell to delay the introduction of competitive services because, in its view, "[t]he more time the new plant has to depreciate, the fewer costs the new competitive services will have to assume" (CWAb32).

While Board Staff agrees with NJ Bell that the accelerated deployment contemplated by ONJ may require changes in its depreciation rates, Staff objects to the use of GAAP as the sole criterion for determining appropriate depreciation rates, particularly because of the impact depreciation may have on the plan's rate adjustment and earnings sharing mechanisms (STb148 to STb149). Board Staff also maintains that NJ Bell's depreciation proposal "would essentially remove any controls regarding depreciation from the Board and replace those controls with GAAP," which, it asserts, would result in arbitrary and/or capricious depreciation rates (STb119). Staff also noted that NJ Bell's return on equity is relatively sensitive to depreciation expense and that under NJ Bell's plan, recovery of depreciation is virtually guaranteed even if demand for new services does not develop (STb119).

Staff proposes that NJ Bell continue to seek Board approval for depreciation changes under the following conditions:

- Should ONJ result in significant changes to NJ Bell's major accounts, then NJ Bell should file annual adjustments;

- All depreciation rates are to be reviewed for possible revision every three years in the context of the FCC triennial meetings;

- NJ Bell must receive Board approval for any annual or triennial changes in depreciation rates;

- Board rejection in whole or in part of any depreciation requests, will not affect ONJ deployment; and

- Depreciation changes must be consistent with ONJ and Board practices, including the use of straight line depreciation practices (STb119 to STb120; STb149 to STb150).

NJ Bell argues in its reply brief that Staff's proposal is inconsistent with the alternative regulatory framework authorized by the Act and the annual filings proposed by

Staff would increase rather than reduce regulatory costs and delay (NJrb52).

Having carefully reviewed the record and arguments on the plan's proposed depreciation provision, the Board FINDS that N.J.S.A. 48:2-21.18(b) authorizes it to depart from the requirements of N.J.S.A. 48:2-18 and other statutory provisions and to permit a local exchange telecommunications company, such as NJ Bell, to set rates based on an alternative form of regulation. Thus, the Board rejects contentions that it cannot depart from N.J.S.A. 48:2-18 and N.J.A.C. 14:11-1.12. However, the Board concurs with various parties that the plan's reference solely to GAAP and the composite depreciation level provides too great a level of flexibility, especially since anticipated depreciation rate changes will affect both monopoly (rate regulated) services and competitive services. The Board, therefore, FINDS that the plan must be modified with regard to depreciation. Although NJ Bell has stated a commitment to do so, the plan must expressly provide that NJ Bell shall use the same depreciation methods and techniques as previously approved by the Board, including the straight line method of depreciation, and any such methods which may hereafter be approved by the Board for depreciation of telecommunications plant and equipment. In addition, although NJ Bell indicated during the course of this proceeding in discovery responses admitted into evidence and in briefs that it would submit annual reports to the Board, along with supporting documentation, which would explain any depreciation adjustments, the plan has no such depreciation reporting provision. The plan must be modified to provide for the filing of annual depreciation reports detailing and explaining on an account by account basis any depreciation adjustments affected by ONJ deployment, as well as supporting documentation, in addition to the composite total rate. The report shall thus detail the effects of ONJ on depreciation accounts. The Board requires that the annual filing be submitted to the Board for review by Staff. If Staff finds that these depreciation rate changes are consistent with ONJ and current Board practices, Staff will provide the Board with a report and the Company shall be allowed to implement the depreciation rate changes unless otherwise directed by the Board. If Staff concludes that proposed rate changes are not consistent with the goals of ONJ, with current Board practices, or otherwise warrant further review, the Board reserves the right to require an audit, and/or initiate a formal investigation and/or review, and ultimately, if found necessary, to order a change in the depreciation rates, and the plan should be modified to so provide. The effective date for the depreciation rate change would be the date of filing regardless of when final Board action occurs, unless otherwise determined by the Board.

In addition, the plan must be modified to provide for a continuation of the use of the represcription process, whereby the FCC reviews carriers' depreciation rates presently on a triennial basis, as a means to review not only NJ Bell's intrastate depreciation rates, in addition to its interstate rates. See, 47 U.S.C.A.

§220(b); 47 C.F.R. §43.43. NJ Bell indicated that it would continue to comply with FCC requirements for interstate depreciation but that its plan would eliminate the triennial represciption process as a means to determine intrastate depreciation rates (S-14, at 36). The Board FINDS, however, that the represcription process with the FCC must continue, as it has in the past, to provide a valuable means to review and determine appropriate intrastate depreciation rates. The depreciation rate standards utilized in the represcription process will provide a cross check on any depreciation rates used by NJ Bell in recognition of the accelerated deployment. NJ Bell, therefore, shall continue to file with the Board the represcription depreciation study, which shall pertain to all accounts and provide appropriate support, absent a change in policy by the FCC. As to the represcription meetings, they will continue as in the past, and therefore, NJ Bell, the FCC, and Board Staff would actively participate in the development of depreciation proposals. See, 47 U.S.C.A. §220(i). Rate Counsel would likewise participate in this process as it has in the past. This two step process -- annual and triennial filings -- will provide the Board with a monitoring process to review the various depreciation rates by account and to track Opportunity New Jersey progress. This procedure will detect any changes in the deployment of technology and alert the Board to any potential problems. If NJ Bell does not follow a reasonable deployment of technology, the Board's approval of the alternative regulation plan will be reviewed.

The Board also has considered the plan's provision that NJ Bell shall not be permitted to set the depreciation rates at an effective composite level less than the composite level resulting from the rates last approved by the Board in Docket No. TR88121324. While this would serve to ensure that depreciation is not used by NJ Bell to increase earnings at the expense of the accelerated ONJ deployment, the Board will not, at this time, predetermine the appropriate depreciation level and FINDS that this provision should be deleted from the plan. The Board MODIFIES the plan to delete this provision and incorporate the other modifications pertaining to depreciation discussed herein.

Finally, the Board has carefully considered parties' arguments that NJ Bell's depreciation proposal provides flexibility to the point where the Company could control earnings sharing. The Board is satisfied that with the modifications set forth herein and by monitoring the depreciation rates annually, this Board can administer the rates with reasonable assurance and control and take any necessary action in the event of any possible manipulation of depreciation rates to avoid earnings sharing or any other abuse involving depreciation rates.

An additional subissue related to whether the plan will produce just and reasonable rates is:

5. Is the revenue neutral provision within the plan

reasonable and in the public interest?

Under the plan, NJ Bell would be allowed to propose revenue neutral rate restructures to rate regulated services throughout its term (Plan, §I(B)(1) and (5)). The revenue neutral restructures provision would allow filings for rate changes separate from the index-based rate changes, and notwithstanding the rate stability elements in the plan. One example offered by NJ Bell would permit a rate restructure involving the Company's intrastate access tariff in order to be consistent with the rate structures, terms and conditions of NJ Bell's interstate access tariff (Plan, §I(B)(5)). Other examples of possible revenue neutral proposals outlined in the record include geographically deaveraging of rates (T163), reductions in business rates and increases in residential basic rates (T767), reduction of toll rates and increases in residential basic rates (T800; T1454; T1455), or altering the percentage of revenue collected from business versus residence customers (T1454; T1455). As with the exogenous events provision, the plan provides that NJ Bell would file its revenue neutral proposals 60 days before the proposed effective date. As part of a request for a revenue neutral restructure, NJ Bell would provide a description of the service(s) affected and an explanation as to why the restructure is proposed; calculations, using currently available and prospective data, demonstrating the revenue neutral effect of the proposed restructure; and a description of the impact of the proposed restructure on all classes of affected customers (Plan, §II(D)).

Under cross-examination, NJ Bell witness Doherty stated it is the Company's view that the Board would have the ability to determine whether 60 days were an appropriate time or if the review period should be longer based on intervention of an interested party (T1091). Further, Mr. Doherty acknowledged that no revenue neutral rate restructure request would take effect until formal Board approval (T1092 to T1094). Mr. Doherty also offered the view that NJ Bell has no plans to raise residential basic service rates by a revenue neutral restructure, but declined a request to so modify the plan (T782 to T783).

NJ Bell contends that the plan's revenue neutral rate restructure provision ensures the Board's retention of "flexibility to address inconsistencies that may arise over time between current rate design and the effects of future competitive, technological, and regulatory changes" (NJBb13). Any proposed revenue neutral rate restructures will be subject to approval by the Board, and NJ Bell notes that in evaluating the restructure proposal, the Board may consider whether the resulting rates will continue to be just and reasonable (NJBb13; NJBrb27).

Rate Counsel contends that the plan's revenue neutral rate restructure provision would allow changes in rates with no means of ascertaining whether individual services would thereby be prejudiced or disadvantaged because there is nothing in the plan which requires the filing of cost apportionment studies (RCb54 to RCb55).

Rate Counsel also is critical of the fact that the plan does not permit initiation by the Board of revenue neutral rate restructures (RCb4).

The NJCTA contends that implicit in NJ Bell's proposed revenue neutral rate restructure provision "is the assumption that it can set individual rate levels anywhere it pleases, just as long as other rates are adjusted upward or downward to make up for it" (NJCTAb62). The NJCTA asserts that this proposal ignores that individual rates must be just and reasonable and that NJ Bell has put forth no guidelines for how the reasonableness of specific revenue neutral rate restructures are to be judged (NJCTAb62 to NJCTAb63).

The NJCTA's witness Dr. Selwyn would require NJ Bell to undertake any major revenue neutral rate design changes, such as toll and local rate rebalancing before the plan goes into effect. Second, Dr. Selwyn would limit revenue neutral rate adjustments to those needed to effect changing cost or demand conditions, and would not include substantial rate design revisions such as a rebalancing of toll and basic exchange rates. Third, Dr. Selwyn would establish three distinct categories of rate regulated services each of which would be subject to its own set of rate adjustment rules and for which revenue neutrality would be effected separately (CTA-T-4, at 22-23).

The NJCTA objects to the 60 day time horizon for review of revenue neutral filings as an inadequate time to allow any meaningful participation by customers and competitors and asserts that such a time limitation would violate its due process. In the NJCTA's view, the 60 day timeframe "effectively gut(s) the Board's ability to effectively review New Jersey Bell's rate proposal including 'revenue neutral rate restructures'" (NJCTAb64).

Sprint argues that NJ Bell should be required to demonstrate the impact of its rate restructure for access services on IXC customers. Referring to testimony of its witness Prohoniak and citing to the Act, Sprint states that the plan would disadvantage IXC customers who would not have sufficient information to determine if a proposed rate restructuring is in fact revenue neutral. Sprint believes that customer specific impact statements would solve this problem, and therefore suggests that NJ Bell be required to provide customer specific impact statements for all revenue neutral proposals (SPrb9).

MCI contends that the revenue neutral restructure portion of the plan should be eliminated (MCIb47). Based on testimony of its witness Dr. Cornell, MCI alleges several problems exist with this proposal. First, it asserts that using historical data to show revenue neutrality does not guarantee that any changes would remain revenue neutral nor does it guarantee that NJ Bell would not use its monopoly power to shift rates from customers whose demand is more elastic to customers whose demand is less elastic. Second, it asserts that a showing of the effects of a restructure on all affected customers is a meaningless safeguard particularly if the class combines those who pay higher rates with those who pay lower rates. Third, MCI believes that revenue neutral proposals could be used to forestall entry by competitors. Fourth, MCI believes that by permitting the exploitation of demand elasticities, revenue neutral changes reduce NJ Bell's incentive to achieve greater efficiencies. Finally, MCI asserts that piecemeal changes in selective rates could over time make the whole rate structure of NJ Bell no longer just and reasonable (MCIb46 to MCIb47; MCI-T-1, at 14-16). MCI recommends that NJ Bell's revenue neutral rate restructure proposal not be accepted (MCIb47). However, it also recommends that if a plan is adopted, the revenue neutral provision should be amended to require notice to all affected parties and an opportunity for hearings, and to specify that no change is to be implemented without an affirmative Board order (MCIb64; MCIrb15).

Through testimony of its witness O'Brien, the NJ Press Association has suggested two changes to NJ Bell's proposal for revenue neutral restructures. The first change would add a provision stating that the Board has the authority not to approve a rate restructure that has an adverse impact on customers or competitors (NJPA-T-2, Appendix). The second change would add a requirement that NJ Bell describe the impact of any revenue neutral restructure on its competitors (NJPA-T-2, Appendix).

In Staff's view, as presently worded, this section of the plan does not incorporate necessary clarifications highlighted during witnesses' testimony and cross-examination. Staff notes that NJ Bell witness Doherty agreed that the 60 day time period for Board consideration is a benchmark which in no way limits that Board's ability to require additional time to review the request (T1092 to T1094), and that no request to implement a revenue neutral rate change will take effect before formal Board action (T1092 to T1094). In addition to specific language changes to incorporate these changes into the revenue neutral rate restructure provision of the plan, Staff proposes the following additional changes to this section:

1. Include language which restricts the use of a revenue neutral restructure to geographically deaverage rates;

2. Generally, limit revenue neutral changes within specific categories of service, except under special circumstances. However, Staff recommends that the Board reserve the right to approve changes outside of the service categories for compelling reasons;

3. Include language that the Board may review any data necessary to determine the reasonableness of a change;

4. Include language requiring NJ Bell to demonstrate, as part of any revenue neutral

restructure proposal, that the proposal does not unduly advantage one customer class over another;

5. Add a statement that makes it clear that if the Board denies or amends a revenue neutral restructure request, NJ Bell cannot discontinue the plan, or lesson its network acceleration investment; and

6. Include language which makes it clear that the Board may, on its own motion, require NJ Bell to file a revenue neutral proposal to effect a public interest change (STb113).

Staff opines that revenue rate neutral restructure proposals are expected to be rare occurrences and most likely will draw interested parties to comment. While the plan provides for a 60 day timeframe for review, in light of the potential complex nature and effects of such requests, Staff believes it is not appropriate to structure a rigid timeframe for review. Revenue neutral restructures also have the potential of altering average monthly bills for residential customers. Therefore, Staff submits that care must be taken to fully investigate customer impacts before any such changes are permitted, and the setting of an arbitrary date certain for Board review may not allow that to occur. Staff agrees that NJ Bell should be permitted to file revenue neutral requests with the Board, but not with the regulatory limitations proposed under the plan. Staff, therefore, recommends that the reference to 60 days should be removed entirely (STb113 to STb114).

Further, Staff urges that it is important to include NJ Bell's witness Doherty's representation (T783) that the Company has no plan to raise residential basic rates by a revenue restructure as one means to ensure the affordability of protected telephone services (STb114). Since the plan provides a mechanism through index-based increases to raise residential basic service, Staff believes it would be counterproductive and inconsistent with the Legislature's intent to ensure the affordability of protected services to also subject residential basic service, which is a protected service, to routine increases on a revenue neutral basis (STb114).

Staff also contends that cross-examination of the NJCTA's witness Baldwin raised an important point regarding revenue neutral requests. According to Ms. Baldwin, the Board should retain the ability to review all rates and costs with any revenue neutral request (T3555 to T3559). Since it is the Board's responsibility to review and rule on proposed rate designs accompanying revenue neutral requests, Staff submits that the rate/cost relationship of affected services must be considered (STb116).

Staff submits that as with exogenous events, it is important to establish as part of the plan that the Board has the ability to consider and reject or modify the merits of individual revenue neutral rate restructure requests without terminating the plan. Staff proposes to incorporate a provision that if the Board determines that a revenue neutral request is not appropriate or modifies a revenue neutral restructure request, NJ Bell would not be permitted to terminate the plan or lessen its network acceleration investment (STb116). Finally, Staff believes it is important to clearly reserve in the plan the Board's ability to require NJ Bell to file revenue neutral rate changes to address public interest concerns (STb116).

Having carefully considered the record and arguments on this issue, the Board FINDS that a revenue neutral rate restructure provision will, as NJ Bell submits, ensure the Board's retention of "flexibility to address inconsistencies that may arise over time between current rate design and the effects of future competitive, technological and regulatory changes," and the Board FINDS that it is appropriate and reasonable to maintain such flexibility in the context of a plan for an alternative form of regulation which, as modified, will be in effect through 1999. The Board FINDS, however, that the plan's provisions pertaining to revenue neutral rate restructures require modification. The Board will not be limited to 60 days to consider a revenue neutral request nor shall any such change take effect until approved by the Board. The Board notes that in reviewing any such revenue neutral rate restructure, it shall consider whether the resulting rates will continue to be just and reasonable, and reserves the right to direct NJ Bell to provide any and all documentation determined to be necessary to enable such review. The Board further eliminates all references in the plan to specific examples of revenue neutral changes and places the full burden on NJ Bell to demonstrate that a particular restructure proposed by it is appropriate and reasonable. NJ Bell shall be required to demonstrate that any revenue neutral rate restructure proposal does not unduly advantage one customer class over another.

Revenue neutral changes shall be generally limited within particular service categories and generally not be used to geographically deaverage rates. However, the Board must be afforded a wide degree of flexibility to not only determine whether a particular proposal should be approved, but also whether changes are necessary. Further, if the public interest requires, the Board shall be able to effect a revenue neutral change on its own motion. Finally, NJ Bell will not be allowed to terminate the plan or lessen its Opportunity New Jersey investment if the Board denies or modifies a NJ Bell proposal or directs the Company to effect a public interest change under this clause. The Board MODIFIES the plan to include a revenue neutral provision under the guidelines and modifications set forth herein.

In summary, for all of the foregoing reasons, the Board FINDS that the plan for an alternative form of regulation as modified herein is carefully constructed and structured to protect monopoly ratepayers and at the same time, to provide adequate incentives for NJ Bell to commit resources to accelerate the deployment of technology as proposed by Opportunity New Jersey. The Board FINDS that the plan as modified herein reasonably balances the interests of NJ Bell's ratepayers and shareholder and by continuing the existing rates until 1996 with only Board approved revenue neutral rate restructures or exogenous events rate changes, and thereafter providing a GNP-PI less 2% rate adjustment mechanism, with no index-based increases for basic residential service, and with a provision for earnings sharing, the plan, as modified herein, will produce just and reasonable rates.

B. WILL THE PLAN PROVIDE FOR THE AFFORDABILITY OF PROTECTED TELEPHONE SERVICES?

In the Telecommunications Act of 1992, the Legislature found and declared that it is policy of the State to, among other things, maintain universal telecommunications service at affordable rates. N.J.S.A. 48:2-21.16(a)(1). Accordingly, pursuant to N.J.S.A. 48:2-21.18(a)(1), to be approved by the Board, a plan for an alternative form of regulation must, among other things, ensure the affordability of protected telephone services.

NJ Bell submits that its rates for protected services are currently among the lowest in the country (NJBb6). It cites as an example that its basic residential services rates are the lowest of the former Bell operating companies (BOCs) and $6.00 less than the average residence rate of the former BOCs (NJBb6; P-2, at 8). In addition, it argues that two other major protected services, intraLATA message toll service and intrastate switched access service, are also priced at levels among the lowest in the country (NJBb6; P-2, at 8-9; T596). Citing to New Jersey as having the second highest per capita income in the country, 33% above the national average, NJ Bell claims that the "combination of low rates and high income is a strong indication that New Jersey Bell's rates are currently affordable" (NJBb6; P-2, at 9). It further cites to data that between 1985 and 1991, the national average residential telephone rate with unlimited local calling, increased from $12.17 to $13.05, an increase of 7.2%, while, in contrast, NJ Bell's highest residential rate remained constant at $8.19 (NJBb6; P-50, at 10).

According to NJ Bell, the plan ensures the continued affordability of protected telephone services in at least four ways: 1) the rates for all rate regulated services, including protected services, will continue to be capped until January 1, 1996 and thus, rates that were last increased in 1985 will have been capped for a period of at least ten years; 2) the monthly rates for Low Use Message Rate Residence service and the non-recurring rate for Link-Up America for customers on some form of public assistance, will incur no increases throughout the term of the plan; 3) the plan limits formula-based rate increases on or after January 1, 1996 to one-half of the CPI, thereby, in NJ Bell's view, forcing it to absorb one-half of the effects of inflation; 4) under the plan's price adjustment mechanism, even in the event of a major CPI increase, the monthly rates for all classes of residential basic exchange services cannot increase more than $0.25 in any one year (NJBb7 to NJBb8). In addition, in the event that the CPI is negative, the plan, as modified by NJ Bell during the proceeding, will result in a rate decrease (NJBb8; P-10). It also maintains that because the maximum formula - based price increase for protected services in 1996 through the end of the plan would be half the rate of inflation, the real cost of those services will continue to decrease (NJBb8; P-2, at 12). NJ Bell asserts that the combination of these provisions will ensure that the rates for protected telephone services remain affordable through the life of plan (NJBb8).

With regard to an argument of the NJCTA that NJ Bell failed to include touch-tone charges in its affordability comparisons (NJCTAb36 to NJCTAb37), NJ Bell responds that even including the touch-tone charge of less than $1.00, the cost of basic service as a percentage of disposable income still dramatically declines over the last seven years; that even with touch-tone charges superimposed, NJ Bell's basic residential service rate is still over $5.00 less than the average residence rate of the former BOCs; and that this difference would be even greater if the average residence rate of the former BOCs were adjusted to fully account for their charges for touch-tone service (NJBrb56; P-2, at 8).

In response to arguments of the NJCTA that NJ Bell's affordability comparisons should include a measure of distance (NJCTAb37), NJ Bell asserts that not only are basic residential rates the lowest among the former BOCs, but intraLATA message toll service (measured by distance) is also priced at levels among the lowest in the country (NJBrb57; P-2, at 8).

With regard to suggestions of the NJCTA and Rate Counsel that data on penetration of telephone service indicates a lack of affordability of basic service (NJCTAb38 to NJCTAb39; RCb19), NJ Bell argues that the data proves the opposite. It points out that New Jersey's penetration percentage has consistently exceeded the national average (NJBrb57; P-50), and that, as conceded by CWA witness Rafferty, any temporary decrease in New Jersey's penetration level is "not statistically significant" (NJBrb57; T3384 to T3385). It asserts that a truer measure can be found by examining a longer span of time, and that, in fact, the penetration rates for New Jersey have increased by almost 2% in the period from March 1984 through March 1992 (NJBrb57).

Rate Counsel argues that the plan does not provide for the affordability of protected telephone services (RCb16 to RCb23). It contends that NJ Bell's plan will result in $1.432 billion of excess charges to ratepayers from 1993 to 1999 and that even if NJ Bell's projections related to the cost of ONJ were adopted as reasonable and in the public interest, the plan, in Rate Counsel's view, would result in ratepayers paying over $576 million in excess of the amount required to fully compensate NJ Bell for its investment and therefore cannot be said to result in affordable rates (RCb16; RCT-3, Sch.1, at 1; RCT-3, Sch. 2, at 1). Rate Counsel further contends that the acceleration of broadband construction as compared to revenues projected to be derived therefrom will create a revenue requirements deficiency of approximately $200 million (RCb17; RCT-3; Sch.3, at 3). Rate Counsel's view is "that while relatively few ratepayers are expected to take advantage of the new investment, rates to existing ratepayers many of whom use only protected services, will be increased significantly to pay for the new investment," and this "makes their rates unaffordable" (RCb17). Rate Counsel asserts that projected new service revenues account for "only $283 million of the $1.432 billion increase in revenues caused by ONJ" and argues that the increased revenues called for by the plan will largely be collected by increasing rates for existing services (RCb18). Asking ratepayers to pay increases in rates while receiving little in new services makes the plan unaffordable in Rate Counsel's view (RCb18). It also contends that no conclusions on affordability or reasonability of rates can be drawn without an overall evaluation of the RSP (RCb20). With regard to rates beyond the initial rates, Rate Counsel also claims that the plan would result in unaffordable rates (RCb21), and that, given rate decreases elsewhere in the country from 1987 through the present, a "plan that calls for automatic rate increases is seriously flawed" (RCb22).

The NJCTA also argues that the plan fails to assure affordability of protected services (NJCTAb34 to NJCTAb41). Citing the Legislature's declared policy of maintaining universal service at affordable rates, the NJCTA states that "universal telephone service has long been recognized as meaning a telephone in every household that wants one, and policies furthering that goal" (NJCTAb35). It criticizes the analysis of NJ Bell's witness Doherty whereby he sought to establish the affordability of rates by comparing monthly service charges and average residential bills to statewide per capita income, for not addressing whether rates are affordable to persons with less than average income and for not including the monthly charge for touch-tone service (NJCTAb36 to NJCTAb37). It further asserts that comparisons of local charges with those of other states must include a consideration of calling areas, which NJ Bell did not do (NJCTAb38). It also contends that no data was presented on the affordability of business local service or service restoration, and that NJ Bell's conclusions on the affordability of residential rates does not take into account the declining residential penetration rate (NJCTAb38 to NJCTAb41; NJCTArb40 to NJCTArb41).

Board Staff concludes that with its proposed modifications, the plan will result in affordable protected telephone services (STb160). Board Staff asserts that the capping of rates absent exogenous events or revenue neutral rate restructures ensures affordability and that under its suggested modifications, the rate escalation measures should only be used infrequently and should not be used to render the plan's protections meaningless (STb158). After January 1, 1996, with Staff's modifications, NJ Bell would be limited in its ability to increase rates for protected services to formula based adjustments minus an offset for productivity and if costs remain constant, rates for protected services may decrease. Staff further notes that protected services have added protections. As it proposed, the maximum permitted annual rate increase for basic residential monthly rates, all classes, and touch-tone service is limited to $0.25 regardless of the increase of the index. Additionally, Low Use Message Rate Residence Service will not increase at all and the available message units with the service will not decrease. As an added safeguard, under Staff's proposal NJ Bell would not be permitted to increase rates for protected services if its intrastate return on equity for rate regulated services exceeds 11%. The combination of all of these safeguards will, in Staff's view, ensure affordability of protected telephone services (STb159).

After a careful review of the record and arguments on this issue, the Board FINDS that the plan, as modified herein, will ensure the affordability of rates for protected telephone services. All NJ Bell telephone rates have remained stable since 1985 when rates were established by the Board in Docket No. 848-856, and, as the plan is modified herein, basic residential exchange telephone rates will continue to be stable until the year 2000, absent Board approved revenue neutral rate restructures or Board approved rate changes due to exogenous events. Any revenue neutral rate restructures or rate changes due to exogenous events will be subject to review and approval by the Board, and in reviewing any such proposed changes, the Board clearly will be mindful of and guided by the State policy of maintaining universal service at affordable rates. N.J.S.A. 48:2-21.16(a). Additionally, current residential service rates are among the lowest in the country and have remained so despite reductions in rates in some other jurisdictions, and the telephone penetration rates for NJ Bell are above the nation's average. Indeed, the Board notes that in finding State policy in N.J.S.A. 48:2-21.16(a), the Legislature declared that it is policy to "[m]aintain universal telecommunications service at affordable rates." By its use of the word "maintain", which means "to keep in existence or continuance, preserve retain," the Legislature indicated that it is State policy to continue the affordable universal telecommunications service provided at the time of the Act's enactment. See, The Random House College Dictionary, 807 (rev.ed. 1982). Nevertheless, to ensure an even greater level of affordability to those who are the most in need, the Board FINDS that the plan should be further modified to eliminate the charge for touch-tone service for Low Use Message Rate Residential Service customers, and the Board MODIFIES the plan accordingly. As to other protected services, rates for these, too, will not be increased prior to January 1, 1996 absent Board approved revenue neutral rate restructures or rate changes due to Board approved exogenous events, and thereafter, any increases will be limited to reasonable, formula based increases, which will not be permitted if the applicable earnings threshold were exceeded. In this way, rates for all protected services will remain affordable.

C. WILL THE PLAN NOT UNDULY OR UNREASONABLY PREJUDICE OR DISADVANTAGE A CUSTOMER CLASS?

As to whether the plan will not unduly or unreasonably prejudice or disadvantage a customer class, this issue was largely discussed by the parties in reference to other issues. The protections in the plan for individual classes of customers include the Board's on-going ability to review tariff design questions on its own motion, and in conjunction with exogenous event and revenue neutral rate restructure filings. The review process will ensure that no customer class is unduly or unreasonably prejudiced or disadvantaged. Further, NJ Bell is on notice that the Board will closely examine any major tariff design changes proposed pursuant to a revenue neutral rate restructure and that such restructures impacting on protected services would only be approved for compelling reasons. Therefore, Board FINDS that the plan, as modified, will not unduly or unreasonably prejudice or disadvantage a customer class.

D. WILL THE PLAN ENHANCE ECONOMIC DEVELOPMENT IN NEW JERSEY WHILE MAINTAINING AFFORDABLE RATES?

N.J.S.A. 48:2-21.18(a)(6) requires that an alternative regulation plan will enhance economic development in the State while maintaining affordable rates. Thus, the Board must determine whether the plan proposed by NJ Bell will enhance economic development in New Jersey while maintaining affordable rates. Additionally, in the Act, the Legislature declared that it is a policy of the State to, among other things, provide diversity in the supply of telecommunications services and products in telecommunications markets throughout the State.[10] N.J.S.A. 48:2-21.16(a)(4). Thus, although it is not expressly identified as a separate criterion for approval of a plan for an alternative form of regulation in N.J.S.A. 48:2-21.18(a), the Prehearing Order identified as a subissue to be considered with regard to the issue of whether the plan will enhance economic development:

1. Will the proposed network deployment (Opportunity New Jersey) provide diversity in the supply of

---

10 The other policies of the Act are identified in N.J.S.A. 48:2-21.16(a) as maintaining universal telecommunications service at affordable rates; ensuring that customers pay only reasonable charges for local exchange telecommunications services, which shall be available on a nondiscriminatory basis; and ensuring that noncompetitive telecommunications services do not subsidize competitive services. Whether the plan meets these policies is addresssed in other sections of this Decision and Order.

telecommunications services and products and otherwise meet the intent and policies of the Act?

NJ Bell argues that the plan itself will support economic development because, "[b]esides providing for affordable rates, the Plan gives businesses predictability of rates to allow for their economic investment" (NJBb18; P-2, at 18; P-4, at 7; T1953 to T1954). Additionally, the plan, according to NJ Bell, gives it "the incentives to offer and market new services and to improve the marketing of existing services" (NJBb18; T1952 to T1953). NJ Bell argues that even without Opportunity New Jersey, the plan satisfies the statutory criterion of enhancing economic development through the combination of providing NJ Bell with "incentives to meet customers' needs, and affording customers the stability and predictability of telecommunications services prices to make long range plans" (NJBb18; P-2, at 18; P-59, at 6).

Beyond the plan itself, NJ Bell argues that economic development will be enhanced by its commitment, upon Board approval of the plan and during its effect, to accelerate network development through ONJ (NJBb18; Plan, at 1 n.3; P-3). Presently, NJ Bell's public switched network transports voiceband services (voice, facsimile and low speed data). ONJ represents NJ Bell's plan to accelerate the deployment of advanced switching and transmission technologies to make available advanced intelligent network, narrowband digital, wideband digital, and broadband digital service capabilities in the public switched network, which will result in a public switched network that is capable of transporting video and high speed data services in addition to voiceband services (P-3, at 3).

NJ Bell's additional investment to accelerate the deployment of advanced transport and switching equipment is estimated by NJ Bell to be approximately $1.5 billion from 1992 through 1999. This is an acceleration beyond those monies that would have been spent for network improvements as part of the business as usual case (BAU). As described by NJ Bell, the following four fundamental service capabilities, the supporting technologies, and potential service applications define the ONJ network acceleration plan (P-3, at 1-2; S-17, at 2):

		BAU	ONJ
Advanced Intelligent Network (AIN):			
	Initial:	1992	1992
	100%:	2001	1998

Digital switching and signaling systems deployed to provide call routing and database access services, which enables "follow me" type services, for example, that allow customers to program the

public switched network to forward their calls automatically to different locations depending on the time of day.			
<u>Narrowband Digital Service</u>:	Initial:	1992	1992
	100%:	after 2001	1998
Switching technologies matched with transmission capabilities to support data rates up to 144,000 bits per second which enables services, for example, that will meet the requirements of customers who use any combination of work stations, personal computers, FAX machines and telephones.			
<u>Wideband Digital Service</u>:	Initial:	1994	1994
	95%:	undetermined but before 2030	2000
Switching technologies matched with transmsision capabilities to support data rates up to 1,500,000 bits per second, which enables services, for example, that will allow students to remotely access multimedia information, including video, from home or school.			
<u>Broadband Digital Service</u>:	Initial:	1996	1996
	100%:	2030	2010
Switching technologies matched with transmission capabilities support data rates up to 45,000,000 bits per second and higher, which enables services, for example, that will allow residential and business customers to receive high definition video and to send and receive inter-active (<u>i.e</u>., two way) video signals.			

The approximate incremental annual expenditure to make the above services available above the business as usual case is as follows (with amounts stated in millions):

<u>Year</u>	<u>BAU (S-1, at 27)</u>	<u>ONJ (S-1, at 26)</u>
1992	$464	$ 40
1993	450	108

1994	454	127
1995	448	180
1996	465	205
1997	484	233
1998	525	290
1999	576	279

NJ Bell's witness Doherty points to the New Jersey Telecommunications Infrastructure Study (Study), commissioned by the Board and conducted by the consulting firm of Deloitte & Touche and completed in January 1991, as recognizing the positive effects of advanced and affordable telecommunications services on economic development in New Jersey (P-2, at 18; S-18). He further cites to testimony of the Study's project director L.C. Mitchell, presented at a December 10, 1991 meeting of the New Jersey State Senate Transportation and Public Utilities Committee regarding Senate Bill No. 3617 (See NJCTA-1-0099; NJCTA-1-0100), wherein Mr. Mitchell described that the Study found that:

> the role of telecommunications in economic development, business attraction and business retention indicates that the availability of telecommunications services is one of the ten most important considerations in business location decisions around the country. However, in New Jersey, the availability of telecommunications services is one of the <u>five</u> most important factors in the decision-making process for businesses which moved to New Jersey in the last couple of years [P-2, at 18-19; See also NJBb21; S-18, at V-115; NJCTA-1-0100].

Mr. Doherty opined that as New Jersey competes for economic development opportunities and the economy becomes more information and telecommunications intensive, the issues of availability and price of telecommunications services become even more critical in retaining and attracting information age businesses (P-2, at 19).

In an effort to quantify the enhancement of economic development as a result of ONJ, NJ Bell retained DRI/McGraw Hill's (DRI) Telecommunications Consulting Group. An analysis was performed at the direction of Dr. Francis Cronin, who presented testimony on the study and its underlying models (P-5; P-57). The study involved an input - output analysis, which Dr. Cronin testified has been an accepted economic analysis tool for over 40 years and is widely used in government public policy research (P-57, at 7).

The results of the analysis presented by Dr. Cronin indicate a positive economic impact of ONJ on New Jersey's economy resultant from increased construction activity, as well as from improved production efficiencies in New Jersey industries induced by the enhanced capabilities of the network. The construction activity, which is the actual physical process of building the network, requires a considerable amount of labor and capital inputs. According to Dr. Cronin, this leads to greater production in order to meet the increased need for materials and services, and it boosts employment and wages, resulting in more spending and tax revenues. The additional New Jersey jobs gained as a result of the projected increase in construction activity associated with ONJ is estimated to be 3,708 (P-5, at 2-4; S-24).

The second positive impact according to Dr. Cronin is what he calls production efficiencies. In Dr. Cronin's analysis, historically, as telecommunications capabilities have been enhanced, businesses have increased their utilization of these capabilities to improve their own efficiencies. Production efficiencies thus generate employment, tax revenues and personal income according to Dr. Cronin. These efficiencies, in turn, have led to increased economic growth (P-5, at 5). In modeling the production efficiency impact of ONJ, DRI considered two scenarios of telecommunications usage in the future, either of which according to the study, results in employment gains that more than double construction activity. The "lower bound" case assumes that future usage of telecommunications would increase in the 1990's at historical levels, i.e., at an average annual rate of 5% per year. The "upper bound" case assumes that future usage would increase by double the historical rate. According to Dr. Cronin, the additional New Jersey jobs gained as a result of production efficiencies associated with ONJ for the lower bound case is 7,630 and the upper bound case would yield 20,952 new jobs by 1999 (S-24). Therefore, the total quantifiable ONJ benefits identified by DRI, i.e., the combination of construction activity and production efficiencies, to the State's employment, are anticipated to be 11,338 jobs under the lower bound case and 24,660 jobs under the upper bound scenario. Dr. Cronin suggests that the upper bound scenario would be the more likely result of ONJ (T1665). The economic benefits that DRI estimated for the 1990's as a result of ONJ will, in DRI's analysis, continue to expand through the 2000 to 2010 period so as to result in the creation of 21,850 jobs in the lower bound scenario and 81,399 in the upper bound scenario (S-24).

Dr. Cronin notes that the DRI study did not attempt to quantify the economic impact of businesses relocating or not moving from New Jersey as a result of ONJ although surveys have shown that the availability of telecommunications services is a critical factor in a business' location decision (P-5, at 7-8; S-24; NJBb21). Another benefit not specifically addressed in the DRI study is the agglomeration or "clustering" effect that Dr. Cronin states is a likely consequence of businesses relocating to New Jersey (P-5, at 8; S-24). The study also does not recognize the new telecommunications and information business services that a fiber optic network will generate, and, according to Dr. Cronin, any new services or information providers that might arise would also contribute to the economic well-being of the State (S-24). For these reasons, Dr. Cronin concludes that the economic impact of ONJ can only be partially quantified in the construction and production efficiency benefits that can be brought to the New Jersey economy and that in addition, the factors not specifically quantified can also substantially compound the economic impact of ONJ. Overall, Dr. Cronin concludes that ONJ will have an overwhelmingly positive impact on the State's economy (P-5, at 9; S-24).

NJ Bell also cites to The NTIA Infrastructure Report: Telecommunications in the Age of Information by the United States Department of Commerce, National Telecommunications and Information Administration (NTIA), October 1991 (P-42; hereinafter referred to as NTIA Report), as supporting the conclusion of Dr. Cronin that ONJ will result in a positive economic development benefit. The NTIA concluded:

> Some economists believe that infrastructure investments can "cause" economic and social development by atteacting businesses to an area and, in turn, generating increases in employment, income and standards of living. Others contend that infrastructure investments occur simply to relieve "tensions" caused by economic development within an area, as in the case where a city constructs mass transit facilities to alleviate traffic congestion.
>
> Most economists, however, occupy the middle ground, concluding that although cause and effect cannot be determined precisely, positive, reciprocal relationships do exist between infrastructure investments and economic development. The record in this proceeding displays a general consensus around this middle ground. It is not surprising, therefore, that public and private organizations alike are currently exploring the use of telecommunications as a tool to promote economic development. [P-42, at 34, footnotes omitted]

Thus, NJ Bell argues that even if Dr. Cronin's exact numbers are not endorsed, "the fact of a positive economic development benefit from Opportunity New Jersey is clear" (NJBb20).

NJ Bell further argues that "the outpouring of support from the New Jersey business community as evidenced in the public hearings provides a compelling and overwhelming demonstration of the importance of New Jersey Bell's proposal to the state's economic development. Many representatives of chambers of commerce and business organizations representing more than 80,000 businesses voiced their support for Opportunity New Jersey" (NJBb21 to NJBb22). It also points to testimony at the September 8, 1992 public hearing by a representative of Local 827, International Brotherhood of Electrical Workers (IBEW) that NJ Bell had made a commitment to utilize Local 827, IBEW's workers to "place, splice, transfer and repair the fiber optic network," which NJ Bell intends to deploy under this filing and will thereby utilize workers who live, work and pay taxes in New Jersey (NJBrb48; 9/8/92T38; P-9; T848 to T849).

Rate Counsel contends that no reliable analysis has been presented which would permit a finding that the plan will enhance economic development (RCb73). Rate Counsel argues that NJ Bell's witness Doherty relied substantially on Dr. Cronin's work and that Dr. Cronin's analysis is unreliable and should be given no weight by the Board (RCb73 to RCb74). The basis for Rate Counsel's claim that Dr. Cronin's analysis should be given no weight is its contention that Dr. Cronin's models and data inputs were regarded as proprietary and that parties were effectively "denied access" thereto (RCb74).

Rate Counsel further contends that Dr. Cronin's projected construction related and efficiency benefits of ONJ are based on incorrect assumptions (RCb75 to RCb81). As to the projected construction benefits, Rate Counsel argues that Dr. Cronin assumed that construction funds would be "provided internally by the Company" although he later acknowledged that the ultimate source of the Company's revenues is its ratepayers (RCb75 to RCb76; T1741; T1765; T1854). Relying on its allegation that the plan projects revenues in excess of those required to provide a fair return to NJ Bell's stockholders, Rate Counsel argues that the plan takes away from ratepayers income which could have been spent on other goods and services (RCb76; RCT-6, at 12). Rate Counsel's witness Wallingford calculated that this would have a severely depressing effect on the State's economy, offsetting the construction benefits and the lower bound scenario efficiency benefits cited by Dr. Cronin (RCb76 to RCb77; RCT-6, at 13).

As to the projected efficiency benefits, Rate Counsel argues that these were derived from assumptions regarding the rate of growth in intensity of businesses' use of telecommunications services, and that the assumptions were purely judgmental (RCb77; RCT-6, at 21). Rate Counsel further argues that Dr. Cronin's growth forecasts are in excess of NJ Bell's own projections of revenue growth under ONJ (RCb78; RCT-6, at 23-27). Rate Counsel cites to additional alleged flaws in Dr. Cronin's analysis asserted to exist by its witness Wallingford. Mr. Wallingford contends that Dr. Cronin's historical analysis ascribes benefits solely to telecommunications infrastructure, when, in fact those benefits may arise from a multitude of factors, which include, but are not limited to, such infrastructure, and consequently, he maintains that the contribution of the infrastructure is overstated by Dr. Cronin (RCb78 to RCb79; RCT-6, at 30). Rate Counsel further criticizes Dr. Cronin for assuming that since investment in technology between 1963 and 1982 may have produced economic efficiencies, investment in new and different technology in the 1990's will produce efficiencies of equal or double the magnitude, without providing substantiation of the relevance of the 1963-1982 comparison to the proposed ONJ investment (RCb79; RCT-6, at 31-32). Rate Counsel also claims that Dr. Cronin assumes all telecommunications infrastructure is homogenous and therefore does not distinguish between useful and useless investment (RCb79; RCT-6, at 33-34). Rate Counsel also contends that although Dr. Cronin criticized its witness Wallingford for interjecting hypothetical error terms into the input-output analysis as violating a fundamental tenet of input-output analysis that inputs into an economy must equal outputs from the economy (P-57, at 4), in Dr. Cronin's own analysis this constraint is not satisfied (RCb80; P-42, Appendix C, at C-12; RC-31, at C-12; T4808 to T4809; T4828).

Further, Rate Counsel contends that prices for components to the fiber network are likely to fall dramatically once production experience and economies of scale have been achieved and that early deployment therefore may cause higher prices for lower quality components (RCb80; RCT-6, at 38-40). Rate Counsel also objects to Board Staff's citation to the New Jersey Telecommunications Infrastructure Study (S-18), arguing that it is hearsay and was admitted into evidence over objections of Rate Counsel and various other parties, and that the Study did not analyze the "comparative efficacy of the provision of an advanced infrastructure by any provider other than a local exchange carrier" (RCrb28 to RCrb29).

The NJCTA takes issue with NJ Bell's claim that the plan provides a foundation to accelerate deployment of advanced technologies and argues that there is no basis to assert that a prudent ONJ could not be financed and constructed under traditional rate base, rate of return regulation (NJCTAb91 to NJCTAb98). The NJCTA asserts that given the characteristics of this State, including a high concentration of telecommunications consumers, New Jersey under traditional regulation would likely be among the first locations where a new telecommunications service would be provided (NJCTAb94). It contends that to attain early investment, the best incentive ratemaking method would be one that ties the level of profit to the level of investment committed, and that method it asserts is rate base, rate of return regulation (NJCTAb96). The NJCTA further alleges that NJ Bell seeks to be regulated under an alternative form of regulation in order to be able to achieve excessive profit levels rather than the reasonable levels provided under traditional ratemaking (NJCTAb97).

The NJCTA also argues that Dr. Cronin's analysis of economic benefits associated with ONJ is flawed. While Dr. Cronin attempted to develop a correlation between telecommunications investment and economic activity, the NJCTA maintains that there is a significant "chicken and egg" type question regarding the causal relationship, and that to establish whether there is any linkage, Dr. Cronin looked to historical data which, the NJCTA argues, he and NJ Bell refused to supply except under a "special," "onerous" proprietary agreement (NJCTAb69 to NJCTAb72; CTA-T-2, at 5 to 7). Thus, the NJCTA contends that no party has been able to perform a reasonableness check of the underlying data (NJCTAb72). Because the underlying data has not been placed in the record, the NJCTA contends that the Board cannot analyze the data, and therefore, Dr. Cronin's analysis and conclusions are entitled to no weight (NJCTAb74; CTA-T-2, at 12). The NJCTA's witness Dr. Roddy also testified that an essentially identical study to DRI's study submitted in the within proceeding had been submitted to the NTIA, whose staff concluded that DRI's assertion that its causality analysis "strongly suggests that increased telecommunications investment and usage causes economic growth" overstates the results of DRI's analysis (CTA-T-2, at 8; P-42, Appendix C, at C-16; RC-31, at C-16).

The NJCTA also argues that besides the issue relating to the input data, there are other problems relating to "what comes out" of Dr. Cronin's analysis (NJCTAb74). The NJCTA argues that the amount of services taken from new plant may be influenced by how they are priced and their level of use (NJCTAb75). The NJCTA also questions how any analysis of past investments and services which were not heavily entertainment oriented and levels of economic activity can have any predictive value in estimating the economic effect of new, heavily entertainment oriented services (NJCTAb75 to NJCTAb76). Its witness Dr. Roddy testified that even if past causality were established by Dr. Cronin's study, it is incorrect to extrapolate causality conditions identified in the past from 1958 through 1988 into a 1993 foward time frame given the structural and competitive changes in the telecommunications industry (CTA-T-2, at 12-14). The NJCTA also criticizes Dr. Cronin's analysis for not netting against the claimed ONJ benefits the economic benefits of the rate decrease which NJCTA asserts would, absent ONJ, occur and provide an economic stimulus (NJCTA89 to NJCTAb91; CTA-T-1, at 32). Its witness Kravtin asserts that NJ Bell also ignores the enhanced economic development which would result if other non-LEC telecommunications providers were given a greater opportunity to supply telecommunications services and products in the State (CTA-T-1, at 32). Other flaws alleged by the NJCTA relate to assumptions that all of the payroll would be earned by New Jersey residents and spent in New Jersey (NJCTAb76), and that data was used prior to the effective date of the sales tax reduction (NJCTAb77).

The NJCTA further contends that ONJ is "an acceleration of investment that would have eventually occurred in any event" (NJCTAb78; CTA-T-1, at 31). The NJCTA also asserts if demands for services fail to significantly materialize, then ONJ "would represent idle investment weighing down" the State's economy (NJCTAb78). The NJCTA further argues that New Jersey will be placed at a disadvantage by serving as "Bell Atlantic's fiber optic pioneer" since the cost of fiber optic digital technology is declining and additionally, when a new technology is deployed, there is a learning curve experience, which will be available for the benefit of Bell Atlantic's other operating companies. Surrounding states, using New Jersey's experience will then, the NJCTA speculates, be able to offer equivalent services at lower cost and prices and thereby become more competitive than New Jersey (NJCTAb84 to NJCTAb89; CTA-T-1, at 33).

MCI contends that NJ Bell's plan as filed will not enhance economic development and because it maintains that the plan does not properly implement competitive safeguards, MCI contends that the plan will likely inhibit entry into competitive markets and prevent effective competition, thereby allegedly denying consumers, including businesses, the benefits of low-cost, innovative telecommunications products, resulting in businesses being less likely to locate in the State (MCIb14 to MCIb15). MCI further asserts that the costs of the investment in ONJ will be borne to a substantial extent by customers of NJ Bell's noncompetitive services, who thus will allegedly have less resources available to pay for other goods and services that they might otherwise have purchased, and to the extent the costs are imposed on competitive firms, their customers, in MCI's view, will lose the benefits of lower prices and innovative products (MCIb15; MCIrb4). While MCI concedes that "industries tend to locate where there are modern telecommunications facilities available," MCI asserts that businesses would not want to locate where their employees would have to pay unduly high prices for basic telephone service (MCIb15; MCI-T-1, at 31).

MCI urges that "a better course for the Board to achieve an efficient and economically productive telecommunications network and enhanced economic development in New Jersey is through competitive entry and the discipline of the competitive marketplace" (MCIb15 to MCIb16; MCI-T-1, at 23-25, 30). It further submits that the Board should consider whether a modern telecommunications network could be achieved more efficiently or effectively by other providers of telecommunications services and notes that encouraging investment by non-local exchange companies would require the Board to alter some of its regulatory policies, including the existing ban on intraLATA competition (MCIb17 to MCIb18).

The CWA criticizes NJ Bell's witness Dr. Megdal's testimony regarding incentive regulation, for not comparing NJ Bell's plan with other regulatory options such as the existing RSP, proposals pending or adopted in other states, and traditional rate of return regulation (CWAb37 to CWAb38). With regard to Dr. Cronin's analysis, the CWA argues that there is no proven causal link between accelerating investment in the telecommunications infrastructure and economic growth in New Jersey. It criticizes Dr. Cronin's analysis for not taking into account the effect of rate increases contemplated by the plan and for assuming that the investment associated with the plan is equivalent to "new" monies flowing into the State (CWAb38; CWA-T-1, at 25 to 29). Its witness Rafferty criticizes Dr. Cronin's analysis for not evaluating whether the specific investments will be used and useful, failing to quantify the extent to which the incremental investment will provide marketable new services that the existing infrastructure cannot provide, and failing to consider the falling price of the investment or to optimize the proposed investment over time (CWA-T-1, at 26). Its witness Kohl contends that it is not realistic to expect that NJ Bell will increase employment through ONJ. He estimates, based on a study by the Midst Center for Labor Research, that past job reductions have cost the State $116,550,000 and projecting the costs of another decline of 26% in NJ Bell's work-force, estimates that there will be an additional $111 million loss to the State economy (CWA-T-2, at 23, 26-27).

Board Staff believes the record supports the conclusion that overall ONJ will have a positive impact on economic development in the State of New Jersey and that the acceleration of an advanced network is of vital importance in New Jersey where telecommunications intensive industries are located (STb131 to STb132). Staff points to the conclusions drawn from the New Jersey Telecommunications Infrastructure Study (S-18) as instructive. Staff notes that, in summary, analysis of the information gathered during the assessment of the role of telecommunications in economic development pointed to the following deductions:

- The increasing role of telecommunications in business can be traced to fundamental forces in the business environment, including the increasing intensity with which businesses use information and communications and the increasing importance of telecommunications-intensive industries in New Jersey and the nation's economy.

- Telecommunications is important to a company's ability to compete in today's business environment.

- Telecommunications is expected to become even more critical to a company's ability to compete in the future.

- Telecommunications is a significant consideration in the business relocation process. As such, telecommunications has clear ramifications for economic development initiatives seeking to attract/retain businesses in New Jersey (STb132; S-18, at V-112 to V-116).

Staff submits that these findings support the conclusion that telecommunications plays an important role in economic development and will be even more important in the future. The results of these analyses demonstrate that the availability of an advanced telecommunications infrastructure can provide a significant contribution to the general business and economic climate in the State of New Jersey (STb132; S-18, at V-116). Staff submits that it therefore is reasonable to conclude there is a relationship between an advanced telecommunications network and economic development (STb133).

With regard to criticisms of Dr. Cronin's analysis and arguments that the plan does not enhance economic development, Staff observes that the NJCTA's witness Dr. Roddy alleges that Dr. Cronin's causality conclusions and use of historical data are inconclusive or inappropriate, yet he himself has no substantiated data for such conclusions and makes general statements and allegations that in Staff's view should be accorded limited weight (STb133). Staff submits that the NJCTA and Dr. Roddy did have the opportunity to obtain the data necessary to conduct its own study to test the validity of DRI's findings, but having chosen not to do so, Dr. Roddy makes unsubstantiated accusations about the accuracy of the results of Dr. Cronin's study and his arguments are, therefore, in Staff's view, of limited use to the Board (STb133 to STb134). In its reply brief, Staff also contends that the information is a relatively minor portion of the overall discussion and neither Rate Counsel nor the NJCTA has suggested why a critical analysis of DRI's study could only be accomplished with the data at issue, noting that the NTIA and its staff were both able to comment on similar issues without even raising the point (STrb44).

With regard to Rate Counsel's suggestions that Dr. Cronin's results are flawed because he makes certain growth assumptions and because his models are subject to errors and its argument, and that of the CWA, that ONJ will take money from ratepayers and reduce disposable income, thus not allowing ratepayers to spend money on other goods and services, Staff submits that these arguments should be rejected. Dr. Cronin agreed that assumptions were made, since a forecast is impossible to formulate without assumptions and that the use of asumptions is a basic economic premise and it is routinely done (STb134). While some errors may be inherent in the data and model, Staff asserts that there is no evidence in the record to indicate that the model is so replete with errors that it is rendered devoid of useful information (STb135).

Although Staff notes that it has not recreated DRI's models and is not taking a position that the employment figures are or are not precise, Staff opines that the methodology used by DRI appears to be reasonable and suggests that the figures are acceptable (STb135). Staff takes exception to intervenors' arguments that the results are overstated because no party utilized available data to refute Dr. Cronin. Secondly, Staff notes that a major factor has not been quantified in the DRI model - the impact on businesses relocating to or not moving from New Jersey. Staff cites to the finding of the Infrastructure Study that the availability of telecommunications services is one of the five most important factors in the decision-making process for businesses which moved to New Jersey in the last couple of years, and to its conclusion, in part, that:

> The importance of evaluating telecommunications issues within the business location process is

> clearly gaining acceptance. Both economic development managers and relocation businesses have noted the importance of the availability of advanced telecommunications services to the relocation decision; the cost of telecommunications services was deemed somewhat less important. Furthermore, economic development managers were nearly unanimous in their belief that technologically advanced telecommunications services would positively impact a state's ability to attract and retain businesses. [S-18, at V-116]

Therefore, Staff submits that while the impact of the availability of telecommunications services on the business location decision-making process may be difficult to quantify, it is clearly a factor that lends support to the positive impact on employment and tax figures estimated by DRI as a result of the implementation of ONJ (STb135 to STb136).

In its reply brief, Staff notes that the issue of the amount of benefit to be derived from investment in NJ Bell's telecommunications infrastructure has generated much discussion on the record, with Dr. Cronin, on the one hand, testifying that DRI's models show a quantifiable link between such investment and growth, and, on the other hand, Dr. Roddy and his firm, Economics and Technology, Inc. (ETI), contending no such linkage can be demonstrated, and that these competing views are not limited to this proceeding. Staff points out that in the NTIA Report (P-42), the NTIA observed that some economists believe that infrastructure investments can "cause" economic and social development by attracting business to an area and generating increases in employment, income, and standards of living, while others contend that infrastructure investments occur simply to relieve "tensions" caused by economic development within an area, but that most economists occupy a middle ground, concluding that although cause and effect cannot be determined precisely, positive, reciprocal relationships do exist between infrastructure investments and economic development (P-42, at 34; STrb41). Staff further notes that as pointed out by the NTIA "DRI's analysis does support the general proposition that telecommunications growth has engendered positive benefits for the US economy" (P-42, at 32, quoting supplemental comments of the International Communications Association, whose consultant before the NTIA was ETI). Staff also cites to the NTIA's conclusion that the benefits of telecommunications for the United States economy are clear enough and pervasive enough to demonstrate the importance of telecommunications issues for policymakers (STrb42; P-42, at 33).

Further, Board Staff asserts that the NTIA Staff's report, offered by various parties herein as a criticism of DRI's analysis, is informative (STrb42; P-42, Appendix C; RC-31). In reviewing DRI's analysis, the NTIA staff paper contends "several methodological issues limit the study's usefulness in analyzing infrastructure policy. In examining these issues we encourage policy analysts to develop and improve upon the models and methods pioneered by DRI." (P-42, Appendix C, at C-2, RC-31, at C-2). Staff notes that the position paper also states:

> Thus, the DRI study does not definitely establish that the changes in the relevant input-output coefficients between 1963 and 1982 (which, in turn, were used to estimate the resource savings realized over the period) were solely attributable to telecommunications infrastructure investment. This does not mean, of course, that there is no link between such investment and the resource savings estimated. It simply means that some of those savings may also be attributable to other factors. [P-42, Appendix C, at C-11]

In Board Staff's view, the discussion between DRI/Dr. Cronin and ETI/Dr. Roddy is a "classic battle of experts in a highly technical discipline and competing emerging theories" (STrb42). However, in Staff's view, as the NTIA study clearly indicates, helpful information for policymakers has been presented. Staff contends that the issue presented in this proceeding is not whether the plan and ONJ will produce a threshold level of employment or a threshold level of increased sales tax receipts, but is whether the plan will promote economic development (STrb42 to STrb43). Staff endorses the "middle ground" approach discussed by the NTIA that there exists some relationship between infrastructure investments and economic development and believes that NJ Bell has established that the plan and ONJ will result in positive benefits to the New Jersey economy even if the precise amount of the benefit is in dispute. The benefits will be the result of the increased construction activity and the efficiencies to be gained from a more advanced ubiquitous telecommunications network. Staff also believes that some of Dr. Cronin's conservative assumptions, such as not including potential business relocations, will tend to outweigh other assumptions, including the sales tax differential and the fact that some construction employees may live in neighboring states (STrb43).

Further evidence that an advanced network, which will be created under ONJ, will have a positive impact on quality of life and stimulate economic development is, Staff believes, in the fields of telecommuting and distance learning, which would enable a reduction in motor vehicle emissions and in commuting costs (STb136). Secondly, Staff notes that an advanced broadband network could help address some major problems facing educational institutions, including budgetary pressures and potential teacher shortages. Distance learning can help improve educational quality by eliminating the geographic constraints which have traditionally prevented experts in specific fields from reaching a regional audience. Through the use of a ubiquitous broadband network, a number of schools can be connected through interactive video (STb136 to STb137). In providing this expanded curricula, distance education can, Staff maintains, help to reduce the costs of providing specific courses by virtue of cost sharing gained through wide dissemination of distance learning courses. Telecommunications can therefore help alleviate educational shortages, and reduce budgetary pressures and therefore build the technological base necessary for efficient performance in the marketplace available to a highly educated work force. Staff notes that there is currently a successful trial of an interactive video network developed by Bergen County schools in New Jersey which is a leading edge application of distance learning using fiber-based telecommunications technology (STb137; S-18, at VI-63). Staff submits that a ubiquitous broadband network would extend the ability to all educational institutions in New Jersey to be interconnected to provide interactive video distance learning (STb137). Staff opines that perhaps the most convincing evidence of the impact of ONJ with respect to distance learning and its connection to positive economic activity was testimony submitted by members of the public, including business representatives, municipal officials, and members of the educational community, at the public hearings held in this proceeding (STb137 to STb138).

Staff indicates it is satisfied that the analysis submitted by NJ Bell, which quantifies certain benefits such as the potential new employment and increased tax revenues due to the accelerated infrastructure deployment, appears reasonable (STb138). However, noting that these calculations have been predicated on the projected deployment of the network and are therefore wholly dependent upon the timely completion of ONJ, and accordingly, that any drastic deviation from the schedule as submitted by NJ Bell would have a direct and likely negative impact on the employment and tax revenue projections, Staff submits that it is, therefore, important for the Board to monitor ONJ and require NJ Bell to commit to achieving the entire plan, including fiber to the curb, so the projected benefits become a reality (STb138 to STb139). Thus, in exchange for permitting NJ Bell to be governed by an alternative form of regulation, Staff recommends that it is critical that the deployment scheme described in ONJ be considered a firm commitment on NJ Bell's part (STb140). While it recognizes that certain elements of ONJ are based upon projections in technology development, Staff submits that the record clearly establishes that the technology is being developed and NJ Bell's projections are reasonable; therefore, Staff recommends that NJ Bell be required to meet or exceed the schedules set forth in ONJ (STb140). Further, Staff recommends that the Board closely monitor NJ Bell's deployment on an ongoing basis and reserve the right to seek a further acceleration of the benefits of ONJ if the technology and/or costs of actual deployment become more advantageous than projected.

Staff further recommends that the Board indicate that it recognizes NJ Bell's commitment for deployment of full broadband capability extends beyond the term of the plan and that NJ Bell will not be permitted to argue that this commitment terminates at the conclusion of the plan at issue in this proceeding (STb141). Staff also urges that NJ Bell be put on notice that if projections on the availability of technology necessary to implement ONJ are overly optimistic and NJ Bell's deployment slips significantly beyond forecasted levels, the Board reserves the right to commence a proceeding and examine key aspects of the plan to ensure NJ Bell does not receive the benefits of an alternative form of regulation without at the same time fulfilling its obligations. Staff urges that NJ Bell be made aware, at the outset, that in the event NJ Bell cannot perform its obligations set forth in ONJ, the Board could consider remedies such as altering the depreciation allowances for NJ Bell, restricting NJ Bell's ability to implement indexed price increases, or, in the extreme scenario, voiding the plan and instituting a traditional base rate proceeding (STb141 to STb142). In this way, Staff submits that the Board will be able to ensure that NJ Bell will provide the advanced network promised under ONJ and that the positive implications will be realized by the citizens of the State of New Jersey (STb138 to STb139).

Having carefully reviewed the record and briefs on this issue, the Board FINDS that the plan as modified herein, including Opportunity New Jersey, will result in positive benefits to the New Jersey economy. The Board disagrees with the claim by Rate Counsel and others that Opportunity New Jersey will have a depressing effect on the State's economy. This argument is based on the view that the rates established by the plan are unreasonably high. As already discussed above, the rates under the plan as modified herein will be just and reasonable.

The Board concurs with Staff that the real issue pertaining to economic development is not whether the plan and Opportunity New Jersey will produce a particular level of increased employment or tax receipts, but rather whether the plan and ONJ will enhance the economic development of this State. By declaring in N.J.S.A. 48:2-21.16(a)(5) that it is the policy of the State to permit the Board the authority to approve alternative forms of regulation in order to "address changes in technology and the structure of the telecommunications industry; to modify the regulation of competitive services; and to promote economic development," and by including in N.J.S.A. 48:2-21.18(a)(6) the enhancement of economic development in the State as a criterion for approval of a plan for an alternative form of regulation, the Legislature, itself, recognized that there can be a positive relationship between a plan for an alternative form of regulation and economic development. Were the positions on the issue of economic development of Rate Counsel, the NJCTA and the CWA in this proceeding to be accepted, it would be virtually impossible for any plan for an alternative form of regulation to ever be approved unless and until a method for precisely quantifying the projected economic benefits of such a plan were developed and concurred in by all economists and other relevant experts. The Board is persuaded by a review of the legislative history of the Telecommunications Act of 1992, that such a result was not intended.

The legislative history of the Telecommunications Act of 1992, parts of which previously have been referenced by parties in this proceeding, reflects that Senator Menendez, the sponsor of Senate Bill No. 3617, which, with revisions by the Senate Transportation and Public Utilities Committee, resulted in the Telecommunications Act of 1992, testified that "[t]he new information technologies, including fiber-optics, would allow New Jersey, in general and urban areas such as Union City in particular to move to the front of the pack in competing for a piece of the 21st century economy." He further opined that "[t]he economic boon driven by an information based economy and the new and better jobs it would create will positively affect a wide range of revenue areas." While Senator Menendez noted that the revised bill allowed for options in technology, as opposed to the original bill which had provided for a particular technology, i.e., fiber-optics, and was thus an "enabling device," he opined, however, that "[t]he information technologies, including fiber-optics, are a chance to bring the world's marketplace, the world's knowledge, and the world's economy to New Jersey." Committee Meeting before Senate Transportation and Public Utilities Committee, Senate Bill No. 3617 (December 10, 1991), at 2-6. In addition, the State's former Commissioner of Commerce, who had left that position four days prior to giving testimony, also testified that an advanced telecommunications network would stimulate the State's economy, create jobs, and strengthen the State's appeal to industries and businesses, including small businesses. He concluded, "as opportunities for economic growth expansion continue to shift toward information services and technology, the quality of our communications infrastructure will determine this State's ability to attract and retain businesses and jobs." Id. at 18-19. Thus, from the legislative history, it does not appear that in including the criterion of enhancing economic development, the Legislature intended for a plan for an alternative form of regulation to be approved only if the economic benefits could be precisely and absolutely quantified.

Furthermore, the Board rejects arguments that Dr. Cronin's analysis should be accorded no weight because parties allegedly were not given access to certain data underlying his study (RCb74; NJCTAb70 to NJCTAb74). This is simply not the case. On September 27, 1992, Chairman Salmon convened a special hearing to consider arguments pertaining to the NJCTA's request for data underlying the study (T2545 to T2603). After carefully considering parties' arguments, he found that the information should be released, but because the information is sensitive financial or trade secret information, found that it was entitled to be protected. This ruling is consistent with N.J.A.C. 1:1-14.1. The Chairman then made various revisions to a draft proprietary agreement proffered by NJ Bell and, among other things, deleted a provision providing for monetary damages. This resulted in an appropriate and fair balancing of the interests of all parties, affording access to the data but affording protection against unwarranted disclosure of the information. The NJCTA concedes that the "information should be available under the normal proprietary agreements" (NJCTAb71) but contends the revised agreement at issue was not signed by its consultant Economics and Technology, Inc. (ETI), because it exposed ETI "to excessive risks for events beyond its control" (NJCTAb71). The Board finds this contention to be untenable. The agreement as carefully revised by Chairman Salmon is a reasonable agreement which was neither "onerous" nor exposed experts to "vast liability" as contended by the NJCTA (NJCTAb72). Similarly, Rate Counsel's bald assertions that Dr. Cronin's "analysis cannot stand where the underlying basis for [Dr. Cronin's] conclusions are not available to the parties for examination and verification" and that "access to both the models...and the data itself input into those models was regarded as proprietary, and effectively denied to the parties" (RCb74) are disingenuous. Clearly, access to the information was not denied and was made available under reasonable terms. Rate Counsel has offered no explanation as to why it has not entered the revised proprietary agreement whereby access would have been provided. Thus, the Board rejects the contention that Dr. Cronin's analysis should be given no weight because the parties were denied access to his models and underlying data. Indeed, the failure to obtain Dr. Cronin's data by entering into the proprietary agreement carefully crafted by Chairman Salmon to reasonably balance the interests of all parties, with no valid reason to not do so, detracts significantly from any credibility of the arguments regarding possible errors in the data underlying his analysis.

The Board finds persuasive the findings of <u>The NTIA Infrastructure Report: Telecommunications in the Age of Information</u> (P-42). The NTIA noted that while "[s]ome economists believe that infrastructure investments can 'cause' economic and social development by attracting businesses to an area and, in turn, generating increases in employment, income and standards of living, [o]thers contend that infrastructure investments occur simply to relieve 'tensions' caused by economic development within an area" (P-42, at 34). The NTIA found, however, that "[m]ost economists...occupy the middle ground, concluding that although cause and effect cannot be determined precisely, positive, reciprocal relationships do exist between infrastructure investments and economic development (P-42, at 34). Indeed, the NTIA notes that even though DRI's methodology was criticized by the International Communications Association (ICA) and its consultants, Economics and Technology, Inc., the consultants herein for the NJCTA, and the NTIA's Staff found various flaws in DRI's analysis, "as ICA notes, DRI's analysis does support the 'general proposition that telecommunications growth has engendered positive benefits for the U.S. economy. There is no debate in the record whether from marketplace participants or policy analysts, about the qualitative importance of telecommunications to the performance and productivity of the U.S. economy" (P-42, at 32). The NTIA also found that telecommunications can produce benefits that extend beyond the realm of economic development, and can enhance social welfare by improving delivery of critical services, such as education, health care, security and public safety services (P-42, at 46 to 73), and enhance the quality of life by enabling telecommuting and permitting persons with disabilities to share in opportunities otherwise unavailable to them (P-42, at 73 to 85).

That there is a positive relationship between the ONJ telecommunications infrastructure investment and economic development is evidenced by an array of additional sources as well. First, the Board looks to the New Jersey Telecommunications Infrastructure Study (January 1991) (S-18), commissioned by the Board and prepared by the consulting firm of Deloitte & Touche and its consulting division, Braxton Associates. While Rate Counsel points to the fact that this study was paid for by the State's local exchange carriers and in large measure by NJ Bell (RCrb29), the Board emphasizes that although the State's local exchange carriers were required to fund the Infrastructure Study, the objectives of the Study were developed by the Board (S-18, at I-1). An objective of the Infrastructure Study was to evaluate and analyze the extent of the linkage between the telecommunications infrastructure and economic growth in New Jersey (S-18, at I-16). In addition, as noted by the NJCTA (T1488 to T1491), the Infrastructure Study indicated that it assessed the issues and implications of technology deployment for the State's LECs but recognized that some of the capabilities might also be offered by the cable television industry or other providers. The Study, however, provides a "foundation for determining whether the availability of these capabilities is essential to the state" (S-18, at I-16 to I-17) and therefore has been considered by the Board in evaluating whether NJ Bell's plan, including ONJ, will enhance economic development.

In this regard, the Board has carefully considered but rejects contentions that the Board should not consider and should accord no weight to the Telecommunications Infrastructure Study. The Board, itself, commissioned this study, which was performed and completed prior to the enactment of the Telecommunications Act of 1992 and NJ Bell's filing of the petition at issue herein. It is clear that even in contested case hearings, all relevant evidence is admissible. N.J.S.A. 52:14B-10(a). Clearly, the Infrastructure Study performed for the Board to examine and analyze the linkage between the telecommunications infrastructure and economic growth is relevant to an issue herein.

Thus, the Study is akin to "preliminary reports, staff memoranda or other noticeable data," which N.J.A.C. 1:1-15.2(c) provides parties must be notified of and afforded a reasonable opportunity to contest. The Study was referenced in NJ Bell witness Doherty's affidavit filed with NJ Bell's petition in this matter and was introduced as an exhibit by Board Staff. Thus, all parties have had an opportunity through discovery and the hearing process to rebut or contest this Study. See, High Horizons Development Co. v. State, Dept. of Transp., 120 N.J. 40, 52-53 (1990); Elizabeth Federal S. & L. Ass'n v. Howell, 24 N.J. 488, 506-507 (1957); Pennsylvania Railroad Co. v. Dept. of Public Utilities, 14 N.J. 41, 427 (1954). In Pennsylvania Railroad Co. v. Dept. of Public Utilities, the Supreme Court of New Jersey explained:

> In the course of the hearing the board must be given full latitude to avail itself of the wealth of general information and expert knowledge which it obtains in the performance of its day-to-day administrative activities. By taking appropriate official notice, making it part of the hearing record, and affording fair opportunity of refutation, the board may adequately protect both the public and private interests concerned. Similarly, official reports and transcripts in other proceedings before the board may readily be made part of the hearing. In this fashion the board may stay within the record and rest thereon its order accompanied by adequate findings which determine the basic facts and the conclusions therefrom [14 N.J. at 427; citations omitted]

Indeed, findings of an administrative agency may be based upon an agency's expertise even without supporting evidence, particularly if the determination is "primarily of a judgmental or predictive nature." Golden Nugget v. Atlantic City Elec. 229 N.J. Super. 118, 126 (App. Div. 1988). Thus, the Supreme Court of the United States, in rejecting a claim that an agency should have adduced testimonial and documentary evidence supporting its forecast, explained: "[W]e do not think that the Commission is so limited in its formulation of policy considerations. Rather...a forecast of the direction in which future public interest lies necessarily involves deductions based on the expert knowledge of the agency." F.P.C. v. Transcontinental Gas Corp., 365 U.S. 1, 81 S.Ct. 435, 5 L.Ed. 2d 377, 395 (1961). See also, FCC v. Nat. Cit. Comm. for Broadcasting, 436 U.S. 775, 98 S.Ct. 2096, 56 L.Ed. 2d 697, 726 (1978).

Moreover, the Board's ratemaking proceedings have been cited by the Supreme Court of New Jersey as an example of hybrid proceedings possessing characteristics of both adjudication and rulemaking. Mortgage Bankers Ass'n v. N.J. Real Estate Comm'n, 102 N.J. 176, 193 (1986); Texter v. Dept. of Human Services, 88 N.J. 376, 385 (1982); Cunningham v. Dept. of Civil Service, 69 N.J. 13, 21 (1975). Although ratemaking proceedings are often conducted like quasi-judicial proceedings, it is well established that ratemaking is a legislative function and therefore, the Board, to whom the Legislature has delegated its ratemaking power, is vested with broad discretion in the exercise of that authority. In re Jersey Central Power & Light Co. Petition, 85 N.J. 520, 526-527 (1981); Cunningham v. Dept. of Civil Service, supra; In re Intrastate

Industrial Sand Rates, 66 N.J. 12, 21 (1974); Public Service Coordinated Transport v. State, 5 N.J. 196, 214 (1950); New Jersey Bell Tel. Co. v. State, 162 N.J. Super. 60, 69, 81 (App. Div. 1978). See also, Matter of Dept. of Insurance's Order Nos. A89-110 and A90-125, 129 N.J. 365, 383 (1992). The manner in which the Board's legislative powers are exercised often involves "consideration of large questions of public policy or business wisdom." Public Service Coordinated Transport v. State, supra, at 215, quoting Public Service Gas Co. v. Bd. of Public Utility Comm'rs, 84 N.J.L. 463, 467 (Sup. Ct. 1913), reversed in part 87 N.J.L. 581 (E.& A. 1914), but affirmed in toto on rehearing 87 N.J.L. 597 (E.& A. 1915), appeal dismissed 242 U.S. 666, 37 Sup. Ct. 243, 61 L.Ed. 552 (1917).

The Board concludes that where, as here, the Board's expertise has been informed by a study performed at its request, it would be irresponsible, in exercising its legislative/regulatory discretion in deciding broad public policy issues, for the Board to ignore such study, provided that, as occurred herein, parties have been placed on notice of the study and have had an opportunity to rebut or contest it. See, Petition of Hackensack Water Co., 249 N.J. Super. 164, 181-182 (App. Div. 1991), certif. den. 127 N.J. 551 (1991).

To perform the Infrastructure Study, the consulting firm obtained direct input from managers of economic and business retention programs, businesses that have been involved in relocation decision-making, education and health care professionals, representatives of various State agencies, telecommunications and computer equipment manufacturers, and research institutions (S-18, I-2). Also reviewed were published literature and policy statements of governmental officials (S-18, at V-8 to V-9). Based on an analysis of the data, the Study concluded, in part, that "telecommunications plays an important role in economic development and will be even more important in the future" and "availability of an advanced telecommunications infrastructure can provide significant contribution to the general business and economic climate in the State of New Jersey" (S-18, at V-116). As further explained by the Study:

> **Public policies that encourage deployment of an advanced telecommunications infrastructure are essential for New Jersey to achieve the level of employment and job growth expected in the state**
>
> Advanced telecommunications capabilities are expected to be particularly important for the attraction and retention of business in New Jersey. The focus of future economic development efforts in the state will be on the services-producing sectors of the economy, such as the finance, insurance, and real estate industries. Many states will be targeting such businesses because of their rapid

growth, low-asset intensity, and job creation. Furthermore, these sectors have also been identified as among the most telecommunications-intensive sectors of the economy. Therefore, it will be essential for the state's telecommunications network to be able to support the capabilities required by these types of businesses.

> **The increasing role of telecommunications in business can be traced to fundamental forces in the business environment, including the increasing intensity with which businesses use information and communications, and the increasing importance of telecommunications-intensive industries in New Jersey and the nation's economy. Advanced telecommunications capabilities are now widely recognized as a "competitive weapon" in economic development and business retention.**

This reflects the overwhelming recognition of the study participants that business is rapidly becoming much more information-and-telecommunications-intensive. The growth in information intensity will contribute to rapidly increasing demand for information technology and data transport capabilities, including the demand for higher bandwidth data transport through the public telecommunications infrastructure.

Advanced telecommunications capabilities can be a significant factor in the location decision-making process, especially for companies in the service-producing sector. Thus, telecommunications can serve as a "lever" to enhance the attractiveness of a state for business in the services-producing sector of the economy. As an ancillary benefit, to the extent that an increasing proportion of the state's new business is in the service-producing section, which typically does not generate environmental hazards, this will also provide an indirect benefit to the state by helping to mitigate the impact of additional environmental/pollutant concerns.

The capabilities of the infrastructure must evolve in a manner to satisfy the increasingly sophisticated and more complex needs of business users. Additionally, because of the wide dispersion of businesses throughout the state, the telecommunications network must have these new capabilities widely available rather than focused in a few major metropolitan business centers as is the case in many states. As a result, it will be essential for New Jersey to have a statewide advanced telecommunications infrastructure to enhance the future economic climate of the state.

....

The combination of these observations suggests an explicit policy role for telecommunications in economic development and business retention

Future public policy directions should consider the "risk" of not achieving the employment growth and job creation expected in telecommunications-intensive industries

The state's economic initiatives should encourage employment in those sectors which are telecommunications-intensive. The deployment of the telecommunications network within the state must, at a minimum, keep pace with the demands of business in these sectors. Many of the businesses in these telecommunications-intensive industries are "innovators" in the use of information technology. Consequently, the deployment of new telecommunications technology must stay ahead of emerging transport requirements if advanced telecommunications capabilities are going to be effectively used as a competitive tool to support economic development and business retention efforts in New Jersey.

Employment growth in telecommunications-intensive sectors are forecast to significantly exceed the growth rate of other industries. Eighty-five percent of New Jersey's employment growth between 1988 and 2000 is expected to come from the services-producing sectors of the economy. The services-producing sectors, many of which have also been identified as telecommunications-intensive, will be the drivers behind the earnings capacity of employees in New Jersey in the future.

The state's ability to realize anticipated economic growth is "at risk" if the job growth in telecommunications-intensive industries is not achieved. Future public policies geared to stimulate economic activity and job growth should recognize telecommunications-intensive industries as a major component of New Jersey's expected future growth.

<u>Therefore, because telecommunications services will play a critical role in economic growth and business attraction, the development of the state's telecommunications infrastructure should be encouraged and supported</u>. The availability of advanced telecommunications services within the state should be particularly attractive to telecommunications-intensive industries and would provide a "competitive edge" to attract and retain these businesses. [S-18, at I-10 to I-11; emphasis supplied]

The Infrastructure Study also noted that "[r]epresentatives of state regulatory authorities around the country indicate increasing support for the role telecommunications play in economic development and business retention initiatives" (S-18, at I-11). See, Re Alternative Regulatory Framework for Local Exchange Carriers, 107 PUR 4th 1, 167 (Cal. P.U.C. 1989).

Furthermore, the FCC also has found a positive relationship between telecommunications infrastructure development and economic development. In approving the use of price caps for LECs, the FCC opined that "incentive regulation can provide the local exchange carriers with the impetus and opportunity to create and advance a communications network that will keep the United States at the forefront of a worldwide 'information economy' approaching $1 trillion this year. In an increasingly service-based economy, communications technologies are more and more important." In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6827 (October 4, 1990). In amending its rules to allow local telephone companies to offer video dialtone, the FCC found that doing so would further its public interest goals, which include "increased investment opportunities for the development of an advanced telecommunications infrastructure, which will provide additional potential for expanded economic development in many communities." In the Matter of Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54-6358, CC Docket No. 87-266, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781, 5787 (Aug. 14, 1992).

The Board further finds persuasive the many comments presented at the public hearings regarding the benefits of ONJ. The Board notes first, however, the objections of the NJCTA to the comments of members of the public regarding benefits of ONJ as speculative and not evidential (NJCTArb8; NJCTArb13). While the NJCTA states that public witnesses are "qualified to reliably testify about how the utility failed to give them proper service, or how they find bills to be unaffordable [and] ... to other matters of which they have first-hand knowledge," and while the NJCTA concedes that "they may be entitled to offer non-expert opinion of why they would like to see a service deployed," it asserts that this is not the type of evidence that should be relied upon to embark upon ONJ (NJCTArb9 to NJCTArb10).

Rate Counsel also disputes NJ Bell's reliance upon public testimony, stating that none of the citizens presented facts or evidence to support the plan, none was put forth as an expert in ratemaking, accounting or economics, and they "were speaking purely from a personal and professional standpoint as to how ONJ, and not the Plan, would be technologically useful to education, health care and various other important fields" (RCrb8). Rate Counsel agrees, however, that "[t]he technological advances on which members of the public commented are unquestionably beneficial to many individuals, businesses and service providers in the state" (RCrb8).

The Board rejects the contention that the public comments cannot be considered by the Board in evaluating NJ Bell's petition in this matter. Public hearings are an established statutory requirement prior to the granting of any proposed adjustment which would result in an increase in rates, N.J.S.A. 48:2-32.4, and N.J.A.C. 1:14-9.2(d) expressly provides that persons opposing or supporting petitions or tariff schedules may testify. Indeed, in Petition of Hackensack Water Co. 249 N.J. Super. 164 (App. Div. 1991), certif. den. 127 N.J. 551 (1991), in reversing Orders of this Board and the Watershed Property Review Board, the Superior Court of New Jersey, Appellate Division criticized the Review Board's failure to allow for "meaningful public input." Petition of Hackensack Water Co., supra, 249 N.J. Super at 178. The Court cited to 613 Corp. v. State Div. of State Lottery, 210 N.J. Super. 485, 498-499 (App. Div. 1986), wherein it had explained:

> [W]here the subject matter of a quasi-judicial adjudication encompasses concerns that transcend those of individual litigants and implicates matters of administrative policy, rulemaking procedures should be followed. Metromedia, Inc. v. Director, Div. of Taxation, 97 N.J. [313] at 331, [478 A.2d 742]; (1984)] see Texter v. Dept. of Human Services, 88 N.J.376, 386 [443 A.2d 178] (1982). These procedural requirements ensure fairness by providing public notice, an opportunity for all interested parties to be heard, full factual development and the opportunity for continuing comment on the proposed action before a final determination is made. [249 N.J. Super. at 179]

This guidance is directly apropos to the within matter, which clearly encompasses concerns that transcend those of the individual litigants. Clearly, the Board must be able to consider the public's comments, for to do otherwise would render the public's input meaningless in a proceeding in which the Board must determine whether the matter before it is in the public interest. N.J.S.A. 48:2-21.18(a)(5). The Board finds persuasive and credible the testimony regarding ONJ by numerous members of the public, including representatives of diverse businesses and business groups, municipal officials, and persons involved in health care, education and law enforcement. The Board concurs with NJ Bell that the public's testimony provides a "compelling and overwhelming demonstration" of the benefits of ONJ to the State's economic development (NJBb21).

Based on all of the foregoing, the Board FINDS that the plan as modified herein, including ONJ, will enhance economic development while maintaining affordable rates, and will provide diversity in the supply of telecommunications services and products. There is no question that a ubiquitous broadband public switched network will create opportunities for new products such as video on demand. This will, in turn, provide opportunities for new service providers to offer their products utilizing the transmission capabilities on NJ Bell's advanced network. Indeed, the Board notes that the FCC likewise has found that video dialtone will advance the FCC's overarching goals, which include enhancing the diversity of video services to the public. In the Matter of Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58, CC Docket No. 87-266; Second Report and Order, Recommendations to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781, 5787 (August 14, 1992). It is important that competitors be able to purchase elements of service from NJ Bell in reasonable increments that allow uninhibited access to the network by competitors. Thus, ONJ, coupled with unbundling and the nondiscriminatory requirements of the Act and this Decision and Order, will promote diversity in telecommunications products and services and will encourage the maximum efficiencies of the public switched network.

The Board agrees with Staff that a drastic deviation from the ONJ schedule submitted by NJ Bell will have a direct and likely negative impact on the level of economic development. Therefore, the Board will monitor the impact of the plan and ONJ on economic development and will require NJ Bell to furnish information in its annual Infrastructure Deployment report showing how and to what extent the plan and ONJ positively impact the New Jersey economy. NJ Bell shall be required to meet or exceed the schedules set forth in ONJ. If projections on the availability of technology necessary to implement ONJ are overly optimistic and NJ Bell's deployment slips significantly beyond forecasted levels, the Board reserves the right to commence a proceeding and examine key aspects of the plan to ensure that NJ Bell does not receive the benefits of an alternative form of regulation without at the same time fulfilling its obligations. In the event that NJ Bell cannot perform its obligations as set forth in ONJ, the Board shall consider remedies such as altering the depreciation allowances for NJ Bell, restructuring NJ Bell's ability to implement indexed price increases, or, in the extreme scenario, voiding the plan and instituting a traditional base rate proceeding. The Board also reserves the right to seek a further acceleration of the benefits of ONJ if the technology and/or costs of actual deployment become more advantageous than projected. Furthermore, the Board recognizes that NJ Bell's acceleration of the deployment of full broadband capability extends beyond the term of the plan. The Board's approval of the plan as modified herein is conditioned upon a commitment by NJ Bell to achieve ONJ in its entirety, including full broadband capability by the year 2010. The Board MODIFIES the plan to expressly include ONJ in its entirety. In this way, the Board can ensure that NJ Bell will provide the advanced network promised under ONJ and that the positive implications will be realized by the citizens of the State of New Jersey.

Finally, the Board also notes with regard to MCI's contentions regarding competitive entry and altering the existing ban on intraLATA competition, that, as anticipated in its Prehearing Order, a petition has been filed by an IXC, Sprint, which seeks authority to provide intraLATA facilities - based telecommunications services and to eliminate existing intraLATA compensation requirements in New Jersey. In the Matter of the Petition of Sprint Communications Company, L.P. for the Elimination of IntraLATA Compensation Payments and Authorization of IntraLATA Competition, Docket No. TE92111047 (filed November 9, 1992). The Board also notes that subsequent to consideration of the within matter at the Board's December 22, 1992 agenda meeting, the Superior Court of New Jersey, Appellate Division rendered a decision in In the Matter of the Petition of MCI Telecommunications Corp. for Authorization of IntraLATA Competition and Approval of Certain Tariffs, Docket No. A-5723-89T1 (February 1, 1993), reversing a May 22, 1990 Board Decision and Order and remanding the matter to the Board for a hearing on the issues raised by a petition by MCI to allow intraLATA competition. Thus, the issue of whether to authorize intraLATA competition will be considered by the Board in another proceeding or proceedings.

E. WILL THE PLAN NOT UNDULY OR UNREASONABLY PREJUDICE OR DISADVANTAGE PROVIDERS OF COMPETITIVE SERVICES?

N.J.S.A. 48:2-21.18(a)(3) requires the Board to consider whether a plan for an alternative form of regulation will unduly or unreasonably prejudice or disadvantage providers of competitive services. N.J.S.A. 48:2-21.18(c) prohibits a local exchange telecommunications company from using revenues earned or expenses incurred in conjunction with noncompetitive services to subsidize competitive services. The Act also allows for Board monitoring to assure that proper allocation procedures are employed by LECs. N.J.S.A. 48:2-21.18(d). Thus, the Board's Prehearing Order also identified as issues to be considered in reviewing NJ Bell's plan:

1. Does the plan incorporate sufficient safeguards to prevent revenues earned or expenses incurred in conjunction with noncompetitive services from subsidizing competitive services as prohibited by N.J.S.A. 48:2-21.18(c)? and

2. Does the plan incorporate sufficient and understandable reporting requirements to enable the monitoring and review of any cross-subsidization?

Beyond the eight criteria and cross-subsidization prohibition in N.J.S.A. 48:2-21.18, the Telecommunications Act of 1992 also contains safeguards which apply to the offering of any competitive service by a local exchange telecommunications company. N.J.S.A. 48:2-21.19(e)(1) requires local exchange telecommunications companies providing competitive services to unbundle each noncompetitive service, which is part of a competitive offering, and to offer it to any customer under tariffed terms and conditions, including price, that are identical to those used by the local exchange telecommunications company in providing its competitive service. N.J.S.A. 48:2-21.19(e)(2) further provides that the rate which a local exchange telecommunications company charges for a competitive service shall exceed the rates charged to others for any noncompetitive services used by the local exchange telecommunications company to provide the competitive service. Thus, the Prehearing Order also identified the following issue for review and determination in this proceeding:

3. Does the plan include compliance with all of the safeguards set forth in N.J.S.A. 48:2-21.19(e), including the unbundling of each noncompetitive service which is incorporated in any competitive service and the separate availability of such noncompetitive service to any customer under tariffed terms and conditions, including price, that are identical to those used by NJ Bell in providing its competitive service?

The Board finds that the above three issues are so interrelated with the Board's consideration of whether the plan will unduly or unreasonably prejudice or disadvantage providers of competitive services that these issues must be considered and addressed together. The Board will first address arguments primarily pertaining to structural and non-structural safeguards and then the issues of imputation, attribution and unbundling.

Non-structural v. structural safeguards

In its plan, NJ Bell indicates that various safeguards have been included to ensure that NJ Bell ratepayers will not bear any of the costs of the competitive services and that NJ Bell's competitors will have access to NJ Bell's network services on the same terms and conditions as NJ Bell (Plan, §III). To show that cross-subsidization between competitive and noncompetitive services does not exist, NJ Bell proposes reporting requirements, which it submits will enable the Board to identify any instances of, or potential for, cross-subsidization. Under the Safeguards section of its plan for an alternative form of regulation, NJ Bell would continue to provide the annual EAS Report (Plan §III(D)). In addition, cost allocation data would be filed to support any proposals to make a service competitive, which would be consistent with the methodology approved by the Board in its June 22, 1987 and January 19, 1989 Orders in the RSP proceeding in Docket No. TO87050398, using the three existing costing methods: fully distributed costs (FDC), embedded and direct costs (Plan, §III(D)). The plan also specifies in the Reporting Requirements section, that NJ Bell will continue to file with the Board quarterly financial monitoring reports for NJ Bell's rate regulated services in a form consistent with the methodology approved by the Board in Docket No. TO87050398 (Plan, §IV(A)).

NJ Bell maintains that by utilizing the EAS cost accounting system, the Board can ensure that noncompetitive products and services are not financially supporting competitive products and services (NJBb15). NJ Bell notes in its brief that it will continue to provide direct cost reports through the term of the plan, in addition to embedded and fully distributed reports, and that the Board can not only review fully distributed cost results but can review incremental costs of individual services as an additional check against cross-subsidization (NJBb14-NJBb15). NJ Bell asserts that the EAS reporting has worked effectively in appropriately allocating costs between its competitive and rate regulated services for the last five years, during which time it has been actively monitored by Board Staff (NJBrb64 to NJBrb65). In addition, NJ Bell's rebuttal witness Taylor performed a review of EAS Level II documentation and concluded that it is adequate to assess whether the allocations that distribute costs are suitably related to the costs being apportioned. NJ Bell contends that an outside audit of the EAS is an unnecessary and burdensome requirement not required by the Act and that regular Board Staff reviews of the EAS can achieve the same purpose (P-60, at 4-5; NJBrb65 n.279).

NJ Bell further argues that it has a "working and reliable method for detecting cross-subsidization in the EAS system," under which it has offered competitive and noncompetitive services since 1987, and no party to this proceeding has demonstrated cross-subsidization (NJBrb66). Accordingly, NJ Bell contends that the NJ Press Association's "claims that the Act's mandate against cross-subsidization can only viably be met by the imposition of a requirement for a divested subsidiary are without support in the record and lack merit" (NJBrb66 to NJBrb67). NJ Bell notes that the FCC in <u>In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards (Computer III Remand)</u>, CC Docket No. 90-623, Report and Order, 6 <u>FCC</u> <u>Rcd</u> 7571 (Dec. 20, 1991), reaffirmed its determination that separate subsidiary requirements for enhanced services[11] are not in the public interest and should be eliminated. "We conclude that permitting the BOCs to participate in the enhanced services industry pursuant to [non-structural] safeguards will not result in significant public interest costs. The benefits in contrast, are substantial and lead us to conclude that on

---

11 "Enhanced services" is defined by 47 <u>C.F.R</u>. §64.702(a) as:

> services offered over common carrier transmission facilities used in interstate communications, which employ computer processing applications that act on the format, content, code, protocol or similar aspects of the subscriber's transmitted information; provide the subscriber additional, different or restructured information; or involve subscriber interaction with stored information.

balance, the public interest is better served by eliminating the structural separation requirement" (Id. at 7617; NJBrb65 to NJBrb66 n.284). Furthermore, NJ Bell notes that the FCC found that "state requirements for separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services would thwart our objectives, and therefore preempt such requirements" (Computer III Remand, at 7632; NJBrb66 n.284).

NJ Bell disputes positions taken by Rate Counsel, the NJCTA and MCI that its plan should be rejected because of how the Company handles its internal directory operations and revenues. Specifically, NJ Bell takes issue with the parties' contentions that the plan violates the Act because: (1) it does not provide subscriber listing and credit information to competitors on a tariffed basis; (2) they believe NJ Bell unreasonably discriminates or disadvantages its directory competitors in the way the Company provides them subscriber information; and (3) they believe NJ Bell's directory operations unit does not pay the Company's rate regulated side of the business the "market" price for the services it receives from NJ Bell's telephone operations.

NJ Bell argues that the Act does not require it to provide subscriber listing and credit information to others under tariff (NJBrb 35 to NJBrb37). NJ Bell's position is predicated on its belief that neither subscriber listing nor credit information are public utility services subject to the Board's regulation, just like NJ Bell's provision of leasing of real estate, payroll and accounting and human resources counseling, which also are provided to its directory operations, are not utility services (NJBrb36). As support for this view, NJ Bell cites to the Board's ruling in Donnelly Directory v. New Jersey Bell Telephone Company, In the Matter of the Board's Inquiry into Yellow Pages Advertising (Donnelly), Docket No. TC87080798 (December 15, 1988), that the Donnelley complaint, which is substantially similar to arguments raised herein, failed to state a claim under New Jersey public utility law upon which relief could be granted.

Regarding the issue of undue discrimination in the provision of subscriber listing information, NJ Bell points to the fact that none of its directory publishing competitors has attempted to intervene in this proceeding nor to raise this issue (NJBrb39). NJ Bell further asserts that it licenses subscriber information, including name, address, telephone number and primary heading information, to competing directory providers and makes the information available to competitors within one to five business days later than to its own publishing operations, and it thus does not discriminate against competitors (NJBrb39 to NJBrb40).

In further opposition to arguments that it unduly discriminates against competing directory publishers by providing itself daily access to subscriber listing information while limiting others to weekly data under licensing agreements, and that NJ Bell's directory operations do not pay the market value for services it receives from the Company's telephone operations, NJ Bell points out that $116 million in Yellow Pages revenue is embedded in today's basic rates. It maintains that the $116 million constitutes a "rent subsidy" or transfer of intangible assets from Yellow Pages to basic services (NJBrb43 to NJBrb44).

Rate Counsel believes that the EAS reports are not sufficient to prevent cross-subsidization of competitive services (RCT-8, at 6; RCb36; RCb64). It contends that EAS reports do not enable tracing of both revenues and costs to every service. In Rate Counsel's view, NJ Bell's annual EAS reports are inconvenient to use because they do not identify whether the listed services are Group I, Group II, or other and cross-subsidization of competitive services is difficult to detect. It asserts that there are no absolute safeguards for detecting or preventing cross-subsidization, other than a separate subsidiary (RCT-8, at 7). While Rate Counsel claims annual EAS reports are inadequate for monitoring cross-subsidization, it argues it has found strong support indicating the existence of cross-subsidization using the annual EAS reports (RCT-8, at 40).

Rate Counsel agrees that to the extent that cross-subsidization of a Group I service leads to unusually high profit rates, compared to similar competitive services offered by other companies, the EAS reports can be used to detect cross-subsidization. However, Rate Counsel witness Stephen Siwek maintains there are many subtle ways to carry out cross-subsidization, and cross-subsidization may occur without producing unusually high profit rates. He aserts that because telecommunications companies are complicated businesses, and Group I Directory Services have many joint and common costs with Group II services these circumstances make it difficult to distinguish beteeen costs incurred for competitive services and costs incurred for noncompetitive services. For these reasons, the annual EAS report is inadequate for monitoring cross-subsidization in Siwek's view (RCT-8, at 42).

Rate Counsel alleges that competitors will be prejudiced and disadvantaged by the plan (RCb64 to RCb70; RCb83 to RCb92). With regard to broadband deployment, Rate Counsel argues that although NJ Bell claims to be taking a risk in investing in the acceleration of this advanced technology, it is actually achieving "supra-competitive" returns on its total operations, including this investment. It also asserts that once broadband is in place, based on Rate Counsel's review of its projections, NJ Bell "appears to be charging prices too low to provide for an adequate return on the accelerated investment" and once the broadband network is in place and the Company is permitted to use pricing methodologies that look to incremental rather than fixed costs, prices can be lowered even further to the disadvantage of competitors (RCb66).

Rate Counsel also contends that the plan unreasonably disadvantages providers of competitive directory services because they are allegedly not provided access to subscriber listing or credit information on the same terms and conditions as NJ Bell's Yellow Pages (RCb66). Although competitors receive subscriber listing information, Rate Counsel argues that it is on less favorable terms and conditions (RCb67 to Rcb70) and because NJ Bell does not propose to sell credit information to its competitors (RCb66, citing RC-9; RCb70), its competitors are disadvantaged (RCb67 to RCb70). Rate Counsel further argues that subscriber listing information and credit information are noncompetitive services (RCb84). To prevent cross-subsidization of Yellow Pages, Rate Counsel argues that the Board must regulate products and services, i.e., subscriber and credit information, created by Group II and used by Yellow Pages (RCb88). Because NJ Bell does not propose to charge the market value of subscriber listing and credit information to Yellow Pages, the plan, in Rate Counsel's view, fails to satisfy the Act's anti-subsidy safeguard (RCb88 to RCb90; RCrb17 to RCrb19).

The NJCTA contends that the only way to prevent cross-subsidization is through the structural separation of entities providing monopoly utility services and those providing non-monopoly services (NJCTAb3). The NJCTA further argues that it was impossible to establish whether the EAS is reasonable and that, except for NJ Bell's witness Taylor, who it asserts was given "extra support," those experts who sought to review the EAS had great difficulty understanding what the Company was doing and why (NJCTArb33; NJCTArb38; NJCTArb39). The NJCTA submits that there is no assurance that the EAS can be used to detect cross-subsidization (NJCTArb38; NJCTArb39). Moreover, the NJCTA asserts that outside independent auditors could not be delegated responsibility to develop underlying procedures and allocation philosophy (NJCTArb32; NJCTArb36 to NJCTArb37).

The NJCTA also presents arguments specifically related to Yellow Pages (NJCTAb103 to NJCTAb115). Essentially, it argues that Yellow Pages is a noncompetitive service but even assuming that it is competitive, Yellow Pages must compensate NJ Bell ratepayers for the benefits provided to it by regulated monopoly telephone service in order to comply with the Act's prohibition against cross-subsidization and its requirement of just and reasonable rates (NJCTAb103; NJCTAb109; NJCTAb115). It disputes NJ Bell witness Willig's claim that NJ Bell customers have been compensated for these benefits through the RSP's freezing of rates (NJCTAb112). Furthermore, its asserts that NJ Bell must offer its competitors equal access to subscriber information (NJCTAb106).

The NJCTA also contends that the differential in franchise lengths of LECs and cable television (CATV) operators gives NJ Bell an advantage over its competitors. Stating that the typical LEC franchise is for 50 years while the typical CATV franchise is 10 years or less, it argues that the longer franchise length granted to LECs "results [in] an undue preference that prejudices and disadvantages CATV's ability to compete, and is therefore in violation of N.J.S.A. 48:2-21.18" (NJCTAb82). It argues that as a prerequisite to determining any service as being competitive under the Act, the Board must equalize the franchise lengths between LECs and CATV operators (Ibid). As additional prerequisites, it argues that the Board must eliminate barriers to competition in noncompetitive and protected services and impose structural separation (NJCTAb82).

MCI criticizes the EAS as having been created in secret, not being generally available to interested parties except under "onerous" protective agreements, and never having been subjected to an independent audit (MCIb52 to MCIb53). MCI argues that the EAS is unreliable as a policing agent against cross-subsidization (MCIb31) and that NJ Bell's 1991 annual EAS report showed that revenues earned from the majority of competitive services were below their costs (MCIb32). While NJ Bell's witness Doherty explained that the fact that a particular competitive service is priced under cost is evidence of cross-subsidization only were this relationship to occur under the Company's incremental or direct cost study, and while MCI concedes that this argument may be correct in theory, it argues that it is inconsistent with the plan's reference solely to the EAS, not the direct cost study, as ensuring against cross-subsidization (MCIb32; MCIrb11). Additionally, MCI contends that while Group I services reflect that total revenues exceed total costs, it is possible that Group II services have contributed to Group I competitive services, and there is no way to trace the allocation of positive contribution under the Company's own analysis (MCIb33 to MCIb34). MCI further alleges that, in fact, Group I services as a whole cover the costs assigned to them solely because of Yellow Pages earnings and "it provides no comfort to New Jersey Bell's competitors to know that revenues from Yellow Pages will be used to ensure that New Jersey Bell's competitive services cover their costs when those competitors must cover their costs using only revenues from the service in question" (MCIb34; MCI-T-1, at 36). MCI further contends that the reliance on Yellow Pages revenues to show a lack of cross-subsidization is insufficient because it alleges Yellow Pages operations use and benefit from its affiliation with NJ Bell's local exchange services (MCIb35). While MCI recognizes that the rates set in 1985 included a contribution from Yellow Pages earnings, it contends there is no provision for Group II services to receive any of those earnings under the plan (MCIb36; MCIb68), and that in calculating earnings for sharing purposes, Group II ratepayers will not be credited with Yellow Pages earnings, thereby resulting in Group II ratepayers subsidizing Yellow Pages operations (MCIb36; MCIb68). MCI recommends that Group II earnings be credited with all or a portion of NJ Bell's Yellow Pages earnings (MCIb67). Finally, MCI urges that the Board require an audit of the EAS in accordance with N.J.S.A. 48:2-21.18(d)(MCIb68 to MCIb70; MCIrb17).

The NJ Press Association contends in testimony and briefs that the presently constituted EAS is not an effective deterent to cross-subsidization (NJPAb2 to NJPAb6; NJPArb5 to NJPArb9) and that any cost allocation system by its nature involves the exercise of accounting judgment and hence cannot ensure no cross-subsidization will occur (NJPAb3; NJPArb8). Therefore, it argues that "only the imposition of, at minimum, a requirement that a divested subsidiary, without sharing of personnel and plant, can viably meet this mandate against cross-subsidization - especially within the informational field which carries with it the importance of the constitutional mandates for survival of a 'free press'" (NJPAb3; NJPAb9; NJPArb4; NJPArb11; NJPA-T-2, at 6).

The CWA alleges that the plan requires ratepayers to "underwrite" NJ Bell's investment in competitive services (CWAb26). Its witness Rafferty also testified that the plan allows the directory advertising operation to obtain free use of NJ Bell assets and services, including binding with white pages, daily access to the database, order entry and billing (CWAT-1, at 5, 8-9).

AT&T submits that adoption and enforcement of the consumer and competitive safeguards proposed by NJ Bell will help to ensure that monopoly services are offered to all competitors on an equal basis, that NJ Bell's noncompetitive services do not subsidize competitive services and that NJ Bell's competitors have access to NJ Bell's network services under the same terms and conditions as NJ Bell (AT&Tb5 to AT&Tb6). AT&T urges the Board to enforce and monitor the operation of the safeguards (AT&Tb6). With regard to cross-subsidization, AT&T contends, based on its witness Schell's testimony, that appropriate cost allocation is necessary to ensure that noncompetitive services do not subsidize competitive services (AT&Tb10).

Board Staff notes that it reviews the annual and quarterly EAS results for changes, trends, etc. and performs a deviation analysis of all accounts. Any account that varies more than five percent (5%) on a quarter to quarter or annual basis is identified for further study and examined by Board Staff. As part of the EAS reporting process, NJ Bell is required to inform Board Staff of any major changes in underlying studies or accounting treatment (STb127). However, based upon its consideration of arguments presented regarding the adequacy of cross-subsidization safeguards, Staff submits that a review of the EAS process by an outside firm is appropriate due to the time that has elapsed since the adoption of the EAS as a safeguard. In Staff's view, going forward, new technology applications and the impact on cost allocation management and reporting systems should be adequately reassessed to assure that the EAS continues to effectively serve its purpose (STb127). Staff therefore, recommends an independent auditor should be assigned this function with the cooperation of Staff to track all cost, investment, expenses and revenue accounting from the origin of these quantities to their destination as EAS reporting results.

Staff submits that this will provide a quantitative analysis and recommendations for any changes where policy involvement may be required to ensure a fair and reasonable allocation of resources between competitive and utility services (STb127 to STb128).

As to arguments for the establishment of a separate subsidiary for the provision of competitive services, in Staff's view, this is an unnecessary burden and will impose unnecessary costs (STrb32). Further, Staff notes that the FCC has considered the issue of requiring BOCs to provide enhanced services through separate corporate subsidiaries. In Computer III Remand, the FCC removed structural separations requirements for the provision of enhanced services, indicating that its "experience with structural separation shows that it inhibits BOC provision of enhanced services." Id. at 7575. The FCC also preempted state requirements which would impose structural separation on the provision of jurisdictionally mixed (intrastate/interstate) enhanced services of BOCs and indicated that many, if not most, BOC enhanced services are "likely to be jurisdictionally mixed in nature." Id. at 7631. Given the potential costs of separate subsidiaries and the fact that such a requirement could not apply to services with both intrastate and interstate characteristics, Staff submits that a structural separation requirement is not a viable option (STrb33).

After careful review of the record and arguments on this issue, the Board FINDS that the EAS is an appropriate non-structural safeguard to ensure that the costs of NJ Bell are properly allocated and to ensure that cross-subsidization does not occur. The system allocates competitive service costs and revenues in such a manner so as to explicitly identify those costs on a separated basis. The EAS is a cost allocation system now used by the Board to monitor NJ Bell's earnings for surveillance purposes under the Rate Stability Plan. Its existing application resulted from a contested phase of the RSP proceeding in Docket No. TO87050398, in which NJ Bell, Staff and Rate Counsel participated. See NJCTA-1/0101; P-60, Attachment 2. Thus, MCI's contention that the EAS is a "secret" model is unfounded. MCI's characterization that information concerning the EAS is "not generally available to interested parties except under onerous secrecy agreements" is misleading. The EAS contains detailed cost and revenue information for competitive services supplied by NJ Bell. It is not unreasonable for NJ Bell to seek appropriate protection of sensitive financial information before its disclosure to competitors.

The annual EAS report identifies and allocates all of the Company's costs, including all overhead costs, among all of the Company's services including not only directly assigned costs, but appropriate indirect costs as well (S-1, at 16). The basic approach used in the annual EAS is to allocate or assign all possible investment and expense accounts (revenues are directly assigned) to the individual service categories and then to separate them between intrastate and interstate. The method used in the study allocates joint intrastate/interstate service categories (e.g., Centrex) in an identical manner (Ibid.). The quarterly EAS category specific report includes the investment, expenses and revenues of NJ Bell's Group I, Group II and regulated interstate services, and excludes all other services while the annual EAS study includes total Company results. The investment, expenses and revenues of the services excluded in the quarterly EAS category specific report are directly assigned in the annual EAS study using FCC cost allocation requirements. Ibid. See also, 47 C.F.R. §64.901.

Each method of cost allocation in the reports submitted pursuant to the Board's RSP Order (Direct, Embedded, FDC) is designed to provide costing information on a separate basis (S-1, at 16). Direct unit costs for each of the Group I services are developed using the investment and associated operating expenses produced from an incremental cost study. The results are converted as necessary from a total company basis to an intrastate basis. The unit investment and associated operating expenses are multiplied by the specified quarterly demand. Depreciation and taxes are then calculated resulting in total direct cost for the Group I services (Id. at 15). Embedded costs are historical accounting costs assigned to categories of service, both Group I and Group II, on a "top-down" method, using a set of allocation rules that directly assign costs to the greatest extent possible. Embedded studies have a common cost category which is not assigned to any service. The common category includes corporate overheads such as executive, legal treasury, and medical. Embedded studies, including the common category, balance to the corporate books (Ibid.). Fully distributed costs (FDC) are identical to embedded costs except the common cost category is distributed to categories of service, using a set of cost allocation rules (Ibid.).

In general, expenses and investments assigned to the Common category are allocated to other service categories using a "cost-on-cost" methodology. This method allocates common costs to the various services proportionately to the costs already assigned to the service categories. In the few cases where 100% of the account has been assigned to the Common category (e.g., Executive and Planning), the distribution of total operation expense is used to allocate common costs among the other service categories (Id. at 17).

As stated by NJ Bell witness Taylor:

> The cost accounting process used in the EAS, which assigns costs from the books of account to cost pools and ultimately to service categories, is fundamentally the same process used by many firms for management, monitoring, and decision making. This process, i.e., distributing costs in the books of account to products and services on the basis of assignment and application rules, has been an

> established cost management practice since the 1920s and is documented throughout the cost accounting literature. These cost distribution principles form the basis of the development of algorithms and resulting cost assignment factors in the EAS. [P-60, at 2]

Taylor further testified that it is possible to review the allocation logic of the EAS in order to determine that the logic is reasonable and that she, in fact, conducted such a review (P-60, at 4). The review used the overview documentation (Level II) and included a review of results, underlying algorithms, input files and special studies. As described by Taylor, included were the following procedures:

> Development of a summary flowchart of the process and documentation, and identification of the key procedures and controls used to ensure the reasonableness of the results;
>
> Review of the Level II documentation to assess its compliance with Board requirements;
>
> Assessment of the potential for utilizing automated test facilities to enhance controls and review; and
>
> Review of selected cost and revenue assignments to confirm [her] understanding of the system processes and documentation and also to confirm that reasonable oversight can be applied to the EAS process. Assignments were traced back to source inputs; calculations were verified for conformance with the Level II documentation. [P-60, at 4]

Based upon her analysis, Taylor testified that the EAS overview documentation can be used to understand the resources of the Company used to provide a service. The overview describes the costs that appear in the accounts through the EAS process and identifies the apportionment bases that are used. She found the EAS input file is comprehensive and can be reviewed and verified, and therefore, a reviewer is equipped to assess whether the allocations that distribute those costs are suitably related to the cost being distributed (P-60, at 4). In her opinion, therefore, the EAS is "not too complex or obtuse to preclude adequate oversight review" (P-60, at 5).

The Board concurs with the foregoing analysis of Taylor, a principle in the firm of Price Waterhouse and the head of its Telecommunications Carrier industry practice, whose testimony the Board finds to be credible. Her testimony confirms the validity of this Board's use of the EAS system, and the Board FINDS that the EAS is an appropriate non-structural safeguard to ensure the costs of NJ Bell are properly allocated and to ensure that cross-subsidizations do not occur. While it is clear from the plan's Safeguards (§III(D)) and Reporting Requirements (§IV) provisions that NJ Bell will continue to file all reports presently filed pursuant to the Board's RSP Orders in Docket No. TO87050398, the Safeguards provision (§III(D)) refers only to the annual report being filed, except with regard to filings to make a service competitive. The Board FINDS that §III(D) should be modified to expressly include as a safeguard the filing of all quarterly reports presently filed utilizing the direct, embedded and fully distributed methodologies. Furthermore, in order that the Board and parties will have further assurance that costs are allocated properly on a going-forward basis, the Board HEREBY ORDERS an operations review of NJ Bell's EAS Categorgy Study for 1992, which is due to be filed with the Board on or about August 1, 1993. The Board will continue the use of the present system subject to any modifications which come to light as a result of the operations review. Any changes in EAS allocators as a result of the operations review shall not be viewed as an exogenous event. The Board also FINDS that the submission of quarterly financial monitoring reports, which provide the intrastate return on equity for NJ Bell's rate regulated services for the most recent four quarters available, are a sufficient and understandable reporting requirement to ensure that earnings are properly reviewable. The operations review of the EAS study on a going forward basis, combined with the annual and triennial reviews of NJ Bell's depreciation rates and adjustments, will provide further assurance of the sufficiency in reporting of NJ Bell's earnings. The Board MODIFIES the plan to incorporate the modifications described herein.

In finding that the EAS is a reasonable mechanism to prevent cross-subsidization, the Board FINDS it unnecessary, at this time, to order structural safeguards. As Staff observes, the FCC has considered the issue of structural and non-structural requirements. After initially favoring and ordering structural requirements (See, Computer III Remand, at 7572-7573), the FCC found from its experience that structural separation requirements inhibited BOCs' provision of enhanced services. Structural separation was found by the FCC to prevent "BOCs from using their existing substantial resources to provide enhanced services, requiring instead separation and/or duplication of facilities and personnel to provide both enhanced and basic services. It imposes direct monetary costs, and results in loss of efficiencies and economies of scope." Id. at 7575. In contrast, it found that "removal of structural separation requirements has resulted and will result in greater BOC participation in the provision of enhanced services" because it enables operational efficiencies, economies of scope and cost saving and that a comprehensive system of cost accounting safeguards effectively protects against cross-subsidization. Id. at 7575, 7591, 7594-7595, 7617-7619. The FCC found that as compared with structural separation, non-structural safeguards benefit basic service ratepayers because, through the allocation of costs, some savings resulting from the integrated provision of basic and enhanced services contribute towards general overhead costs of the basic service operations, which would not occur with structural separation. Id. at 7621-7622 n.209. Furthermore, the FCC also observed that structural separation imposes certain administrative burdens and hence rejected contentions that herein administrative burdens imposed by non-structural safeguards requires the imposition of structural safeguards. Id. at 7632. Instead, it found no significant administrative advantages to structural separations. Id. at 7622.

It also is noteworthy that the FCC found that LEC price cap regulation "is a significant regulatory development...that reduces BOC incentives to cross-subsidize enhanced services with basic services." Id. at 7596. As the FCC explained:

> Under rate-of-return regulation, a regulated carrier is entitled to charge basic service rates that reflect regulated costs plus a reasonable rate of return on investment. As a practical matter, misallocation of nonregulated costs to regulated operations under rate-of-return regulation increases a carrier's regulated costs and therefore permits higher regulated rates to recover the improperly allocated nonregulated costs. By contrast, because price cap regulation severs the direct link between regulated costs and prices, a carrier is not able automatically to recoup misallocated non-regulated costs by raising basic services rates, thus reducing the incentive for the BOCs to shift non-regulated costs to regulated services. [Id. at 7596]

The view that increased use of incentive regulation of LECs by the FCC, as well as the states, decreases incentives to cross-subsidize also has been expressed by the NTIA (P-42, at 233 n.834).

Moreover, the FCC has preempted "state requirements for structural separation of facilities and personnel used to provide the intrastate portion of jurisdictionally mixed enhanced services," because, in the FCC's view, such state requirements would thwart or impede the non-structural safeguards pursuant to which carriers may provide interstate enhanced services and the federal goals that they are intended to achieve. Computer III Remand, at 7631-7635. While the FCC has not preempted state structural separation requirements that apply to purely intrastate enhanced services, the FCC recognized that many, if not most, enhanced services are likely to be jurisdictionally mixed in nature.[12] Id. at 7632.

---

12 The FCC rejected arguments that BOCs do not provide interstate enhanced services because of the interexchange restriction of the Modification of Final Judgment (MFJ),

The Board also notes that the FCC, in authorizing LECs to provide video dialtone services, whereby they may make available to multiple service providers, on a nondiscriminatory common carrier basis, a basic platform that will deliver video programming and other services to end users, concluded that its current safeguards designed to prevent cross-subsidization would fully apply to the provision of video dialtone services. It clarified, however, that it would impose additional safeguards tailored to specific video dialtone proposals in the Section 214 (47 U.S.C.A. §214) certification process, if necessary, and, "in recognition of the evolutionary nature of technology and the nascent status of services which could be offered by the local telephone companies and others in conection with video dialtone," would implement a review of its video dialtone regulatory framework beginning in three years to reassess its rules and determine if additional safeguards or other changes may be necessary. In the Matter of Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58, CC Docket No. 87-266, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781, 5823, 5827-5832 (August 14, 1992). The FCC also determined to recommend to Congress that it amend the Cable Communications Policy Act of 1984, 47 U.S.C.A. §521 et seq. to remove the telephone cable cross-ownership ban (47 U.S.C.A. §533) so as to permit local telephone companies to provide video programming directly to subscribers in their telephone service areas, subject to appropriate safeguards. 7 FCC Rcd at 5847. In the event that Congress removes the statutory telephone company - cable television cross-ownership restrictions so as to authorize local telephone companies to provide video programming directly, the FCC has indicated it will, as it did with regard to enhanced services, "carefully balance the costs and benefits of telephone company provision of video programming pursuant to structural separation and nonstructural safeguards," and it indicated further that it "anticipate[s] imposing structural separation for these and potentially other activities encompassed within provision of video programming unless [its] public interest balancing shows significant benefits for telephone company

---

(Footnote 12 continued from previous page)
United States v. AT&T, 522 F.Supp. 131 (D.D.C. 1982), aff'd sub nom Maryland v. United States, 460 U.S. 1001, 103 S.Ct. 1240, 75 L.Ed. 2d 472 (1983), explaining that intraLATA services may be interstate either because the service is transmitted by the BOC across state lines or because the service is part of a communication or service transmitted across state lines and that the FCC has jurisdiction over physically intrastate facilities and services used to provide interstate services. Computer III Remand, at 7663 n.249.

involvement in these activities on an integrated basis with basic communications services." 7 FCC Rcd at 5847, 5850.

The contention that approval of NJ Bell's plan must be conditioned upon a requirement for the establishment of completely divested subsidiaries that do not share plant or personnel with the regulated company presents serious questions as to preemption by the FCC of the Board's jurisdiction to order structural safeguards for at least certain services. The Board FINDS that the non-structural safeguards incorporated in the plan, as modified herein, are appropriate safeguards, and a requirement for fully separate subsidiaries is not necessary at this time. The Board retains the right to monitor and review the continued use and effectiveness of non-structural safeguards and to consider the impacts of any changes in the law upon the effectiveness and appropriateness of the safeguards approved herein. The Board reserves the right to consider, and impose to the extent permitted by law, other safeguards, such as fully separate subsidiaries, if this subsequently appears necessary.

As noted above, NJ Bell's petition was considered by the Board at its December 22, 1992 agenda meeting. At that time, the Board determined that non-structural safeguards provide effective safeguards against cross-subsidization and that fully separate subsidiaries would not be required at this time. However, Commissioner O'Connor expressed the hope that the NJ Press Association and NJ Bell would continue to review this issue and attempt to reach an agreement in the future (12/22/92T52). Prior to issuance of this written Decision and Order, NJ Bell and the NJ Press Association, by letter dated March 23, 1993, filed a proposed modification to NJ Bell's plan, which would add a §III(J), encaptioned "Separate Entity for Electronic Publishing," to the plan's enumerated safeguards.

The proposed modification would prohibit NJ Bell from engaging in electronic publishing except through a corporate affiliate. The separate corporate affiliate would be prohibited from having directors, officers, employees, property or facilities in common with NJ Bell or any subsidiaries of or other entities controlled by NJ Bell, except that the separate corporate affiliate could obtain facilities, services or information from NJ Bell or any subsidiaries of or other entities controlled by NJ Bell if they are made available on the same terms and conditions to all. "Electronic publishing" is defined for purposes of the modification as meaning the dissemination, provision, publication or sale, using NJ Bell's telecommunications network, of information of a type published, or reasonably foreseeable to be published, by newspapers via any media. "Electronic publishing" expressly does not include, among other things, the transmission of information as a common carrier for unaffiliated persons, protocol conversion, language translation, and conversion data from one format to another.

Following service of the proposed modification upon other counsel of record and notice that the Board would consider the proposed modification at its April 14, 1993 agenda meeting, the NJCTA and MCI filed letters with regard thereto, and NJ Bell filed a response to the NJCTA's letter.

The NJCTA states that while it "does not oppose the establishment of a separate subsidiary as proposed by New Jersey Bell and the Press Association, without a proper motion having been filed, the NJCTA is deprived of the opportunity to analyze the rationale supporting the agreement" (Letter of NJCTA, dated April 8, 1993, at 2). It is NJCTA's position that separate subsidiaries should be required by the Board for all services provided by NJ Bell beyond the provision of basic telephone service. The NJCTA requests that consideration of the proposed modification be deferred until a motion with supporting affidavits is filed and other parties have had an opportunity to respond and propose additional modifications with respect to other services. If the Board regards NJ Bell's March 23, 1993 letter as itself constituting a motion, the NJCTA requests that the matter be set down for hearing and that supporting affidavits be required and responses thereto be permitted.

MCI indicates it has no objection to the proposed modification but "urges the Board to recognize that a separate subsidiary requirement...may be appropriate for other unregulated activities undertaken by New Jersey Bell and that this modification...should not preclude the Board from imposing such a requirement in the future" (Letter of MCI, dated April 12, 1993, at 2). It requests the Board to confirm that approval of the separate subsidiary agreed to by NJ Bell and the NJ Press Association "may be extended to other activities in the future, and should in no event be interpreted as precluding similar arrangements for other competitive activities to be undertaken by New Jersey Bell" (Ibid.).

In response to the NJCTA, NJ Bell submits that the subject of structural and non-structural safeguards to prevent cross-subsidization of competitive services by rate regulated services was fully litigated during this proceeding, and the NJ Press Association specifically argued for a separate entity requirement for NJ Bell to be permitted to engage in electronic publishing. All parties had the opportunity to submit evidence on this subject and to cross-examine witnesses concerning cross-subsidy safeguards generally or any specific separate subsidiary proposals. NJ Bell argues that in its oral decision on December 22, 1992, the Board found that a separate subsidiary requirement is not necessary for the provision of competitive services; however, the NJ Press Association and NJ Bell were encouraged to attempt to reach an agreement in the future. NJ Bell states that notwithstanding the Board's ruling that the EAS is an appropriate non-structural safeguard to ensure that cross-subsidization does not occur and that a requirement for fully separate subsidiaries is not necessary at this time, NJ Bell and the NJ Press Association have reached a consensus and NJ Bell has voluntarily agreed to a separate entity requirement for electronic publishing. NJ Bell submits that although the proposed separate entity for electronic publishing is not required by the Telecommunications Act of 1992, it satifies the interests of the NJ Press Association and meets the criteria set forth in the Act. NJ Bell also notes that "since the outset of this matter, New Jersey Bell has advised all parties of its willingness to discuss achieving common ground" (Letter of NJ Bell, dated April 12, 1993, at 2). NJ Bell, therefore, requests approval of the modification and requests that the Board deny the NJCTA's request for the filing of affidavits and a hearing on the modification.

Having considered the propsed modification and the parties' letters with regard thereto, the Board concurs with NJ Bell that all parties have been afforded a full opportunity to be heard regarding the issue of structural and non-structural safeguards both during the hearings and in briefs. The parties also were served with the proposed modification and have had an opportunity to submit any comments with regard thereto. The NJCTA states that it does not oppose the modification, and it does not appear that anything further would be gained by requiring additional filings or hearings given the full opportunity already afforded the parties to address the issue of structural and non-structural safeguards. The Board, therefore, DENIES the NJCTA's request to require the filing of affidavits.

Although not required to do so by the Board's ruling in this matter, in the proposed modification, NJ Bell has voluntarily agreed to not engage in electronic publishing except through a separate corporate affiliate. The Board notes that the modification, itself, states that its intent is to ensure that NJ Bell's plan and its transmission of electronic publishing shall allow the development of diverse, competitive electronic publishing services within the State, to further ensure that cross-subsidization does not occur, and to "create a cooperative environment in New Jersey that fosters the development of diverse electronic publishing services." Furthermore, the Board notes that given its definition of "electronic publishing," the modification does not provide for structural safeguards with regard to enhanced services preempted by the FCC. NJ Bell's voluntary agreement is not inconsistent with the Board's ruling that the non-structural safeguards in the plan are appropriate safeguards against cross-subsidization and a requirement for fully separate subsidiaries is not necessary at this time. The Board HEREBY APPROVES the proposed modification except to the extent that paragraph 7 thereof pertains to the awarding of damages by the Board against NJ Bell for violations of the proposed modification. The Board has no legal authority to impose monetary damages and therefore, does not approve of this provision. The Board notes that there is strong public policy in this State in favor of settlements, which is grounded on the premise that "the parties to a dispute are in the best position to determine how to resolve a contested matter in a way which is least disadvantageous to everyone." Dept. of Public Advocate v.

N.J. Bd. of Public Utilities, 206 N.J. Super. 523, 528 (App. Div. 1985). Approval of the modification presented by NJ Bell and the NJ Press Association is consistent with this strong public policy. The Board continues to reserve the right to monitor and review the continued use and effectiveness of non-structural safeguards and will carefully review any revisions by the FCC of its policy in this area, including any determinations should local telephone companies subsequently be authorized to provide video programming directly. The Board will consider, to the extent permitted by law, the imposition of safeguards such as fully separate subsidiaries in addition to that agreed to by NJ Bell for electronic publishing, if this subsequently appears necessary.

In further considering whether the plan will unduly prejudice or disadvantage competitors, the Board has considered but rejects the NJCTA's arguments regarding the lengths of LEC and CATV franchises. The franchise requirements for both LECs and cable operators are set by the Legislature. See N.J.S.A. 48:3-11 to 17; N.J.S.A. 48:5A-15 to 30; N.J.S.A. 48:17-10 to 12. Pursuant to N.J.S.A. 48:5A-19, the Board award a cable television operator a certificate of approval valid for 15 years or until the expiration, revocation, termination or renegotiation of any municipal consent upon which it is based, whichever is sooner, with a 10 year automatic renewal if provided for in the municipal consent. The franchises of cable television operators and the renewal thereof also are subject to federal law, and a cable television operator cannot be denied a renewal of its franchise unless certain specific procedural and substantive criteria have been met.[13] Municipal consent

---

[13] The FCC has concluded that a LEC providing video dialtone service would not be providing "cable service" as defined in 47 U.S.C.A. §522(5) and therefore would not be a "cable operator" as defined in 47 U.S.C.A. §522(4), subject to the franchise requirement of 47 U.S.C.A. §541(b). In the FCC's view, a LEC providing video dialtone service does not fall within the definition of a "cable operator," which requires an entity to either 1) provide cable service over a cable system in which it owns a significant interest or 2) otherwise control or be responsible for the management and operation of a cable system, because with video dialtone, the LEC, itself, is not providing the video programming directly to subscribers but is "simply acting as a conduit in providing broadband common carrier-based service that enables its customer/programmers to provide video programming to subscribers." In the Matter of Telephone Company-Cable Television Cross-Ownership Rules, Sections 63.54-63.58, CC Docket No. 87-266, Further Notice of Proposed Rulemaking, First Report and Order, and Second Further Notice of Inquiry, 7 FCC Rcd 300, 325-327 (November 22, 1991); Memorandum Opinion and Order on Reconsideration, 7 FCC Rcd 5069 (August 14, 1992); and Second Report and Order, Recommendation to Congress, and Second Further

granted to a telephone company may, pursuant to N.J.S.A. 48:3-15, be for a period of 50 years. It is not reasonable to claim, as the NJCTA in essence has, that the Legislature, which is presumed to be cognizant of its own enactments, in enacting N.J.S.A. 48:2-21.18, which provides that a plan for an alternative form of regulation not unduly or unreasonably disadvantage providers of competitive services, meant to include its own language set forth elsewhere in Title 48 as such an undue disadvantage. Moreover, the Board has no authority to unilaterally change these legislative enactments.

The Board now turns to consideration of imputation, attribution and unbundling. Arguments referred to above pertaining to Yellow Pages will be addresed in the discussion below pertaining to unbundling.

Imputation

To the extent that NJ Bell charges for noncompetitive services necessary to compete with competitive services that NJ Bell offers, the plan provides that the rates NJ Bell charges for its own competitive service shall exceed the rates charged to others for the noncompetitive services on which the competitive service depends (Plan, §III(A)). Asserting it has no obligation to cover the other costs associated with the provision of a competitive service, NJ Bell claims that it can price a competitive service under cost as long as the price is in excess of tariffed rates for the noncompetitive function and still satisfy the requirements of the Act without prejudicing or disadvantaging any competitor (T1190). NJ Bell opposes MCI's claim that its competitive services should be priced above the incremental cost of the competitive activity plus the tariff rate for the unbundled noncompetitive element of the service (NJBb44 to NJBb45;

(Footnote 13 continued from previous page)
Notice of Proposed Rulemaking, 7 FCC Rcd 5781, 5786 (August 14, 1992). The FCC has further explained that a LEC's provision of video dialtone is not "cable service," defined in 47 U.S.C.A.§522(5) as "(A) the one-way transmission to subscribers of (i) video programming, or (ii) other programming services, and (B) subscriber interaction, if any, which is required for the selection of such video programming or other programming service." The FCC has interpreted "transmission" as requiring active participation in the selection and distribution of the video programming, which LECs are foreclosed from doing under the FCC's current video dialtone policy. The FCC has further found that the facilities a LEC uses to offer video dialtone service do not consitute a "cable system," as defined by 47 U.S.C.A.§522(6), and on this basis as well a telephone company providing video dialtone would not be a "cable operator" subject to the cable franchise requirements. 7 FCC Rcd at 5071-5073.

NJBrb59). It argues that such a pricing rule would constitute Board regulation of the price of a competitive service contrary to the prohibition in N.J.S.A. 48:2-21.19(a) that the Board "shall not regulate, fix, or prescribe the rates...of competitive services." NJ Bell also criticizes MCI's proposed rule as failing to address the situation where the noncompetitive service element is unnecessary for competitors who elect to use a different technology or style of supply and as driving up the price of competitive services (NJBb44 to NJBb45). It also asserts that if the noncompetitive services are not made available to competitors on terms that "leveled the playing field," the services would not meet the standards for determining competiveness proposed by its witness Dr. Willig and regulation would then apply directly (NJBb45).

Rate Counsel's witness Dr. DePodwin states that unless competitive services are priced to include the full long-run cost of capacity added for their use, the result could be anti-competitive (RCT-7, at 27). Further, he testified that NJ Bell will not attribute the long-run incremental cost of capacity to be added for competitive services, thereby disadvantaging users of regulated services. He opines that at least through the end of the decade, and quite possibly beyond, it will not be possible for the Company to do otherwise without incurring large losses because the assessable demand for new competitive services will not reach significant levels until the next century (RCT-7, at 28). Further, as new services prove to be competitive, the Company may be driven to price at marginal cost (RCT-7, at 29). In Dr. DePodwin's view competition will be harmed if ONJ is approved and short run marginal cost is deemed appropriate for pricing new services. He further questioned whether N.J.S.A. 48:2-21.19(e)(2), offers meaningful protection for consumers and competitors (RCT-7, at 38).

MCI contends that the price floor for competitive services proposed by NJ Bell would still place its competitors at a significant competitive disadvantage and therefore, in its view, the imputation test proposed by NJ Bell falls short of satisfying the Act's requirement that a plan for alternative regulation not unduly or unreasonably prejudice or disadvantage providers of competitive services (MCIb25 to MCIb26). MCI contends that entry and effective competition will only come about if the Board adopts "a rigorous imputation formula" and it urges the Board to adopt the imputation formula advanced by its witness Dr. Cornell (MCI-T-1, at 37-38; MCIb57). Dr. Cornell's formula would require that the price for each competitive service offered by NJ Bell cover the tariffed charges it imposes on its dependent competitors for the noncompetitive functions it uses, plus the costs of its other competitive functions (MCIb57). To be certain that NJ Bell is complying with this standard, the revenues from each of its competitive services would be required to cover the price times the quantity used of noncompetitive functions plus the additional costs it incurs, and this test would be required to be met on a service by service basis (MCI-T-1, at 36; MCIb58; MCIb67). MCI contends that a literal reading of

N.J.S.A. 48:2-21.19(e) as requiring only the price floor proposed by NJ Bell would be inconsistent with the Act, which, MCI asserts, when taken as a whole, makes it clear that the Legislature intended that a regulatory framework be put in place to allow for the development of full and effective competition in New Jersey (MCIb26 to MCI27). MCI suggests that the Board must avoid any interpretation of the competitive safeguard provision, including the imputation requirement, that results in preventing this legislative objective and that therefore, NJ Bell's proposed imputation standard must be rejected (MCIb27). MCI contends that its proposed imputation test "no more amounts to regulation of competitive services than does [N.J.S.A. 48:2-21.18(a)]." (MCIrb7).

MCI argues that any price less than its proposed formula would mean that NJ Bell cannot show that it is charging itself the same price it charges its competitors and that NJ Bell is not covering its total costs to provide the service, in which case, customers of noncompetitive services could be making up the difference (MCIb29; MCIb30). MCI further argues that the failure to cover both sets of costs also means that NJ Bell will have engaged in an anticompetitive "price squeeze," which would allow NJ Bell to price below its dependent competitors not because it is more efficient, but rather because it is in effect charging itself less than it is charging its dependent competitors for the same noncompetitive services it uses, and in order to compete, an equally efficient competitor would have to lose money on each sale (MCIb29). MCI contends that this would be bad for NJ Bell's customers, who would be denied the benefits of increased efficiency and lower costs that come with competition, and for monopoly ratepayers, who would benefit from fewer sales to dependent competitors of noncompetitive services (MCIb29 to MCIb30). In response to arguments of NJ Bell, MCI notes that if, in what MCI refers to as an unlikely event, NJ Bell competes with firms which, all things being equal, choose not to use NJ Bell's monopoly functions, then, by definition, those competitors are not dependent competitors and the imputation requirement would not apply, although NJ Bell would still have to price its competitive services above their total service long run incremental costs in order to ensure against cross-subsidization (MCIrb8; MCI-T-1, at 28). With regard to NJ Bell's argument that Dr. Cornell's test would impose inefficiencies on it by requiring it to raise the prices of its competitive services even if it costs NJ Bell less to serve itself than to serve its competitors, MCI argues that it is virtually impossible for NJ Bell to demonstrate that it costs less to serve itself than to serve its competitors and that, as explained by Dr. Cornell, history has shown that local exchange companies have deliberately raised the cost of serving its competitors (MCIrb8 to MCIrb9). MCI claims that Dr. Cornell's test would eliminate this incentive.

AT&T describes imputation as meaning that the price that NJ Bell charges for its competitive service must exceed the sum of the tariff rates of the noncompetitive components used to provide the competitive service as well as its other costs to provide the service (AT&T-1, at 4,6; AT&Tb6 to AT&Tb7) and is intended to ensure that NJ Bell pays the same rates as its competitors for the noncompetitive components used to provide a competitive service (AT&T-1, at 5; AT&Tb6). Unless the Board requires the unbundling and imputation safeguards, NJ Bell would be able to foreclose from the market existing and potential competitors, not because the other firms are less efficient, but merely because they must pay more for an essential noncompetitive component than NJ Bell charges itself (AT&Tb7 to AT&Tb8). Therefore, AT&T urges the Board to enforce imputation, and when NJ Bell files for competitive treatment of a service which uses noncompetitive components, it submits that the Board must ensure that NJ Bell's proposed price for the competitive service exceeds the tariffed rate for such noncompetitive components as well as other costs to provide the service (AT&T-1, at 6-7; AT&Tb8).

The NJCTA's witness Dr. Selwyn criticizes the plan as offering no real protection to customers and competitors with respect to the pricing of unbundled elements, claiming that there would be very little to prevent NJ Bell from recovering most of the cost of its competitive services in the monopoly rate elements, providing an unreasonably low margin with which its rivals would have to compete, and that over time, the Company could increase the prices of these monopoly elements without necessarily making commensurate increases in its competitive service rates, thereby further squeezing out its rivals and forcing customers of its monopoly service to effectively cross-subsidize its competitive market initiatives (NJCTA-T-4, at 48). To address this issue, Dr. Selwyn proposes that the imputation requirement be revised to require NJ Bell to set the rates that it charges for its own competitive service at a level equal to or greater than the sum of (1) the rates charged to others for the noncompetitive "bottleneck" services upon which the competitive services depends, and (2) the incremental costs of the balance of the competitive service that it provides (NJCTA-T-4, at 51).

Board Staff submits that imputation is an important safeguard in the plan and, in combination with other safeguards, will provide sufficient assurance that cross-subsidization concerns are adequately addressed (STb125). With regard to the charges for noncompetitive elements within competitive services, Staff believes NJ Bell's plan meets the intent of the Act and, in conjunction with the EAS, provides the necessary safeguards (STb125).

Having carefully considered arguments of various parties that dependent competitors may be disadvantaged if incremental costs are not covered by NJ Bell, the Board finds that by the plain language of the Act, the Board no longer regulates competitive services, specifically their rates, terms and conditions. While various parties seek to require that the price for each of NJ Bell's competitive services cover not only charges to dependent competitors for the noncompetitive functions but also the additional costs incurred to provide the competitive service, N.J.S.A. 48:2-21.19(a) expressly provides that the Board shall not regulate, fix or prescribe the rates of competitive services. Essentially the Board is being asked to violate or ignore this provision. In N.J.S.A. 48:2-21.19(e)(2) the Legislature provided that "[n]othwithstanding the provisions of [N.J.S.A. 48:2-21.19(a)]," the rate charged by a LEC for a competitive service shall exceed the rates charged to others for any noncompetitive services used to provide the competitive service. The Legislature in N.J.S.A. 48:2-21.19(e) expressly contemplated the need for some exceptions to the prohibition in N.J.S.A. 48:2-21.19(a). It did not, however, provide the more extensive exception sought herein by various parties. Accordingly, the Board FINDS that the plan's imputation provision is in accordance with N.J.S.A. 48:2-21.19(e)(2). The Board concurs with Staff that the imputation provision in combination with other safeguards in the plan as modified herein will provide adequate assurances that cross-subsidization will not occur.

Attribution

As an additional competitive safeguard, the plan also provides:

> Following adoption of the plan, to the extent the Board uses revenues from access charges paid by interexchange telecommunications carriers to support the cost of local exchange or any other non-competitive services, equivalent access charges shall be attributed to NJ Bell and shall be treated in the same way (Plan, § III(G)).

NJ Bell witness Doherty described the intent of this provision:

> That was a revision of the plan. I believe that was one of the revisions we made to the plan. And that was in response to concerns that were raised by interexchange carriers. That the Board recognize that in the event that the Board should want to use access services, access charges as a way of raising funds, if you will, for a public policy reason that the Board would recognize that NJ Bell also has access to the network and therefore whenever the Board wants to take that kind of action to raise capital or raise funds for some public policy reason, it will recognize that NJ Bell has access to the network and attributes some of that cost to NJ Bell. [T182]

Mr. Doherty further indicated that this mechanism is in the plan as a safeguard focused on interexchange carriers (T182).

AT&T, the only intervenor to address this issue, argues that attribution requires NJ Bell's competitive services to pay the regulated side of NJ Bell's business for the use of noncompetitive access services on the same basis as any other access customer. Thus, the revenue from access services would, under this provision, be booked to NJ Bell's regulated side whether it is NJ Bell or a competitor using the noncompetitive acess service (AT&T-1, at 8 to 10; AT&Tb8). AT&T contends that the attribution requirement thus ensures that any revenues generated by noncompetitive access services will be attributed to the rate regulated side and not the competitive side (AT&Tb8). To the extent that the Board treats revenues from access charges paid by IXCs as revenues available to support rates for local exchange service or any other noncompetitive service, it would treat revenue from access rates imputed to NJ Bell's competitive services in the same way (AT&T-1, at 10; AT&Tb8 to AT&Tb9).

Staff argues that the incorporation of this provision in the plan for alternative regulation is premature. While the concept of NJ Bell charging itself access charges for services that compete with IXCs may be appropriate, Staff asserts that this proceeding is not the forum for such an analysis. Therefore, in Staff's view, this issue would be more appropriately addressed in a proceeding regarding intraLATA competition, wherein intraLATA access charges could be established and quantified, inclusive of a contribution, if appropriate, to flow to other noncompetitive services. Therefore, Staff recommends that this provision, described by NJ Bell as a safeguard emplaced at the request of IXCs, is not appropriate in this proceeding and should be removed from the plan (STb130).

Having carefully considered the record and arguments on this issue, the Board FINDS that the attribution section is redundant with the imputation provisions of the plan as a special provision for imputation of access services. AT&T's contention that attribution is necessary to ensure that NJ Bell books noncompetitive access revenues properly when utilized as part of competitive services is misplaced because the revenues and expenses from all noncompetitive and competitive services are separated for earnings review purposes. Moreover, to the extent that this provision raises a potential need to identify some special treatment for access, if and when competition in intraLATA toll service is allowed by the Board, a proceeding on whether to allow such competition or some other subsequent proceeding would be the appropriate forum to address this issue. At the present, however, it is premature to do so. Therefore, the provision is not appropriate in this proceeding and accordingly, the Board MODIFIES the plan to delete the attribution provision. The Board reserves the right to consider this issue if and when intraLATA competition is allowed.

Unbundling

As noted above, also to be considered is whether the plan includes compliance with the unbundling requirement set forth in N.J.S.A. 48:2-21.19(e)(1). This provision requires that a local exchange telecommunications company unbundle each noncompetitive service which is incorporated in the competitive service and make all such noncompetitive services separately available to any customer under tariffed terms and conditions, including price, identical to those used by the local exchange telecommunications company in providing its competitive service.

The plan provides that in connection with any filing to make a service competitive, NJ Bell shall identify each noncompetitive service, if any, incorporated in competitive services and make them separately available to any customer under tariff terms and conditions, including price, identical to those used by NJ Bell in providing its competitive service (Plan, §III(C)). NJ Bell subsequently clarified that its unbundling "commitment extends to any noncompetitive service that is incorporated in a competitive service, including those services that were already designated by the Board to be competitive prior to the filing of the Plan" (NJBb14; S-1, at 18). Its witness Doherty explained, "whenever we introduce a competitive service of our own and there are non-competitive elements the plan specifically says that we will provide those non-competitive services on an unbundled basis, on the other hand, if competitors feel they need a product or service...that is bundled and they need it unbundled [NJ Bell] would examine that and as long as there is a demand for that and we are technically able to unbundle that service into a separate category, then we would do that"(T180).

MCI contends that NJ Bell is not proposing to make the noncompetitive services incorporated in competitive services available on the same terms and conditions including price that are identical to those available to NJ Bell (MCI-T-1, at 16). The only way that NJ Bell can demonstrate that it has paid the same price for noncompetitive services as it charges its competitors is, according to MCI, if the revenues from each competitive service cover the sum of the costs to NJ Bell of providing the competitive functions plus its tariffed rates for the noncompetitive functions that it uses (MCI-T-1, at 17). If the revenues are less than this amount, MCI claims that NJ Bell cannot demonstrate that it has covered the same charges that it levies on its competitors (MCI-T-1, at 17). MCI contends that a deficit means either that NJ Bell is not covering its additional costs or that it is not paying the same amount for the noncompetitive services, which, in either case, it asserts results in an anticompetitive price squeeze (MCI-T-1, at 19).

MCI recommends that three steps be taken to ensure compliance by NJ Bell with N.J.S.A. 48:2-21.19(e)(1)

(MCIb57 to MCIb62; MCI-T-1, at 20-22). First, it maintains that all noncompetitive services should be available on as unbundled a basis as is feasible to tariff and should not be delayed due to insufficient demand for a particular function on an unbundled basis. If there is any bona fide demand for the function on an unbundled basis, it should be provided as soon as it can be tariffed (MCIb57; MCI-T-1, at 20). Further, in any instance where NJ Bell's competitive service rate fails to have either a zero or a positive contribution, MCI asserts that it should be required to either raise the competitive service price or reduce rates charged for noncompetitive services to a level that results in NJ Bell's competitive service showing either a zero or positive contribution (MCIb58; MCI-T-1, at 21).

Finally, and for the long run, MCI recommends that NJ Bell implement the "building blocks" approach to costing and pricing its network (MCIb58 to MCIb62). The building blocks approach would involve an examination of NJ Bell's existing tariffed services to ascertain the basic network functions which comprise these services. Examples of the basic functions used to provide basic service include: access from a customer's premise to a central office, interoffice transport, and local switching. These basic functions are the "building blocks" that are combined with other inputs (e.g., billing and marketing) to create what are referred to as "services" (MCIb60; MCI-T-1, at 22). MCI submits that these basic functions, or building blocks, should be priced in order that all users pay the same price for each building block regardless of whether it is purchased as part of a bundled service or purchased separately on an unbundled basis (Ibid). In this way, MCI contends true nondiscrimination would be provided between customers and among customers for the monopoly building blocks (MCIb60). MCI would allow exceptions from the building blocks pricing requirement for only those services that are considered part of universal service, and then only if and to the extent necessary to ensure universal service (MCIb60).

MCI contends that the building blocks approach applies the same principles to developing the costs and prices for the basic functions of the local exchange network as was originally contemplated by the unbundling in the FCC's Open Network Architecture (ONA) proceeding, but, in MCI's view, the FCC's ONA plan has not resulted in true, nondiscriminatory unbundling of the network, and the building blocks approach goes further in unbundling the network (MCIb59) and will better achieve the goals of ONA: expanding the uses of the local exchange network, preventing anticompetitive activity and enhancing economic development (MCIb59). While MCI states that it recognizes that the building blocks approach may not be able to be fully implemented prior to the Board approving a plan for alternative regulation, it urges the Board to begin the process of implementing building blocks either in an order approving a plan, in its pending ONA rulemaking, in NJ Bell's ONA tariff filing or in a separate proceeding (MCIb61 to MCIb62).

Staff submits that the unbundling provision must apply to all competitive services and not just for new filings to make a service competitive and that, as proposed, the unbundling provision gives NJ Bell too much latitude in deciding what it may want to unbundle. NJ Bell proposed to examine the need for unbundling based on its perception of demand. Staff agrees with MCI that all noncompetitive services should be available on an unbundled basis, to the most practical extent feasible to tariff, and the unbundling should not be delayed due to insufficient demand. If there is demand, then the noncompetitive service should be provided as soon as it can be tariffed (STb128). Staff recommends that NJ Bell be required to unbundle into small elements but not necessarily to the extent suggested by MCI, noting that any analysis of unbundling must also consider the cost and technical feasibility of unbundling (STb128).

After careful consideration of the record and arguments on this issue, the Board FINDS that it is essential that this Board encourage optimal use of the public switched network, and that therefore, NJ Bell shall be required to unbundle all noncompetitive services into service arrangements, based on reasonable demand for such rearrangements, so that competitors may market such services. The Board MODIFIES the plan to provide that this requirement shall apply to existing as well as future services and the extent to which NJ Bell is required to break services into smaller piece-parts is to be based on the reasonably perceived needs of competitors considering the cost and technical feasibility of unbundling, rather than NJ Bell's own market demand. Any complaints as to the reasonableness of NJ Bell's unbundling should be brought to this Board for review and appropriate resolution.

The Board also notes that the plan provides that nothing therein is intended to supersede the Board's final decision in BRC Docket No. TX91061131 (Plan, §III(E)). In Docket No. TX91061131, In the Matter of the Implementation of Open Network Architecture (ONA) and the Enhanced Services in New Jersey, the Board issued an Order dated July 15, 1991, in which it determined it to be appropriate to begin to monitor ONA developments, including enhanced service offerings, on an intrastate level. In its Order, the Board explained that ONA involved a proceeding before the FCC to implement policies intended to boost the efficiency of the telecommunications network by unbundling the components of the network and permitting service providers to purchase the individual Basic Service Elements (BSEs) or Basic Service Arrangements (BSAs) and to combine those elements with other features to produce and market new services. See, Report and Order, In Re Amendment of Section 64.702 of the Commission's Rules and Regulations, Docket No. 85-229, 104 F.C.C.2d 958 (1986). In the FCC's ruling, the regulation of enhanced services by state commissions was preempted. However, in California v. F.C.C., 905 F.2d 1217 (9th Cir. 1990), the Ninth Circuit Court of Appeals vacated and remanded the FCC's Order and found that the FCC's preemption of state regulation of intrastate enhanced services was invalid.

In the Board's July 15, 1991 Order, Board Staff was directed to develop a Notice of Pre-Proposal of Rulemaking in order to institute State procedures for the telecommunications services that fall within the ONA environment and to institute a procedure for the regulatory treatment of intrastate enhanced services. In the interim, the Board further ordered LECs and IXCs to file with the Board all enhanced services offered in New Jersey along with ONA information, including BSEs and BSAs. Thereafter, the Board issued a Notice of Pre-Proposal regarding Open Network Architecture Requirements to solict comments on the Board's role in regulating enhanced services and/or developing a state-specific ONA policy. 23 N.J.R. 3239 (November 4, 1991). This matter remains pending before the Board. Following the remand, the FCC has ordered BOCs to implement plans for ONA. In the Matter of Computer III Remand Proceedings, CC Docket No. 90-368, Report and Order, 5 FCC Rcd 7719 (December 17, 1990); In the Matter of Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier 1 Local Exchange Company Safeguards, CC Docket No. 90-623, Report and Order, 6 FCC Rcd 7571 (December 20, 1991).

With respect to enhanced services, NJ Bell agrees that the rates it charges for enhanced services in New Jersey shall exceed the rates for NJ Bell's noncompetitive BSEs or BSAs or their successors, upon which enhanced services are based. Therefore, while enhanced services are considered to be competitive services by NJ Bell, NJ Bell believes they are not subject to rules for competitive services, but should be subject to the rules established in the ONA proceeding. In the interim, NJ Bell is continuing to offer enhanced services in compliance with FCC requirements and the requirements established by the Board in the Interim ONA Order dated July 15, 1991.

AT&T argues that because the Act requires that competitive safeguards shall apply to a LEC's offering of any competitive service, the noncompetitive components of NJ Bell's enhanced services are subject to the Act's unbundling and imputation provisions (AT&Tb9; AT&Trb8; AT&T-1, at 7-8). MCI suggests likewise (MCIb25 n.7). Board Staff submits that while enhanced services are considered to be competitive by NJ Bell, they are not subject to the rules for competitive services but should be subject to the rules established in the ONA proceeding (STb131).

The Board FINDS that NJ Bell is currently required to offer enhanced services in compliance with FCC requirements and the requirements established by the Board in the July 15, 1991 Interim ONA Order in Docket No. TX91061131. The Company shall be required to continue to do so. The Board FINDS that in this manner, NJ Bell is, in effect, providing enhanced services in compliance with the Act. The Board emphasizes that nothing in the Board's approval of the plan as modified will supersede this Board's treatment of enhanced services or ONA issues in the pending ONA proceeding.

In determining whether the plan will unduly prejudice or disadvantage competitors, the Board also has considered the parties' arguments referred to earlier regarding Yellow Pages in particular.

While NJ Bell is correct that not every service performed by a public utility, such as real estate services, benefit and pension management and automobile fleet maintenance, are public utility services subject to regulation, its reliance on the Board's Donnelly decision is misplaced. As Rate Counsel correctly observes, the Act clearly requires NJ Bell to unbundle noncompetitive components it uses to provide competitive services, and to provide them to all users, including itself, under identical terms, and such a requirement did not exist at the time of the Board's decision in Donnelley.

Upon a careful review of the record and arguments regarding Yellow Pages, the Board FINDS that the subscriber listing information NJ Bell provides to itself is a noncompetitive element used by the Company in providing both noncompetitive white page listing services and competitive advertising service. The record is clear that NJ Bell electronically shares listing information with its directory services organization from the service order network on a daily basis without charge (RCT-8, Appendix, Interrogatory Response GCG-11). The service order network provides the directory services organization with timely, accurate information which assures that information provided to NJ Bell's directory competitors through licensing agreements is correct. Thus, while NJ Bell asserts that neither subscriber nor credit information are public utility services subject to the Board's regulation, the record is clear that the source of the customer listing information that is used to provide regulated listing services and non-regulated/competitive advertising services is NJ Bell's service order database. Moreover, customer service orders are a fully regulated component of NJ Bell's operations. Inasmuch as subscriber listing information is an essential component that NJ Bell uses in providing both noncompetitive and competitive services, the Board believes that such information is a noncompetitive service as contemplated by N.J.S.A. 48:2-21.16 et seq. and must, therefore, be unbundled and provided to all users, including NJ Bell itself, under identical terms and conditions, including price. To comply with the Act and its own plan, the Board FINDS that NJ Bell must unbundle the subscriber listing information used by its directory organization to compile its directory and provide it to all users, including itself, under identical rates, terms and conditions. Thus, NJ Bell's competitive services must pay its noncompetitive services for the use of this information.

With regard to the issue of credit information, however, the Board is not persuaded from the record in this proceeding that the credit information NJ Bell provides to itself is any more unique or valuable than information commercially available from credit reporting agencies to warrant a noncompetitive designation and require unbundling. Such credit information would therefore not meet the criteria to be considered a noncompetitive service as contemplated by N.J.S.A. 48:2-21.16 et seq. and this Decision and Order. The Board notes, however, that if credit information is provided on anything more than a de minimis basis, any costs involved must be appropriately accounted for through the EAS.

Finally, the Board notes that the basic rates established in the RSP included $116 million in Yellow Pages revenues. By maintaining the current rates, this amount continues under the plan to be embedded in basic rates, to the benefit of ratepayers.

In summary, the Board FINDS that the foregoing demonstrates that the plan, as modified herein provides adequate safeguards such that competitors will not be unduly or unreasonably prejudiced or disadvantaged.

F. DOES THE PLAN INCLUDE SUFFICIENT SAFEGUARDS AND REPORTING REQUIREMENTS TO ENABLE THE MONITORING AND REVIEW BY THE BOARD OF THE APPROPRIATENESS OF ANY RECLASSIFICATION OF SERVICES?

Pursuant to N.J.S.A. 48:2-21.19(a), the Board is prohibited from regulating, fixing or prescribing the rates of "competitive services," defined in the Act as any telecommunications service determined by the Board to be competitive prior to the effective date of the Act or determined to be competitive pursuant to N.J.S.A. 48:2-21.19 or N.J.S.A. 48:2-21.20. N.J.S.A. 48:2-21.19(b) authorizes the Board to determine whether a telecommunications service is a competitive service and further provides "in making such a determination, the board shall develop standards of competitive service which, at a minimum, shall include evidence of ease of market entry; presence of other competitors; and the availability of like or substitute services in the relevant geographic area." N.J.S.A. 48:2-21.19(d) authorizes the Board to reclassify any telecommunications service that it has previously found to be competitive, if, after notice and hearings, it determines, based on application of the criteria set forth in N.J.S.A. 48:2-21.19(b), that sufficient competition is no longer present. Upon such a reclassification, the Board may determine rates for the service; however, the Board is to continue to monitor the telecommunications service and, whenever it finds that the service has again become sufficiently competitive, the rate regulation prohibition of N.J.S.A. 48:2-21.19(a) is again to apply. The Board is empowered by N.J.S.A. 48:2-21.19(c) to determine what reports are necessary to monitor the competitiveness of any telecommunications service.

In prehearing memoranda, certain parties proposed that the Board in this matter should determine the guidelines for competitive versus noncompetitive services. In the Prehearing Order, the Board noted that it has discretion to consider this issue in the within proceeding or to develop standards in a separate proceeding, and in fact, the Board had issued a notice of proposed rulemaking regarding competitive telecommunications services (Docket No. TX92020201). See 24 N.J.R. 1868 (May 18, 1992). The Board further noted that certain parties in the rulemaking proceeding had suggested that the within proceeding pertaining to NJ Bell's plan is the appropriate forum to assess competitiveness of local exchange telecommunications company services and that NJ Bell had included testimony on this subject in this matter. Therefore, in the Prehearing Order, the Board determined to permit the parties to address the issue of guidelines for the determination of competitive and noncompetitive services as to NJ Bell, but reserved the right to determine whether to consider and address the record established herein on this issue in the proposed rulemaking proceeding.

By its witness Dr. Robert Willig, NJ Bell proposed that the Board should find that the market for a particular telecommunications service is competitive if it meets either one of two standards:

1. The level of competition from firms that currently produce reasonably close substitutes is sufficient to rule out the exercise of significant market power; or

2. The level of competition from potential entrants is sufficient to rule out the exercise of significant market power [P-6, at 2; P-58, at 2; NJBb, Appendix, at 3]

In order to determine or measure the level of competition from current market rivals, Dr. Willig believes the Board should examine evidence concerning market share (where the relevant market is defined to include all reasonably close substitutes), rivalrous behavior among market competitors, and the ability of competitors to expand their output in response to shifts in demand (P-6, at 15-16; NJBb, Appendix 1, at 3). The Board could measure the level of potential competition, according to Dr. Willig, by assessing the magnitude of barriers to entry into the relevant market from both start-up firms and firms currently operating in other markets (Ibid.).

Finally, Dr. Willig believes that the Board can effectively monitor a service's competitive status by periodically assessing the occurrence of significant changes in the scope of the relevant market, market share, substitute service availability, and the ability of firms to enter the relevant market in response to business opportunities (P-6, at 2). Attachhment 2 to Dr. Willig's testimony (P-6) presents a suggested outline of a monitoring report for such services, containing Baseline Characteristics and a Summary of Significant Changes for competitive services. Dr. Willig believes that his proposed standards and reports are consistent with N.J.S.A. 48:2-21.19(b) and (c) (P-58, at 2).

In response to the testimony of several intervenor witnesses, NJ Bell submitted rebuttal testimony suggesting that prior to designating a service as competitive, the Board is not required to determine that, at a minimum, the service satisfies all three of the conditions listed in the Act, i.e., entry is easy, other competitors are present, and substitutes are available (P-58, at 3). NJ Bell argues that while the Board must consider all three conditions, the Act does not say that the service must satisfy all three conditions (P-58, at 3). There is no basis, according to NJ Bell, for the view that each of the three conditions specified in the Act is a necessary condition for competition. Dr. Willig suggests that it is generally acknowledged that either competition from existing firms or competition from potential firms is sufficient to produce a competitive outcome (P-58, at 5). NJ Bell also argues that the alternative standards for competitiveness proposed by other parties' witnesses "are either redundant to Dr. Willig's proposed standards or inappropriate given the statutory language of the Act" (NJBrb68 to NJBrb69; P-58, at 6).

Rate Counsel argues that the Act prescribes standards of competition based on at least three criteria contained therein: ease of market entry, presence of other competitors, and the availability of like or substitute services (RCb94). Rate Counsel argues that while the Act requires evidence of actual competition from actual competitors selling actual products, under Dr. Willig's proposed standards, NJ Bell need only demonstrate "the level of competition from potential entrants is sufficient to rule out the exercise of significant market power" and hence is speculative and more subjective than the Act prescribes (RCb94).

Rate Counsel proposes the use of the three criteria specified in the Act as well as five additional measures proposed by its witness Dr. DePodwin:

1. Profit level - this standard would consider the carrier's earnings to measure its degree of market power;

2. Market shares - this standard would provide an indication of a firm's market power and its ability to control prices and the behavior of market rivals;

3. Competitive action - this standard would measure such actions as changes in price, terms and conditions of sale; product and service improvements; the provision of post sale services, i.e., instruction, repair and extended guarantees at no additional cost;

4. Relative strengths of buyers and sellers relative to one another and the market effect on this comparison; and

5. Harm to competition - this standard would measure

> the potential harm to competition of telecommunications competitive behavior. [RCb98 to RCb99; RCT-7, at 5 to 19]

Rate Counsel contends that unlike Dr. Willig's proposed standards, Dr. DePodwin's proposed standards consider the special cirrcumstances of LECs and would require NJ Bell to submit "proof regarding the competitiveness of a service that is specific and economically meaningful" (RCb99).

The NJCTA argues that Dr. Willig's suggested standards for a finding of competitiveness are so broad and so loosely connected to the factors that he has identified that they offer the Board virtually no concrete guidance in assessing New Jersey telecommunications markets or services (CTA-T-4, at 31-32; NJCTAb98 to NJCTAb99). It further argues that, most importantly, Dr. Willig's standards do not conform to the standards established by the Legislature in N.J.S.A. 48:2-21.19(b) as minimum standards for a service to be determined to be competitive, i.e., evidence of ease of market entry; evidence of presence of other competitors and availability of like and substitute services (NJCTAb99). The NJCTA contends that Dr. Willig improperly changes the plain meaning of the statute to effectively mean that the Board need only consider these standards but need not find that all have been satisfied (NJCTAb99 to NJCTAb100).

NJCTA's witness Dr. Selwyn proposes seven tests or measures that NJ Bell's services would need to satisfy in order to be determined competitive:

1. Functional Equivalence of Competitive Offerings - NJ Bell would be required to demonstrate that a competitively supplied service is technically capable of providing the same function as the telecommunications carrier provided service and that it is likely to be perceived as similar or identical by a customer. NJ Bell would also need to demonstrate that the competitively supplied service is available with the same degree of ubiquity throughout its service territory;

2. Substitutability of Competitive Offerings in the Presence of Multiple Competing Suppliers - NJ Bell would need to demonstrate that reasonable substitutes for the proposed competitive service are offered and generally available from more than one other supplier with the same degree of ubiquity throughout NJ Bell's service territory;

3. Not an Essential or Bottleneck Service - The proposed competitive service must not be one whose use is required by a provider of a competing service that NJ Bell asserts is functionally equivalent or substitutable for its service;

4. No Barriers to Entry - The proposed competitive

service must not have significant legal or economic barriers to entry, either in the form of franchuse requirements, easements or rights-of-way, pre-qualification, financial requirements or exceptionally high start-up costs;

5. No Social or Economic Externalities - The proposed competitive service must not be essential to economic and social development of the State; or have externalities engendered by the service's expanded penetration; or be an essential input to some other economic, social and/or governmental activity or function either because (a) it is readily available from alternative sources, or (b) it represents a luxury or convenience feature that is provided directly to the ultimate customer;

6. No Adverse Impact Upon Basic Service or Universal Service Availability - The proposed competitive service must have no present or foreseeable adverse effect upon the price, availability and quality of basic, universal telephone service as it is presently defined or as it may be redefined or otherwise modified or expanded in the future; and

7. The Proposed Classification Does Not Conflict with Other Public Interest Criteria - The proposed service classification must not conflict with any public interest criteria not expressly contemplated by tests one through six. [CTA-T-4, Appendix 2, at 10-11]

Dr. Selwyn also points out that Dr. Willig makes no recommendation that the Board make its findings on competitiveness based on data other than that provided by NJ Bell in the periodic reports that he proposes. According to Dr. Selwyn, while Dr. Willig has suggested during cross-examination that the Board would be able to access additional sources of information for this purpose, he does not appear to fully appreciate the problem of relying wholly or principally on the representations of the Company, which Dr. Selwyn asserts, has a strong vested interest in the outcome (CTA-T-4, at 32 n.15). The correct approach according to Dr. Selwyn is for the Board to draw upon multiple sources of information, including the Company, its competitors, and other interested parties in developing an objective characterization of a market (Ibid.).

AT&T objects to Dr. Willig's competition from potential entrants standard as allowing competitive treatment of a service even where there are no competitors operating within a relevant market. AT&T contends that Dr. Willig's proposed test ignores the plain language of N.J.S.A. 48:2-21.19(b) and hence is inadequate to determine that a service is competitive under the statutory standard

(AT&Tb12; AT&T-1, at 14). AT&T argues that the statutory language requires the existence of actual competition and not a mere potential for competition, and that the plain statutory language, which utilizes the term "shall," makes it clear that the Act's standards are mandatory and not merely permissive (AT&Tb13; AT&T-1, at 4). AT&T, therefore, argues that the statute compels the Board to adopt the standards set forth in the Act and to reject the standards proposed by NJ Bell through its witness Dr. Willig (AT&Tb13 to AT&Tb14; AT&Trb6). In response to Staff's suggestion that the Board incorporate into NJ Bell's plan certain of the rules proposed for the regulation of competitive telecommunications services in Docket No. TX92020201, 24 N.J.R. 1868 (May 18, 1992), AT&T argues that these proposed rules are not an issue in this proceeding and that if the Board determines to incorporate any of the proposed rules into NJ Bell's plan, it should be made clear that the rules are applicable to NJ Bell only, not to the IXCs (AT&Trb9 to AT&Trb10).

MCI maintains that the standards proposed by Dr. Willig are only correct if applied to markets where firms can act completely independent of one another. It argues that this is not the case with telecommunications because as long as NJ Bell has a monopoly over the supply of local exchange services to end users, it also has bottleneck control over inputs needed by every other supplier of virtually any telecommunications service in New Jersey (MCIb71; MCI-T-1, at 35). Therefore, MCI urges that NJ Bell's proposed standards for determining whether a service is competitive be adopted only if the Board first requires NJ Bell to comply with MCI's recommended imputation test discussed above and also requires adherence to rigorous unbundling and equal access rules (MCIb70 to MCIb72).

Staff concurs with the parties that argue that NJ Bell's proposal for the standards for determining competitiveness is insufficient to meet the mandates of the Act. Staff recommends that the plan be modified to incorporate the standards set forth by the Board in the proposed regulations in Docket No. TX92020201, 24 N.J.R. 1868 (May 18, 1992) (STb123 to STb124). Staff also expressed concern that the data supplied by NJ Bell may be skewed or biased (intentionally or unintentionally) causing the report to be inaccurate and unreliable. Staff does not believe the Board should rely solely on NJ Bell to provide the critical data on a going forward basis to determine the competitiveness of services. Staff also recommends that in addition to the report proposed by the Company, an annual filing be ordered requiring more detailed data, consistent with the Board's proposed regulations in Docket No. TX92020201, to ensure the Board that a thorough review with respect to the competitiveness of individual services will take place.

After careful review of the record and arguments regarding this issue, the Board FINDS that the standards proposed by NJ Bell to determine competitiveness are insufficient. The Board concurs with those parties who have argued that the plain meaning of the Act compels the conclusion that all three criteria contained in the Act must be met in order to determine that a service is competitive. NJ Bell shall be required to file a report in the form proposed by its witness, Dr. Willig, on an annual basis. In addition to that data, any other information deemed necessary by the Board over the life of the plan must also be supplied.

Further, the Board FINDS that the plan should be modified to incorporate standards for determining and monitoring the competitiveness of services set forth in the Board's established competitive service rulemaking in Docket No. TX92020201, subject to any additional regulations applicable to local exchange carrier competitive telecommunications services in the regulations which may be established by the Board in adopting regulations in Docket No. TX92020201, or in any subsequent proceeding. Data shall be filed on a quarterly basis for each competitive service and shall include the following:

1. Total number of customers by service category;
2. Total minutes of use by service category;
3. Total number of calls by service category;
4. A description of each service offering;
5. A summary of complaints by service category; and
6. Any other information deemed necessary by the Board to fulfill the mandates of the Telecommunications Act of 1992.

The data shall be required for all new and existing services as well as any service NJ Bell proposes to reclassify from rate regulated to competitive.

In determining the competitiveness of services, the Board reserves the right to, among other things and as may be determined to be appropriate in a given circumstance:

1. Use this information to conduct an analysis as to whether services are becoming more or less competitive; specifically, monitor the market shares of carriers as measured by number of calls, minutes of use, number of customers and customer complaints;

2. Use an economic measure of concentration or any other appropriate economic indicator to measure market share and the competitiveness of individual services; or

3. Use a customer survey to solicit information related to the perception of the level of competition by actual telecommunications users.

This Board has the authority to, after notice and hearing, determine whether any competitive services should be reclassified and if regulated services are reclassified as competitive, it will be necessary to reallocate the costs and revenues from those services. The Board reserves the right to determine and order such reallocation as may be determined to be appropriate. The following shall be incorporated in the plan as specific criteria that will be used to determine if a service previously found to be competitive should be reclassified:

1. That the market concentration for an individual carrier results in a service no longer being sufficiently competitive;

2. That significant barriers to market entry exist;

3. There is a lack of significant presence of competitors;

4. That there is a lack of like or substitute services in the relevant geographic area; or

5. That a carrier is not providing safe, adequate and proper service.

With these modifications, the Board FINDS that sufficient safeguards and reporting requirements will be in place for this Board to monitor the competitiveness of services and the appropriateness of any reclassification of services. The Board has carefully reviewed and considered the criteria proposed by Rate Counsel and the NJCTA and believes that the criteria set forth above essentially incorporates their proposed criteria. Nothing in this Decision and Order shall preclude the Board from adopting and requiring NJ Bell to abide by any such additional rules and regulations pertaining to competitiveness of telecommunications services, including any such services provided by NJ Bell, as may be determined to be appropriate in the rulemaking proceeding in Docket No. TX92020201 or in such future proceeding as the Board may hereinafter determine to commence.

Notice of new competitive services or proposed reclassification

The Board also notes that under the plan, NJ Bell proposes to file notice to the Board and interested parties at least 14 days before introducing a new competitive service or as otherwise may be required by the Board as a result of the rulemaking in Docket No. TX92020201 (Plan, §III(F)(1)). The plan further provides that NJ Bell will provide notice to interested parties of a proposed reclassification of an existing rate regulated service as competitive 30 days before it files the request with the Board (Plan, §III(F)(2)). Notice to the Board and interested parties will include a copy of the filing, except that any proprietary information may be provided subject to an appropriate protective agreement, and information to show that the applicable safeguards in §III of the plan have been met for reclassified or new competitive services.

AT&T is the only intervenor which addressed this as a separate issue and its witness John Schell testified that the notice provision of the plan will help assure that interested parties have the opportunity to evaluate whether a proposed competitive service meets the statutory test for a competitive service and satisfies the safeguards in the plan (AT&T-1, at 12; AT&Tb10). The Board FINDS that NJ Bell's proposed notice provisions for competitive services or the proposed reclassification of an existing rate regulated service is accepted. Although it so finds, the Board reserves the right to modify the notice timeframes and content as a result of the rulemaking proceeding in Docket No. TX92020201 and the Board's further consideration of these issues in that proceeding. NJ Bell's filings must additionally comply with all aspects of the Act and the within Decision and Order, including N.J.S.A 48:2-21.19(b), which requires Board approval, after notice and hearing, prior to any LEC service being deemed competitive.

Filing of tariffs for competitive services.

The Board further notes that pursuant to N.J.S.A. 48:2-21.19(a), the Board may require LECs and IXCs to file and maintain tariffs for competitive telecommunications services, and pursuant to N.J.S.A. 48:2-21.19(e)(3), tariffs for competitive services shall either be in the public domain or filed under seal and available under the terms of an appropriate protective agreement should the Board determine that the rates are proprietary.

Under the plan, NJ Bell would file tariffs with rates for all services that the Board deems to be competitive, with exceptions for services for which NJ Bell was not required to file a tariff as of the date it filed the plan, services that the Board detariffs, and services which, in the future, NJ Bell offers without a tariff being required by the Board (Plan, §III(B)). The plan provides that the rates for competitive services may be either in the publicly filed tariffs, or, if the Board determines the rates to be proprietary, they will be on file with the Board and interested parties would be permitted to review any unpublished rates under the terms of an appropriate protective agreement. Changes to competitive services tariffs would be made upon 5 days notice to the Board unless the Board adopts another time period for notice in its rulemaking in Docket No. TX92020201 (Plan, §III(B)).

As with the timeframe of notice to be provided regarding competitive and reclassified services, AT&T is the only intervenor to address this as a separate issue. AT&T's witness Schell testified that tariffs have been the traditional means that NJ Bell has informed the Board, its customers and others in the marketplace of the prices and terms of its service, and have allowed the Board to monitor the provision of service (AT&T-1 at 10-11). AT&T believes that tariffs for competitive services continue to be important and provide a means to assure that the rates for competitive services cover the rates for its noncompetitive components and that appropriate access components are paid or booked to the regulated side of NJ Bell's business (AT&Tb10 to AT&Tb11). It, therefore, recommends that the tariffing requirement for NJ Bell's competitive services should not be removed but that the Board should consider a request for detariffing or the provision of services without a tariff on a case by case basis as in the past (AT&T-1, at 10-11; AT&Tb11).

Board Staff recommends that tariffs be filed for NJ Bell's competitive services unless the Board decides such tariffs are not necessary (STb152).

The Board agrees that it is important for NJ Bell to file and maintain tariffs for its competitive services. The Board FINDS that the requirements set forth in Docket No. TX92020201 with respect to existing competitive services should apply to NJ Bell and MODIFIES the plan to so provide. Further, to maintain the Board's flexibility in this area, the Board reserves the right to require tariffs for all competitive services, whether previously tariffed or not, and rejects NJ Bell's proposed exceptions in this regard. Therefore, NJ Bell is required to file tariffs for all competitive services unless the Board does not require tariffs for particular services. All competitive tariff changes or additions shall be filed in accordance with the competitive rules in Docket No. TX92020201 or in such subsequent proceedings as the Board may hereinafter determine to commence.

G. DOES THE PLAN CONTAIN A COMPREHENSIVE PROGRAM OF SERVICE QUALITY STANDARDS WITH PROCEDURES FOR BOARD MONITORING AND REVIEW TO ENSURE THE PROVISION OF SAFE, ADEQUATE AND PROPER SERVICE?

N.J.S.A. 48:2-21.18(a)(7) requires that any plan for an alternative form of regulation contain a comprehensive program of service quality standards with procedures for Board monitoring and review. NJ Bell's plan proposes to continue the service quality standards developed as part of its Rate Stability Plan proceeding in Docket No. TO87050398. Specifically, the plan provides that NJ Bell will continue to file quarterly service quality reports established pursuant to the RSP and will continue to work closely with Board Staff to identify whether additional standards are necessary (Plan, §IV(B); NJBb24). NJ Bell submits that the current service standards are comprehensive and establish measurement standards for service order installation time frame; installation commitment compliance; toll and local assistance operator response time; directory assistance and intercept response time; availability of NJ Bell representatives at business offices and repair bureaus; sufficiency of network switches as to dial tone availability and completion of local and toll calls; network transmission and noise requirements on local loops, interoffice trunks, and special trunk circuits; and customer trouble reports regarding service maintenance, out-of-service restorals, and commitment times for trouble clearance (NJBb24). Furthermore, NJ Bell notes that the standards include a provision that allows the Board the ability to revise, modify, cancel or supersede the standards as appropriate (NJBb24) and cites to testimony of its witness Doherty that "the standards that are in place today are comprehensive and sufficient, but [NJ Bell is] always willing to discuss with the Board improvement in quality standards" (T1029) as evidencing its commitment to service quality (NJBb25). NJ Bell claims that this commitment will continue under the plan and contends that as the network is modernized under ONJ and fiber replaces copper lines, an all fiber network will provide clearer transmission and be easier to maintain (NJBb25). With regard to a suggestion by Board Staff that there be a separate proceeding on service quality, NJ Bell responds that because it has agreed to work with Board Staff to develop new standards as needed, the Board should defer any suggestion of a costly proceeding and allow that process time to work (NJBrb74 to NJBrb75).

The NJCTA contends that the plan fails to address adequately issues relating to the quality of service that NJ Bell provides to customers of its rate - regulated services, and thereby fails to satisfy the requirement of N.J.S.A. 48:2-21.18(a)(7) that a plan contain a comprehensive program of service quality standards, with procedures for Board monitoring and review (NJCTAb18 to NJCTAb19). NJCTA's witness Baldwin asserted that the entry by NJ Bell into new and competitive markets gives it an incentive to dilute the attention NJ Bell provides to customers of its basic services and to place greater priority on the quality of service provided to its customers of competitive services (CTA-T-3, at 21). The plan's principal weaknesses relative to service quality are, according to NJCTA witness Baldwin, that NJ Bell would be less accountable to the Board for service quality than it is under the RSP; that the standards are long overdue for re-evaluation; that there is no compelling evidence that ONJ will improve the quality of basic telephone service; and that unlike with the RSP, the plan does not include provisions for adverse consequences if NJ Bell fails to meet the established service quality thresholds (CTA-T-3, at 21 to 22). Under the RSP, performance results must meet or exceed the established standards or the following actions are taken:

> for exception levels, a threshold violation requires NJ Bell to investigate the sub-standard performance, take appropriate corrective action and inform Board Staff of the results;
>
> for surveillance level threshold violations, in addition to the exception level requirements, a formal report must be filed with the Board itself, which may take action as deemed appropriate by the Board. [See, S-4]

These consequences have not been expressly included by NJ Bell in its plan.

The CWA also contends that the plan does not contain the comprehensive program of service quality standards mandated by N.J.S.A. 48:2-21.18(a)(7) (CWAb35).

Asserting that "incentive regulation produces strong inducements to cut costs by downsizing the workforce, deferring maintenance and generally cutting corners," the CWA urges that "[c]ountervailing disincentives to undermine service quality must be an integral part of the plan "(CWAb35). The CWA suggests that with price caps "every dollar the Company saves goes directly to its bottom line" (CWAb36). According to the CWA and its witness Kohl, with price caps "the former service ethic that once dominated the industry is uprooted and totally replaced by a mentality of cost-cutting" (CWAb36; T3431 to T3432). Thus, the CWA argues that it is unacceptable for NJ Bell to propose an incentive regulation plan without also proposing a series of multi-year service quality improvement targets and penalties for any failure to meet service quality improvements targets or to provide accurate service reporting data (CWAb36).

Board Staff recommends in its initial brief that, because the parties to the proceeding did not identify specific minimum service levels, the Board should conduct a further investigation into appropriate service quality standards and protection mechanisms for violation of such thresholds (STb131). It indicates, however, that the current standards are comprehensive and that no evidence was presented challenging the adequacy of the standards (STb166). It recommends that the Board further review the standards to determine if more stringent standards or additional standards would be appropriate in light of the fact that NJ Bell is instituting advanced digital and fiber optics technologies (STb155; STb166).

In its reply brief, Board Staff, while recognizing that there are advantages of alternative incentive forms of regulation compared with traditional rate base, rate of return regulation, agrees with the CWA that there is a potential for adverse consequences (STrb55 to STrb56). Board Staff explains that with traditional rate base, rate of return regulation, a utility has an incentive to invest in plant and may recover associated expenses for the provision of the most reliable service possible; such incentives clearly may be in the public interest but may be costly (STrb56). With an incentive regulatory approach, Board Staff suggests that a utility might not invest in necessary backup equipment and might not fund adequate staff for sufficient response for service outages (STrb56). Board Staff believes that an appropriate balance between these goals must be accomplished and that with the adoption of an incentive regulatory approach, appropriate service standards must be set, monitored and enforced and that "as technology develops so must the standards" (STrb56). Thus, Board Staff opines that as technology and deployment develop it will become increasingly important to revise the appropriate service quality standards. Accordingly, while it believes existing standards are appropriate for initiation of the plan, Board Staff recommends that a proceeding be commenced to evaluate the standards going forward so as to ensure that NJ Bell does not reduce its staff in an inappropriate manner and maintains proper repair and maintenance procedures (STrb57).

Having carefully considered the record and arguments regarding service quality standards, the Board FINDS that the service quality performance standards currently in place for the Rate Stability Plan are comprehensive and maintain a reasonable level of service accountability to the Board. The Board notes that no non-NJ Bell employee members of the public commented at the public hearings adversely about NJ Bell's present service quality. The Board has very carefully considered the testimony presented by various NJ Bell employees who are members of the CWA at the public hearings, particularly with regard to contentions as to the future impacts of the plan and the deployment of technology. Although the Board is satisfied that the present standards ensure a reasonable level of service, this is not to say that additional and/or more stringent standards may not be appropriate, especially as technology moves forward and the industry evolves. Therefore, given the scope and depth of NJ Bell's proposed plan, a review of service quality standards shall be instituted in 1995, after the technology has begun to be deployed. The Board concurs with the NJCTA that the plan must be modified to include provisions included in the RSP matter, for action to be taken if NJ Bell fails to meet the established service quality thresholds. Thus, performance results must meet or exceed the service quality standards or the following actions are to be taken:

> For exception levels, a threshold violation shall require NJ Bell to investigate the sub-standard performance, take appropriate corrective action and inform Board Staff of the results;
>
> For surveillance level threshold violations, in addition to the exception level requirements, a formal report must be filed with the Board, itself, which may take action as deemed appropriate by the Board. The Board reserves the right to terminate the plan in the event that a substantial degradation of service is found to exist by the Board, after notice and hearing.

The Board MODIFIES the plan in accordance with the foregoing.

The Board shall continue to monitor NJ Bell's compliance with the standards and any deviations by NJ Bell therefrom. Any party hereto or any other person having a complaint with regard to NJ Bell's service quality should bring such matters to the Board's attention. The Board emphasizes that it is committed to ensuring that service quality is not impaired during the life of the plan, and the Board reserves the right to make any revisions to the service quality standards that it may hereafter determine to be appropriate and reasonable after affording NJ Bell an opportunity to be heard with regard to the need for any such revisions. In this way, the Board is satisfied that the plan as modified contains a comprehensive program of service quality standards with procedures for Board monitoring and review which will ensure the provision of safe, adequate and proper service.

H. WILL THE PLAN REDUCE REGULATORY DELAY AND COSTS?

N.J.S.A. 48:2-21.8(a)(4) requires that if the Board approves a plan or approves a plan with modification, it must find that the plan will reduce regulatory delay and costs. In proposing the plan at issue herein, NJ Bell submits that regulatory delay and costs will be reduced. Because of the plan's rate adjustment mechanism, NJ Bell asserts that under the plan there would not be protracted and costly rate case proceedings (NJBb16). Under rate base, rate of return regulation, NJ Bell cites to having been involved in 13 rate proceedings in less than 10 years (NJBb16; P-4, at 3), not including costly and time-consuming depreciation proceedings, which would be replaced under the plan by a streamlined depreciation process (NJBb16). Although it presents no New Jersey specific cost of regulation estimates, NJ Bell cites to 1987 estimates from the NTIA that the direct cost of state rate of return regulation of local exchange carriers averages $6 to $8 per access line per year. Applying its 5 million lines to this estimate, NJ Bell argues that traditional regulation could cost New Jersey ratepayers between $30 million and $40 million annually. Citing the length of its rate proceedings (12.7 months) over the last ten years, and its belief that the plan's formula to set rates would eliminate the need for elaborate rate proceedings and should take no longer than 60 days to complete, NJ Bell concludes that the plan will reduce regulatory delay and cost (NJBb16).

Rate Counsel takes issue with NJ Bell's use of the 1987 NTIA data as evidence of the cost of rate of return regulation. Rate Counsel points to the lack of New Jersey specific cost information and the lack of evidence that regulatory delay has had a negative impact on NJ Bell's operations (RCb70 to RCb71). Contending that the true issue with regard to regulatory delay and cost is the effectiveness of the existing regulatory process, Rate Counsel points out that in the 1970's and 1980's, NJ Bell received an average of about 37% of the rate increases it requested (RCb71; RC-8). Relying on the difference from NJ Bell's last rate proceeding between its $250 million requested increase and the $94 million approved increase, Rate Counsel argues that rate of return regulation saved ratepayers more money than would have been saved if NJ Bell's proposal had been in effect during this period (RCb71).

Staff concurs with NJ Bell that the plan will reduce both regulatory delay and costs (STb162). It will avoid the need for traditional rate base, rate of return filings and instead, reasonable rate increases or decreases will be accomplished via a streamlined proceeding using a formula known in advance and readily calculated (Ibid.). Thus, although Staff proposes an annual filing mechanism to address as many ongoing issues contained in the plan as practicable (STb150 to STb151), it asserts that this procedure will be easier to administer and less costly and complex, thereby enabling adjustments to become effective more quickly than with traditional regulation (Ibid.).

After careful consideration of the record and arguments, regarding this issue, the Board FINDS that under the plan, as modified herein, reasonable rate increases and decreases will be accomplished through streamlined proceedings using a formula known in advance and readily calculated. The Board FINDS that in so providing, the plan will avoid the costs and delay known to this Board, through its experience, to exist with traditional rate base, rate of return regulation. Rate Counsel's reliance on the cost differential between the rate increase requested and the rate increase actually found to be just and reasonable by the Board in NJ Bell's last rate case points not in favor of traditional regulation, but rather, in fact, highlights problems and administrative burdens imposed by traditional regulation, which will be avoided by the plan's reliance, in large measure, on a formula for reasonable increases and decreases. The Board notes that the FCC also has found that rate base, rate of return regulation is "presently expensive" and imposes significant administrative burdens, which would be substantially lessened by incentive regulation. In the Matter of Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Further Notice of Proposed Rulemaking, 3 FCC Rcd 3195, 3227 (May 23, 1988); Report and Order and Second Further Notice of Proposed Rulemaking, 4 FCC Rcd 2873, 3012, 3063-3065 (April 17, 1989). Accordingly, the Board FINDS that the plan, as modified herein, will reduce regulatory delay and costs.

I. DOES THE PLAN SPECIFICALLY IDENTIFY BENEFITS TO BE DERIVED FROM THE ALTERNATIVE FORM OF REGULATION?

N.J.S.A. 48:2-21.18(a) requires that any plan for an alternative form of regulation specifically identify the benefits to be derived from the alternative form of regulation. NJ Bell contends that the plan's core benefit is the continuation of low rates for rate regulated services as the deployment of state-of-the art technology is accelerated (NJBb34). In this way, NJ Bell claims that the plan meets the challenge set out in the Telecommunications Infrastructure Study that "acceleration of telecommunications technology be accomplished in a manner which does not jeopardize the significant public interest benefits achieved to date in New Jersey - the lowest basic exchange rates in the courntry" (NJBb35; S-18, Vol. I, at 15-16). NJ Bell further contends that the plan meets the regulatory objectives which its witness Dr. Megdal testified a plan should satisfy: the provision of appropriate customer safeguards, encourgement of efficiency and innovation, facilitation of competition, and a reduction of regulatory burdens and costs (NJBb35). Accelerating the availability of advanced technology is a benefit of the plan cited by NJ Bell (NJBb35), as is the promotion of statewide economic development (NJBb36). In addition to direct benefits, NJ Bell contends that the plan achieves a certainty in the regulatory environment that enables it to make the long-term investment required for ONJ, through which New Jersey will reap additional benefits in the areas of education, health care, the environment, business and public services (NJBb25 to NJBb34).

This issue is largely addressed by the other parties as part of comments on other issues and in addresssing various other aspects of the plan. Rate Counsel does, however, separately address this issue and argues that the plan does not specifically identify benefits to be derived therefrom (RCb81). As to two main benefits advanced by NJ Bell, enhanced economic development and the deployment of advanced technology with the associated service capabilities, Rate Counsel argues that economic development will not occur in the magnitude claimed by the Company and that the deployment is unnecessary and prohibitively expensive to serve the expected demand (RCb81). Accordingly, Rate Counsel concludes that there are no specific benefits to be derived from the plan (RCb81). MCI also argues that the only party that will benefit from the plan is NJ Bell (MCIb3). On the other hand, Board Staff submits that numerous benefits will be derived from the plan (STb166 to STb167).

As should be clear from the discussion of other requirements of the Act, the Board FINDS that the plan, as modified herein, provides specific and substantial benefits, including the following:

- protected telephone services will remain affordable through the end of the century;

- rates for basic residential service will not be increased absent a Board approved event or exogenous neutral rate restructure throughout the plan;

- no rates will be increased prior to January 1, 1996 absent a Board approved exogenous event or revenue neutral rate restructure;

- rate increases or decreases after January 1, 1996 will be in accordance with a reasonable formula which will produce just and reasonable rates;

- an opportunity is included for ratepayers to share in earnings;

- competitors will not be unduly or unreasonably prejudiced because non-structural safeguards will be utilized to preclude cross-subsidization, noncompetitive services will be unbundled and made available to competitors on the same terms and conditions including price, as those used by NJ Bell in providing its competitive services, and the rate charged by NJ Bell for a competitive service will exceed the rates charged to others for any noncompetive services;

- depreciation rates will be subject to Board monitoring and review;

- the accelerated deployment of an advanced, state-of-the-art telecommunications network; and

- a comprehensive program of service quality standards, with procedures for Board monitoring and review, including a comprehensive review after technology has begun to be deployed.

All of the foregoing identify specific benefits of the plan, as modified, and accordingly, the Board FINDS that this requirement of the Act is satisfied.

J. IS THE PLAN IN THE PUBLIC INTEREST?

The issue of public interest was primarily addressed by the parties as part of their comments and positions on other issues. Having carefully considered the record and all of the arguments, the Board FINDS that the plan, as modified herein, is in the public interest. First, is the acceleration of the deployment of advanced technology in NJ Bell's public switched telecommunications network. Opportunity New Jersey will put New Jersey in the forefront of technology and will result in substantial benefits to the residents of the State. As discussed above, such benefits were articulated by many individuals at the public hearings conducted by the Board in Trenton, Hackensack, and Millville. Those comments clearly support a finding that the plan is in the public interest. The Board notes that the FCC likewise has found that "under video dialtone, telephone companies will have the opportunity and incentive to create an advanced telecommunications infrastructure capable of transporting voice, data and video services" and that "[s]uch opportunities and incentives to improve infrastructure are clearly in the public interest." In the Matter of Telephone Company - Cable Television Cross-Ownership Rules, Sections 63.54 - 63.58, CC Docket No. 87-266, Second Report and Order, Recommendation to Congress, and Second Further Notice of Proposed Rulemaking, 7 FCC Rcd 5781, 5795 (August 14, 1993). Additionally, the plan will institute an incentive regulatory approach which will ensure reasonable and affordable rates for NJ Bell's customers and will promote efficiency on the part of the Company. The Board is, therefore, satisfied that the plan, as modified herein, will be in the public interest.

IV. CONCLUSION

For the foregoing reasons, the Board FINDS that, as modified herein, the plan for an alternative form of regulation filed by NJ Bell:

(1) will ensure the affordability of protected telephone services;

(2) will produce just and reasonable rates for telecommunications services;

(3) will not unduly or unreasonably prejudice or disadvantage a customer class or providers of competitive services;

(4) will reduce regulatory delay and costs;

(5) is in the public interest;

(6) will enhance economic development in the State while maintaining affordable rates;

(7) contains a comprehensive program of service quality standards with procedures for Board monitoring and review; and

(8) specifically identifies benefits to be derived from the alternative form of regulation.

The Board CONCLUDES that NJ Bell's plan as modified herein satisfies the criteria set forth in N.J.S.A. 48:2-21.18 and otherwise provides for compliance with the Telecommunications Act of 1992. Accordingly, the Board HEREBY APPROVES WITH MODIFICATIONS set forth herein the plan for an alternative form of regulation filed by NJ Bell and as modified by NJ Bell pursuant to its agreement with the NJ Press Association. The modifications shall include a provision that, should NJ Bell not comply with the provisions of the plan as modified herein, in whole or in part, and/or the specific requirements of the Telecommunications Act of 1992, the Board reserves the right to take such action as may be found by the Board to be appropriate, including the ordering of further modifications or reinstitution of rate base, rate of return regulation and termination of the plan. The Board emphasizes that except as expressly set forth herein or in the Telecommunications Act of 1992, all other provisions of Title 48 and Board regulations and policies will remain applicable to NJ Bell, unless the law hereinafter provides otherwise or the Board hereinafter orders or directs otherwise. NJ Bell is HEREBY ORDERED to file a plan modified in accordance with this Decision and Order and to serve copies upon all parties to this proceeding within 14 days of the entry of this Decision and Order. By filing such a modified plan, NJ Bell shall be deemed to have consented to all of the modifications set forth herein.

DATED: May 6, 1993

BOARD OF REGULATORY COMMISSIONERS
BY:

Edward H. Salmon

DR. EDWARD H. SALMON
CHAIRMAN

Jeremiah F. O'Connor

JEREMIAH F. O'CONNOR
COMMISSIONER

Carmen J. Armenti

CARMEN J. ARMENTI
COMMISSIONER

ATTEST: Irene Johnson
IRENE JOHNSON
SECRETARY

Docket No. TO92030358

SERVICE LIST

Robert Mulvee, Esq.
New Jersey Bell Telephone Co.
540 Broad Street
Room 1800
Newark, New Jersey 07102

Sidney Sayovitz, Esq.
Greenwood, Young, Tarshis,
Dimiero & Sayovitz
Skyline Plaza
414 Eagle Rock Avenue
West Orange, New Jersey 07052

Elisa T. Sorrell, Esq.
Sills Cummis
One Riverfront Plaza
Newark, New Jersey 07102-5400

Michael Gallagher
Director of Telecommunications
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Vincent J. Sharkey, Esq.
Riker, Danzig, Scherer,
Hyland & Perretti
Headquarters Plaza
One Speedwell Avenue
Morristown, New Jersey 07962-1981

Mahasti Pourdastan
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

John DeLuca
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Robert Melendez
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

James Murphy
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Francis R. Perkins, Esq.
Meyner & Landis
One Gateway Center
Newark, New Jersey 07102

Wilma McCarey, Esq.
AT & T
3101 Jermantown Road
Fairfax, VA 22203-2885

A. F. McGimpsey, Jr. Esq.
McGimpsey & Cafferty
285 Davidson Avenue
Somerset, New Jersey 08873

Martin C. Rothfelder, Esq.
Kraft & McManimon
One Gateway Center
Newark, New Jersey 07102

Mark. L. Mucci, Esq.
LeBoeuf, Lamb, Leiby, MacRae
One Gateway Center
Newark, New Jersey 07102

Marc C. Beyer
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Anthony Centrella
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

William Furlong
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Lisa Nicastro
Board of Regulatory Commissioners
Two Gateway Center
Newark, New Jersey 07102

Docket No. TO92030358

SERVICE LIST CONT.

Dr. Fred Grygiel
Chief Economist
Board of Regulatory Commissioners
Newark, New Jersey 07102

Celeste Fasone
Director of Cable Television
Two Gateway Center
Newark, New Jersey 07102

Daniel T. Dineen, Esq.
V.P. General Counsel
United Telephone of N.J.
201 Walnut Bottom Road
Carlisle, PA 17013

Elise Werner Goldblat
Deputy Attorney General
Division of Law & Public Safety
124 Halsey Street
Newark, New Jersey 07102

William R. Holzapfel
LeBoeuf, Lamb, Leiby & MacRae
One Gateway Center
Newark, New Jersey 07102

Tracey Thayer, Esq.
Dept. of the Public Advocate
Division of Rate Counsel
31 Clinton Street, 11th Floor
PO Box 46005
Newark, New Jersey 07101

Robert Berger, Esq.
Swideler & Berlin
300 K Street, N.W.
Washington, DC 20007

Keith Townsend, Esq.
US Sprint Communications
Suite 1110
1850 M Street
Washington, DC 20036

James H. Laskey, Esq.
Norris, McLaughlin & Marcus
721 Route 202-206
PO Box 1018
Somerville, New Jersey 08076-1018

Susan Reisner, Esq.
Dept. of the Public Advocate
Division of Rate Counsel
31 Clinton Street, 11th Floor
PO Box 46005
Newark, New Jersey 07101

Dennis C. Linken, Esq.
Stryker, Tams & Dill
2 Penn Plaza-East
Newark, New Jersey 07105

Joan M. Campion
MCI Telecommunications
1150 17th Street, N.W.
Washington, DC 20036

Helene Wallenstein, Esq.
Deputy Attorney General
Division of Law & Public Safety
124 Halsey Street
Newark, New Jersey 07102

Robert G. Goode, Esq.
Deputy Attorney General
Division of Law & Public Safety
124 Halsey Street
Newark, New Jersey 07102

Robin Portnoi, Esq.
Dept. of the Public Advocate
Division of Rate Counsel
31 Clinton Street, 11th Floor
PO Box 46005
Newark, New Jersey 07101

Steven F. Weissman, Esq.
CWA, District One
One Executive Drive
Suite 1
Somerset, New Jersey 08873

David Mintz, Esq.
CWA, AFL - CIO
80 Pine Street
New York, New York 10005

Raymond Makul
881 Berkshire Valley Road
Wharton, New Jersey 07885

Michael Yourshaw, Esq.
Wiley, Rein & Fielding
1776 K Street, N.W.
Washington, DC 20006

Patricia E. Martin, Esq.
Wiltel
PO Box 21348
Tulsa, OK 74121