DT 02-165

VERIZON NEW HAMPSHIRE

Investigation of Verizon New Hampshire's Treatment of Yellow Page Revenues

Order Addressing Treatment of Yellow Page Revenues

July 9, 2004

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O R D E R N O. 24,345

July 9, 2004

APPEARANCES: Victor D. Del Vecchio, Esq. for Verizon New Hampshire; Douglas L. Patch, Esq. of Orr and Reno, on behalf of Destek Networking Group; F. Anne Ross, Esq. for the Office of Consumer Advocate, on behalf of residential ratepayers; and Edward N. Damon, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 17, 2002, the New Hampshire Public Utilities Commission (Commission) issued an Order of Notice initiating this docket pursuant to RSA 365:5 and 378:7 for purposes of investigating Verizon New Hampshire's (VNH) treatment of Yellow Pages revenues, including the proper regulatory treatment of the revenues realized as a result of the publishing of New Hampshire Yellow Pages directories, whether the accounting treatment of these revenues currently in place is in accord with such determination, and whether any harm has resulted or remedy is necessary.[1] The scope of this inquiry included, *inter alia*, whether VNH retains, or should have retained, any rights or interests in these revenues, whether VNH fully complied with the requirements of RSA 366, and if so, whether, as VNH contends, its March 8, 2000 filing of the affiliate contract without further Commission action effectively changed the treatment of these revenues for rate-making purposes, and whether VNH has complied with all applicable Commission rules.

[1] The Order of Notice followed the Commission's receipt of a Report on a Financial Audit of VNH dated September 6, 2002 by the Liberty Consulting Group which, among a number of other matters, discussed VNH's Account 5230Directory Revenues. Exhibit (Ex.) 13 at 48-54.

On September 18, 2002, the Office of Consumer Advocate (OCA) filed notice of its intent to participate in this docket on behalf of residential utility consumers pursuant to RSA 363:28, II. On October 15, 2002, Devine, Millimet & Branch filed a petition to intervene on behalf of Granite State Telephone, Inc., Dunbarton Telephone Company, Inc., Northland Telephone Company of Maine, Inc., Bretton Woods Telephone Company, Inc. and Dixville Telephone Company (Telephone Companies).

The Order of Notice established a Prehearing Conference which was held on October 23, 2002. At the Prehearing Conference, the Commission orally granted the Telephone Companies' petition to intervene. Following the Prehearing Conference, the parties and Commission Staff (Staff) held a technical session and developed a proposed procedural schedule. On November 1, 2002, Staff filed with the Commission a letter containing the proposed procedural schedule, which the Commission approved by secretarial letter dated November 20, 2002.

On December 6, 2002, VNH filed with the Commission the direct testimony of John F. Nestor III and Kevin O'Quinn. On February 14, 2003, Staff filed with the Commission a motion to extend the time for filing Staff and intervenor testimony and to make certain related adjustments to the procedural schedule, which the Commission granted by secretarial letter dated February 14, 2002. On February 25, 2003, Staff filed the direct testimony of ChristiAne G. Mason.

On March 3, 2003, VNH filed with the Commission a motion to compel staff responses to discovery and to suspend the procedural schedule until the discovery dispute was resolved. On April 4, 2003, pursuant to discussions between Staff, VNH, and OCA regarding VNH's motion to compel, Staff filed with the Commission a letter setting forth an agreed-upon

revised proposed procedural schedule, including the filing of pre-hearing briefs and reply briefs, and deferring a ruling on VNH's motion to compel.[2] By secretarial letter dated April 10, 2003, the Commission approving the revised procedural schedule.

On April 25, 2003, VNH, Staff and OCA filed with the Commission their pre-hearing briefs. On May 13, 2003, with the concurrence of all parties, Staff requested an extension of time to file reply briefs and to make related adjustments to the procedural schedule, which the Commission granted by secretarial letter the same day. On May 21, 2003, VNH, Staff and OCA filed with the Commission their pre-hearing reply briefs.

On June 4, 2003, VNH filed with the Commission the rebuttal testimony of John F. Nestor III, Kevin O'Quinn and Dr. William E. Taylor. On June 13, 2003, Staff filed a motion to suspend schedule, allow additional discovery and opportunity to file responsive testimony. On June 18, 2003, OCA filed a motion to strike concerning VNH Yellow Pages issues.

On July 10, 2003, by secretarial letter, the Commission confirmed the oral ruling made at its June 27, 2003 public meeting which denied the OCA's motion to strike and granted the Staff's motion to suspend schedule, allow additional discovery and opportunity to file responsive testimony. The letter also established a revised procedural schedule. On September 8, 2003, Staff filed with the Commission the reply testimonies of ChristiAne G. Mason and Chris M. Schegel as well as John Antonuk and Lawrence N. Koppelman of Liberty Consulting Group.

On October 15, 2003, VNH filed with the Commission a motion to compel staff responses to data requests regarding Staff's reply testimony. On October 17, 2003, Staff filed a letter with the Commission objecting to VNH's motion to compel. On October 17, 2003, by secretarial letter, the Commission suspended the date for filing VNH's surrebuttal testimony pending the Commission's ruling on VNH's most recent motion to compel and Staff's objection.

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[2] VNH did not further pursue this motion to compel.

By secretarial letter dated October 24, 2003, the Commission granted in part and denied in part VNH's motion to compel and established a revised procedural schedule.

On November 10, 2003, VNH filed with the Commission the surrebuttal testimony of John F. Nestor III, Kevin O'Quinn, Dr. William Taylor and Donna Loftus. On December 10, 2003, Orr and Reno filed an appearance and petition to intervene on behalf of the Destek Networking Group (Destek), which the Commission granted by secretarial letter dated December 30, 2003, conditioned on Destek's willingness to abide by the procedural schedule previously approved by the Commission.

On January 9, 2004, Destek filed with the Commission a letter objecting to VNH's plans to call all of its four witnesses as one panel at the hearing scheduled for January 12, 2004. On the same day, VNH filed a letter with the Commission opposing Destek's objection.

The hearing before the Commission was held over four days, commencing on January 12, 2004 and ending on January 15, 2004. At the commencement of the hearing, the Commission overruled Destek's objection and allowed VNH to conduct its direct examination by means of a four person panel in the interests of administrative efficiency and creating a more coherent record while preserving the right to conduct an effective cross examination.[3] At the end of the hearing, the Commission provided the parties and Staff with an opportunity to file post-hearing briefs and post-hearing reply briefs. On January 27, 2004, VNH filed with the Commission responses to six record requests made during the hearing.

On February 24, 2004, Staff filed with the Commission a letter requesting an extension of time for filing post-hearing reply briefs until April 9, 2004. On February 27, 2004, by secretarial letter, the Commission granted the extension of time to file post-hearing reply briefs. On March 5, 2004, VNH, Staff and OCA filed with the Commission post-hearing briefs

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[3] Day 1 Transcript (Tr.) at 7-9.

and Destek filed a letter in support of the briefs filed by Staff and the OCA. On April 9, 2004, VNH, Staff and OCA filed post-hearing reply briefs.

II. SUMMARY OF THE POSITIONS OF THE PARTIES AND STAFF

A. Verizon New Hampshire

During the course of this proceeding, VNH advanced numerous arguments in testimony and briefs seeking to show that the Directory Publishing Agreement entered into by New England Telephone & Telegraph Company (NET) and NET's directory publishing affiliate, Bell Atlantic Yellow Pages Company (BAYPC), and dated as of January 1, 2000 (2000 DPA) [4], is just and reasonable. The 2000 DPA provided in part that NET had "no rights or interest in any revenues received by [BAYPC] in connection with the sale or other marketing of Directory Advertising."[5] Relying on many of the same arguments in support of the reasonableness of the 2000 DPA, VNH also argued that the imputation to it of revenues generated by VNH's directory publishing affiliate in connection with its Yellow Pages directory advertising activities would be unjust and unreasonable. In addition, VNH argued that imputation is beyond the Commission's statutory authority to order.

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[4] Since the 2000 DPA was executed, NET has been succeeded by Verizon New England Inc. (VNE), which does business in the New England states under the name Verizon (and under the name Verizon New Hampshire for New Hampshire's regulatory purposes). NET was known as Bell Atlantic (and Bell Atlantic-New Hampshire for New Hampshire's regulatory purposes) from 1997 and 2000; before that, NET did business exclusively under its own name.

According to VNH, BAYPC's successor is Verizon Yellow Pages Company (VYPC). In this docket, Staff and VNH have frequently referred to VNH's directory publishing affiliate as Verizon Information Systems (VIS) or VIS-NH to denote VIS doing business in New Hampshire; the parties have also referred to the directory publishing affiliate as Verizon Yellow Pages. BAYPC's predecessor was NYNEX Information Resources Company (NIRC).

The name of a company in effect at the time of an event is typically used in this Order. However, identification of a particular company is intended to include its predecessors and successors unless the context otherwise requires.

There is no dispute that VNE is a public utility and VYPC is an affiliate of a public utility for purposes of RSA 366, as were their predecessors.

[5] NET continued to receive revenues from BAYPC for providing subscriber listing information under a standard Listings License Agreement between NET and BAYPC dated as of January 1, 2000 (2000 LLA) as well as for billing and collection services rendered to BAYPC.

1. VNH Chronology of Events[6]

VNH presented a chronology of events as follows:

NET's directory publishing operations and associated assets were transferred as of January 1, 1984, to NIRC, an unregulated affiliate, as part of the American Telephone & Telegraph (AT&T) divestiture process. VNH agreed with the other parties and Staff that prior to the transfer, the revenues, expenses and assets associated with the directory operations was included in the regulated books of NET and specifically NET New Hampshire.[7] Parties and Staff also agreed that the revenues paid to NET after 1983 under the directory publishing agreements described below were also included in the regulated books of NET and NET New Hampshire. VNH stated that in conjunction with the transfer, NET and NIRC entered into a Directory Publishing Agreement dated as of January 1, 1984 (1984 DPA) under which NIRC agreed to publish and distribute the White Pages listings that NET was required to provide to its customers.[8] VNH characterized the 1984 DPA as one in which, in return for a grant by NET to NIRC of "the exclusive right of the Telephone Company during the term of [the contract] to contact subscribers of the Telephone Company, and all others, for the purposes of soliciting and obtaining, Directory Advertising to appear in all Telephone Directories published hereunder," NIRC agreed to pay its revenues, net of certain allowed costs, to NET for five years.[9] VNH

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[6] The positions set forth in this chronology are primarily based on VNH's Post Hearing Brief at 2-5, unless otherwise noted. VNH's Prehearing Brief at 2-5 also sets forth a brief chronology.

[7] Kevin O'Quinn Rebuttal Testimony at 5.

[8] N.H. Code Admin. Rules Puc 405.04 requires a utility to: (a) publish, or arrange to be published, one or more telephone directories covering all the exchanges it serves, listing the name, address and telephone number of all customers who can be called in the local service area; (b) provide a copy to each customer; and (c) revise the telephone directories annually. White Pages directory listings services are described in VNH's tariff, NHPUC No. 83, Part A, Section 5.6 at pages 35-37.

[9] At other points in the proceeding, VNH argued that payments to NET under the 1984 DPA, as well as under a subsequent Directory License Agreement entered into by NET and NIRC and dated as of January 1, 1991 (1991 DLA, discussed in more detail below), compensated NET for the transfer of the directory assets and operation that occurred when NIRC was created. *See* Kevin O'Quinn Rebuttal Testimony at 5; *see also* Kevin O'Quinn Surrebuttal Testimony at 6. Mr. O'Quinn estimated that NET and Verizon New England Inc. have received approximately $2 billion in compensation since divestiture, of which New Hampshire has received over $200

further stated that the Commission reviewed the transaction in detail and allowed the 1984 DPA to go into effect in *New England Telephone and Telegraph Company*, Order No. 17,744 in DR 84-12, 70 NH PUC 630 (July 12, 1985).

VNH filed new affiliate agreements with the Commission on November 13, 1990, including the 1991 DLA, which superseded the 1984 DPA. VNH pointed out that according to the terms of the 1991 DLA, NET granted NIRC a “nontransferable and exclusive license … for the term of the Agreement to: (i) use the Telephone Company’s name in soliciting Directory Advertising; (ii) use the Telephone Company’s name, slogans and marks in publishing and distributing Telephone Directories; and (iii) designate the Telephone Directories as the ‘official’ directories of the Telephone Company.” In addition, VNH pointed out that NET agreed not to compete with NIRC. According to the terms of the 1991 DLA, in consideration for the license and the covenant not to compete, NIRC agreed to meet NET’s regulatory obligation to publish White Pages and certain other listings and to pay to NET an annual “license fee.” [*See* generally Ex. 16 at 215-233.]

VNH argued that the rights granted to NIRC were more than “window dressing.” According to VNH, they were the “legal underpinnings that gave NIRC the exclusive right to present its directories to the public as having a special association with NET, something that no other directory had the right to do.”[10] VNH also stated that in addition to assuring NET had the benefit of the revenue sharing arrangement for five years, the 1991 DLA was thereafter renewable on a year to year basis and was terminable on one year’s notice. VNH pointed out

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million. Kevin O’Quinn Rebuttal Testimony at 5. NET could not say how much revenue was retained by the directory publishing affiliate since 1984 in respect to directory publishing and advertising activities. Day 1 Transcript (Tr.) at 201-202.
[10] VNH’s Post Hearing Brief at 3.

that the Commission approved the 1991 DLA in *New England Telephone Company*, Order No. 20,074 in DE 90-200, 76 NH PUC 130 (March 6, 1991, revised March 15, 1991).

In 1996, Congress enacted the Telecommunications Act of 1996, 47 U.S.C.A. 151 *et seq.* (TAct), which VNH stated, was intended to increase competition in the telecommunications industry. According to VNH, several provisions of the TAct, specifically sections 222(e), 254 and 274, and the pro-competitive regulatory framework established by the Federal Communications Commission (FCC) to implement those sections,[11] had a significant effect on the relationship between NET and NIRC. More particularly, VNH maintained that the new Federal directives ushered in sweeping legal, regulatory and economic changes, which established a new regulatory framework designed to encourage and develop competition in the directory publishing and telecommunications marketplaces. VNH said this new pro-competitive regulatory framework set in motion the need for BAYPC and NET to change the 1991 DLA, particularly the directory revenue sharing provision, to comply with key provisions of the TAct and to reflect the competitive environment facing both companies.[12]

On December 29, 1997, BAYPC notified NET that it was terminating the 1991 DLA as provided in Article 6.1 effective January 1, 1998. According to VNH, because the 1991 DLA governed all New England states served by NET and because NET and BAYPC needed to keep the revenue sharing provision in place with regard to Maine until further action by the Maine Public Utilities Commission[13], NET and BAYPC accomplished the termination of revenue sharing through an amendment to the 1991 DLA signed on December 23, 1998, and

[11] In its Post Hearing Reply Brief at 1, VNH repeated its assertion without further elaboration that imputation "is an unlawful subsidy that serves no legitimate public interest." Otherwise, VNH did not press its arguments based on sections 254 and 274 in its two post-hearing briefs; rather, it suggested that section 222(e) had the most significance to the issues in this proceeding because it effectively turned telephone company subscriber listings into a commodity that was available to all directory publishers on the same terms. *See* VNH Post-Hearing Brief at 4.
[12] *See* VNH Prehearing Brief at 3-4.
[13] Under Maine law, the Maine Commission had to approve the 1999 Amendment in advance before it could become effective. *See* VNH Prehearing Brief at 4.

dated as of January 1, 1999 (1999 Amendment). The 1999 Amendment maintained the revenue sharing provisions for Maine but eliminated them for the other states, including New Hampshire. On December 24, 1998, BAYPC withdrew its December 29, 1997 termination of the 1991 DLA and provided a new notice of termination of the 1991 DLA, as amended, effective January 1, 2000. On January 1, 2000, BAYPC extended the termination date for the 1991 DLA until March 31, 2000, in order to provide time for the signing and filing of a new directory publishing agreement. The 2000 DPA was signed on December 30, 1999, by BAYPC and on January 14, 2000, by NET for effect on January 1, 2000. NET d/b/a Bell Atlantic-New Hampshire filed the 2000 DPA with the Commission on March 8, 2000, together with the 2000 Listing License Agreement (LLA) that complied with section 222(e) and the FCC's fee-for-service rules, according to VNH. Under the 2000 LLA, NET agreed to provide its subscriber listings to BAYPC on terms and conditions that were the same as those made available to other directory publishers.

VNH maintained that unlike the prior publishing arrangements, the 2000 DPA did not grant BAYPC an exclusive license nor include a non-compete provision. In its Post-Hearing Brief, VNH claimed that such provisions would have been illegal or unenforceable due to section 222(e) of the TAct. VNH further contended that there is no legal basis on which it could have asserted a right to compensation from VYPC for entering into the 2000 DPA. VNH concluded that the lack of a revenue sharing provision in the 2000 DPA was reasonable and that imputation is unjustified.

2. Impact of the TAct and FCC Regulations Implementing the TAct on the Directory Publishing Business and the Relationship between NET and NIRC

a. Section 222(e) of the TAct[14] and the Issue of VNH's Right to Compensation from its Directory Publishing Affiliate

VNH relied on section 222(e) of the TAct in its Post-Hearing Brief to support its claim that its grant of special rights to VYPC, such as the license and the non-compete benefit provided in the 1991 DLA, would have been illegal. Section 222(e) specifies that notwithstanding certain provisions regarding the privacy of customer information, telecommunications carriers that provide telephone exchange service must provide subscriber list information gathered in its capacity as a provider of such service "on a timely and unbundled basis, under nondiscriminatory and reasonable rates, terms, and conditions" to any person upon request for the purpose of publishing directories in any format. VNH argued that after the enactment of section 222(e), subscriber listings became a commodity that could be used by any publisher, including VYPC, without the need for any special grant from the telephone company[15] and further that VNH was legally prohibited from granting special rights on an exclusive basis to VYPC as it had previously done.

According to VNH, the only potential argument for requiring VYPC to compensate VNH for publishing a telephone directory would be that by agreeing to publish and distribute its own directory in accordance with standards set by VNH, VYPC receives some

[14] This summary is primarily based on VNH's Post Hearing Brief at 11-16, unless otherwise noted.

[15] In part, this argument resembles an argument VNH made in its Pre-hearing Reply Brief at 4-5 et seq. There VNH argued that it is fully compensated by VYPC for providing directory listings and no additional compensation should be applied for the benefit of VNH customers. However, the argument in the Pre-hearing Reply Brief was grounded upon VNH's assertion of the existence of robust competition and the lack of VYPC's dominance in the directory publishing and related advertising market. VNH argued that because there is robust competition in the market, VYPC does not have a dominant position in the market and if VYPC does not have a dominant position in the market and the listings utilized by VYPC are freely available to others on the same terms and conditions, there is no basis to find that VYPC has received something of value from VNH beyond the listings themselves. Dr. Taylor's Rebuttal Testimony, together with previous VNH testimony and prehearing briefs, sought to demonstrate the existence of robust competition and lack of dominance in the relevant advertising market. However, commencing with Dr. Taylor's Surrebuttal Testimony, VNH has not continued to press its assertion of robust competition and lack of dominance. As further discussed below, Dr. Taylor's later testimony stresses the importance of a market being "open" to competition irrespective of the degree of competition in the markets. *See e.g.*, Dr. Taylor Surrebuttal Testimony at 1-3 and Day 1 Tr. at 24, 26.

additional value from VNH over and above what it would otherwise have on its own after purchasing subscriber listings. VNH disputed at great length the validity of Staff's section 222(e) argument set forth in its Prehearing Brief at 7-10. In this regard, VNH denied that it has any assets on its books that are associated with the directory advertising operation.[16] In addition, VNH denied that VYPC currently receives any value from its association with the regulated telephone company and, although the companies share the same name, no compensation for that is owed by VYPC to VNH.[17] VNH contended that Staff's assertions about the benefits transferred to VYPC are vague and insufficient and that the twenty year separation of the directory publishing business from NET means that VYPC derives no benefit today from NET's putative relationship with directory advertisers twenty years ago.[18] VNH also protested that Staff had not quantified the value of the benefits of the association between it and VYPC.[19]

VNH claimed that Staff witness John Antonuk's reference to VNH's right to a revenue stream is flawed. According to VNH, Mr. Antonuk did not point to any contract provision, any legal principle or any order of the Commission that created such a right, which could only arise from one of two sources: (i) an asset whether tangible or intangible that is owned by VNH and that VYPC now requires in order to publish its directories; or (ii) the 1991 DLA, which indisputably did not contain any such right. [*See* Post Hearing Brief at 9, 13.]

VNH argued that VYPC has the right without any license or need for consent from VNH to publish its own directory and seek advertising for that directory under the name Verizon Yellow Pages. VNH advanced five reasons why no compensation is owed to VNH for VYPC's use of the Verizon name: (i) VNH does not have a unique right to use the Verizon name

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[16] *See e.g.*, Kevin O'Quinn Surrebuttal Testimony at 3-4, 6-7.
[17] *See e.g.*, Kevin O'Quinn Rebuttal Testimony at 3.
[18] *See e.g.,* John F. Nestor III Rebuttal Testimony at 10.
[19] *See e.g.*, John F. Nestor III Surrebuttal Testimony at 13.

and it uses the name with the consent of the holding company; (ii) the Verizon name is new and does not have an obvious connection to another name that has been in existence for a long time, there is no goodwill created by customers of the regulated company associated with the name and there is no evidence they have a claim to such goodwill; (iii) most important, VNH's customers have not paid for the holding company's efforts to develop any goodwill associated with the name, and having allocated to shareholders the expense of developing goodwill, it would be unreasonable to claim now that any value associated with the name belongs to ratepayers; (iv) goodwill is not a regulatory asset at all according to the Commission's rulings; and (v) VNH's association with the name arguably contributes negatively to goodwill.[20] VNH concluded that with the subscriber listings and Verizon Yellow Pages name in hand, VYPC needed nothing further from VNH to publish and distribute its own directories.

b. Section 254 of the TAct[21]

VNH argued against imputation, concluding that imputation effectively subsidizes local rates is in conflict with section 254 of the TAct. In arguments made prior to its Post Hearing Brief, VNH asserted that the 2000 DPA and 2000 LLA are not only reasonable in light of the competitive markets in which VNH and VYPC operate, but they are necessary for the companies to comply with certain other Federal regulatory and statutory obligations arising under sections 254 and 274 of the TAct.[22]

One of the major duties of the FCC and the advisory Federal-State Joint Board under section 254 (Universal Service) is to establish a definition of the services to be supported by Federal universal support mechanisms. VNH pointed to several subsections of section 254,

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[20] *See also* VNH Prehearing Brief at 8-10.
[21] This summary is based primarily on John F. Nestor III Rebuttal Testimony at 27 and VNH Prehearing Brief at 16 unless otherwise noted. VNH's Prehearing Reply Brief at 15-17 also describes VNH's section 254 argument.
[22] *See e.g.,* VNH Prehearing Brief at 1-2, 13-16.

including subsection (b) which contains references to the principles on which the FCC and the Federal-State Joint Board must base their policies for "the preservation and advancement of universal service." One of the principles is that "[a]ll providers of telecommunications services should make an equitable and nondiscriminatory contribution to the preservation and advancement of universal service." VNH also pointed to Section 254(f) (State authority) which provides:

> A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State. A State may adopt regulations to provide for additional definitions and standards to preserve and advance universal service within that State only to the extent that such regulations adopt additional specific, predictable, and sufficient mechanisms to support such definitions or standards that do not rely on or burden Federal universal service support mechanisms.

In addition, VNH referred to the FCC order implementing section 254 entitled, *In the Matter of Federal-State Joint Board on Universal Service,* CC Docket 96-45 (May 8, 1997) (*Universal Service Order*).

VNH contended that termination of the 1991 DLA revenue sharing provision and implementation of the 2000 DPA were consistent with section 254 and therefore reasonable. VNH further contended that imputation would conflict with Federal requirements in four respects: (i) imputation would be an implicit subsidy to universal service when only explicit subsidies are permitted; (ii) imputation would be an unfair burden on VNH and VYPC and would therefore not be carrier neutral or consistent with the "competitive neutrality" principle adopted by the FCC; (iii) imputation would not be a contribution to universal service based on telecommunications revenues derived from end users as is required; and (iv) universal service funding would not be technologically neutral as required because imputation would unfairly

favor other directory competitors' new technology offerings over that of VYPC print directories.[23] VNH said it was not arguing that all subsidies that reduce local rates automatically conflict with the TAct or FCC rules. VNH claimed, however, that imputation would constitute an illegal new regulatory policy of implicit subsidies based on the imputation of unregulated revenues to support regulated local service rates and thus universal service. VNH said that underlying each of the FCC's requirements is "an understanding that hidden and discriminatory subsidies - such as the imputation of revenues from unregulated operations as is the case here – create artificial barriers to cost-based competition, and thus limit the potential benefits that customers can derive from competition."[24] VNH further claimed that imputation would turn back the clock on the development of competition in New Hampshire by embedding indirect subsidies into VNH's retail rates.

VNH protested Staff's reliance on an FCC decision regarding rates for unbundled network elements for the proposition that revenue sharing is not a subsidy prohibited by the FCC.[25] VNH said that this order dealt with the application of a nationwide imputation rule for wholesale unbundled network elements and not with specific policies to guide a state in adopting a new universal service support mechanism such as Staff is proposing by advocating that the Commission adopt a new regulatory policy of imputation to continue the subsidy to local rates. VNH further said that Staff's failure to address how its recommendation for imputation is consistent with the FCC's pro-competitive policies for universal service is not explained away by the fact that the FCC chose not to adopt a nationwide imputation rule for UNEs in 1996. Nor, according to VNH, does the FCC's decision in the *Local Competition Order* support the claim by

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[23] *See* John F. Nestor III Direct Testimony at 16-20 and Rebuttal Testimony at 24-28; *see also* VNH Prehearing Brief at 14-16.
[24] VNH Prehearing Brief at 16.
[25] *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, 11 F.C.C.R. 15499* (*Local Competition Order*) *See* VNH Prehearing Reply Brief at 16-17.

Staff that the FCC has recognized that subsidies to local service exist but declined to address the matter. VNH asserted that, among other things, the FCC was well aware of its decision in the *Local Competition Order* when it formulated its policies for universal service; however, the *Local Competition Order* predates the FCC's establishment of its pro-competitive universal service policies (released May 8, 1997) by almost nine months. Finally, VNH contended that nothing in the *Local Competition Order* undermines the FCC pro-competitive policies on universal service support.

At hearing, VNH presented a clarification of its position regarding section 254. According to VNH, Staff's rationale for imputation was based on Judge Greene's statement in the Modification of Final Judgment (MFJ)[26] that he had awarded the directory advertising operations to the Bell operating companies (BOCs) instead of to AT&T because it was a subsidy to local service in support of the goal of universal service. VNH contended that if the State of New Hampshire is going to develop a new intrastate mechanism, to support universal service, as it would in effect be doing by ordering imputation, it must do so by regulations that are not inconsistent with the Federal policies for preserving and advancing universal service.[27]

c. Section 274 of the TAct[28]

VNH's argument based on section 274 of the TAct (Electronic Publishing by Bell operating companies)[29] proceeded along the following lines: section 274 required that if a BOC

[26] *United States v. American Telephone and Telegraph Company,* 552 F. Supp. 131, 194, 48 P.U.R. 4th 227 (D.D. C.1982).
[27] *See* Day 2 Tr. at 36-38; *see also* Day 3 Tr. at 37.
[28] This summary is primarily based on John F. Nestor III Direct Testimony at 7-9 and VNH Prehearing Brief at 13 unless otherwise noted.
[29] Section 274(a) prohibited a BOC or affiliate from engaging in electronic publishing disseminated through basic telephone service, although a "separated affiliate" or an electronic joint venture operated in accordance with section 274 was permitted to engage in electronic publishing.

Under section 274(h)(10), a BOC included any entity or corporation "owned" or controlled by a BOC except an electronic publishing joint venture.

wanted to participate in the new and growing field of electronic publishing, it could only do so through a "separated affiliate." Because NET received more than 10 percent of the gross revenues of NIRC-BAYPC, NIRC-BAYPC did not qualify as a separated affiliate. In order for NIRC-BAYPC to qualify as a separated affiliate and offer both print and electronic publishing on an integrated basis, NIRC-BAYPC had to significantly reduce its licensing payments to NET. Otherwise, NIRC-BAYPC would have been placed in a non-competitive position in the directory publishing marketplace of having to offer electronic publishing through another non-telephone company subsidiary.

VNH further argued that had NIRC-BAYPC been unable to qualify as a section 274 affiliate, it could have been prevented from offering and jointly marketing electronic features in the printed telephone directories and NIRC-BAYPC would not have been able to use its traditional sales and marketing organizations to jointly sell and package print and electronic products. According to VNH, from a marketing perspective, the requirement of yet another separate non-telephone company affiliate for electronic publishing alone would have been inefficient, duplicative and costly, and from a customer's perspective these restrictions would have made no sense. For example, these restrictions would have meant that a customer would have to deal with one NIRC-BAYPC sales representative to place their print advertising and then

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For purposes of section 274, ownership meant to have an equity interest of more than 10 percent of an entity or the "right to more than 10 percent of the gross revenues of an entity under a revenue sharing or royalty agreement." Section 274(i)(8). Under section 274(i)(9), a "separated affiliate" was defined as a corporation under common control with a BOC that does not "own" or control a BOC and is not "owned" or controlled by a BOC and that engages in electronic publishing disseminated by means of such BOC's or an affiliate's basic telephone service.

Section 274(b) contained requirements applicable to separated affiliates and electronic joint ventures, including a provision specifying that a separated affiliate or electronic joint venture and an affiliated BOC may "not use for the marketing of any product or service of the separated affiliate or joint venture, the name, trademark, or service mark of an existing [BOC] except for the names, trademarks, or service marks that are owned by the entity that owns or controls the [BOC]." Section 274(b)(6). Section 274(c) contained certain restrictions on joint marketing applicable to BOCs and separated affiliates or affiliates related to the provision of electronic publishing.

BOCs and affiliates offering electronic publishing services to the public on February 8, 1996 had until February 8, 1997 to comply with section 274; section 274 did not apply to conduct occurring after February 8, 2000. *See* section 274(g)(1) and (2).

have to deal with a totally separate representative to handle their electronic publishing requirements for the same or additional advertising. VNH maintained that such an arrangement would not only have been inconvenient, inefficient and burdensome for customers, but it would have severely undermined both the value and the revenue stream of both the print and electronic directories. According to VNH, in order to remain competitive, NIRC-BAYPC chose to terminate the 1991 DLA in 1997.

3. Economic Policy Arguments

In its Prehearing Brief, VNH argued that the reasonableness of the 2000 DPA must be determined based on consideration of the current telecommunications and directory publishing marketplaces rather than those of the past, particularly in light of the significant expansion of competition that these markets have experienced since the 1984 DPA. VNH argued that the 2000 DPA and 2000 LLA are reasonable and consistent with the pro-competitive policies of the TAct and applicable FCC rules. VNH asserted that consideration of directory advertising revenues from Verizon Yellow Pages in setting VNH's intrastate rates is a subsidy to VNH regulated local rates from an unregulated entity. It complained that in addition to being discriminatory, such a subsidy would impose an artificial barrier to competition for local telephone service rates, against which other carriers would in turn have to compete. VNH said that imputation would reverse the recent trend toward cost-based pricing of regulated services and would distort the proper pricing signals for competitors who would have to compete against VNH's subsidized retail rates. VNH described both the directory publishing and local telecommunications marketplaces as being "open to competition and experiencing active, vibrant competition,"[30] and thus it would be bad public policy to look to those markets for subsidies.

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[30] *See* VNH Prehearing Brief at 17.

VNH urged the Commission to reject Staff's recommendation to impute non-regulated directory revenues to support the regulated rates of VNH in competitive markets. VNH concluded that in light of the evidence regarding the existence of competition for directory advertising and related advertising, there is simply no basis to find that such a subsidy would be in the public interest or that the 2000 DPA and 2000 LLA are unreasonable.

Dr. William E. Taylor, a professional economist, provided Rebuttal Testimony and Surrebuttal Testimony on behalf of VNH regarding the competitiveness of the directory advertising business and public policy considerations in connection with Staff's recommendation for imputation. In his Rebuttal Testimony, he asserted that Verizon Yellow Pages faces strong and increasing competition, including many competing print directories in NH and alternative forms of local advertising, all of which he said compete in the same economically relevant market as Verizon Yellow Pages. He concluded that Verizon Yellow Pages directory services are provided in an economically competitive market and that under these circumstances imputation would distort Verizon's incentives to compete in the directory advertising market and result in a distortion of efficient prices for Verizon's other services, such as local exchange services. He said imputation would have the effect of reducing the prices of Verizon's local exchange services in New Hampshire, an outcome which would distort the incentives of competitive entrants and forestall the development of efficient competition in New Hampshire.

Dr. Taylor said that, in economic analysis, the degree of competition faced by a firm is measured by its ability to control the price for its products in the market. He relied on the definition of the economically relevant market for measuring competitiveness provided in the Merger Guidelines published by the Federal Trade Commission and the Department of Justice.

According to Dr. Taylor, that definition requires an analysis of product "substitutes"[31] and whether a competing product is a sufficiently close substitute for Verizon Yellow Pages directories that it constrains Verizon's ability to impose a significant and non-transitory increase in the price it charges for directory advertising.

Dr. Taylor said that one factor to be considered is evidence that customers regard products to be substitutes, based on market or survey data or from the functions and physical characteristics of the products. He said another factor is whether producing firms regard their products as substitutes, including whether firms take each other's prices and marketing decisions into account when setting their own prices and marketing strategies.

In Dr. Taylor's view, customers who purchase Verizon Yellow Pages advertising treat as substitutes "all other forms of local advertising, including all other print directories, newspapers, radio, broadcast and cable television, magazines, direct mail, telemarketing, flyers, signs, outdoor advertising, electronic information services, the Internet, etc."[32] Dr. Taylor said that all other print directories are included in the relevant product market because they all provide similar advertising functions in similar ways. He said there are 59 alternative Yellow Pages directories published in New Hampshire provided by 8 different companies. As support for his claim that all other forms of local advertising are in the same product market, Dr. Taylor asserted that: (i) rivalry among advertising media indicates that the different media regard each other as competitors, (ii) the prices of different media appear to move together in aggregate over time, suggesting that the media view each other as competitors in the same market, and (iii) purchasers of advertising view different media as substitutes and allocate their advertising

[31] William E. Taylor Rebuttal Testimony at 5.
[32] William E. Taylor Rebuttal Testimony at 5-6. He also claimed that "word of mouth" advertising served niches of the local advertising market. *See* pages 9-10.

expenditures to different media depending on the price of each medium and the ability of each medium to attract additional sales for that business.

According to Dr. Taylor, different media perform the function of increasing sales in different ways, but many different media are substitutes for business customers in that they increase sales. He maintained that the functions that Verizon Yellow Pages serves for readers is irrelevant in analyzing competition except insofar as those functions affect the additional sales an advertiser could expect to obtain. On the issue of the relevant product market, Dr. Taylor concluded that if a company were to monopolize the production of telephone directories and raise its advertising prices above the competitive level, many customers who purchase Yellow Pages directory advertising would find it profitable to substitute some or all of these advertising expenditures into these other media.

Turning to an assessment of the degree of competitiveness in the relevant product and geographic market, Dr. Taylor said that a particular market is competitive if no firm possesses a significant amount of market power, which he said exists when a firm can profitably set its price significantly above the competitive level. According to Dr. Taylor, a firm's ability to raise its price above the competitive level is limited by the customer's ability to shop elsewhere. He said that for a firm to have market power there cannot be sufficiently close "substitutes" for the firm's product available in sufficient quantities to which customers can switch. He also said that a firm cannot profitably price above the competitive level if there are no barriers to entry to prevent potential competitors from producing and selling such substitutes. Thus, he said that market power requires the absence of sufficiently close substitutes and the presence of barriers to entry to prevent the production of close substitutes in response to an attempt to set a price above the competitive level.

Dr. Taylor said that there are several alternative ways to measure market power. He said the most direct way is to measure the elasticity of demand facing the firm based on observed data on prices, quantities, and costs for the firm and its competitors. In this way, he said the price elasticity of demand of the firm, measured at the competitive price level, is a direct measure of the ability of customers to substitute away from the firm's product in response to a price increase.

Dr. Taylor said such a direct measure of market power is not available in this case. He said, however, that indirect measurement methods are available, referring to the measures described by Landes' and Posner in a 1981 Harvard Law Review article, "Market Power in Antitrust Cases." These tests involve the supply elasticity of competitors, the firm's market share and the market price elasticity of demand. According to Dr. Taylor, that all else is equal, a high supply elasticity of competitors implies low market power because the output of competitors will increase in response to a firm's attempt to raise prices; low market share implies low market power because changes in a firm's level of output have little effect on the market price when its market share is low; and a high market price elasticity of demand leads to low market power because customers can substitute to products outside the market in response to a market price increase.

Dr. Taylor said that two verifiable conditions are sufficient for a firm to lack market power: the presence of close substitutes for a firm's product or the absence of barriers to entry into the market. He said the presence of substitutes means that there will be other products in the relevant economic market so that a firm's market share will be lower, all else being equal. In addition, he said that the closer the substitutes for a firm's product are within the relevant

market, the higher will be the supply elasticity of competitive firms. Finally, he said the absence of barriers to entry also increases the supply elasticity of competitive firms.

Dr Taylor argued that there were both close substitutes for Verizon Yellow Pages in New Hampshire and there are no significant barriers to entry in the relevant economic markets in which Verizon Yellow Pages directories compete. According to Dr. Taylor, all indications are that Verizon Yellow Pages directories have a small share of the economically relevant markets which are in turn likely to be un-concentrated by conventional economic standards. He concluded that Landes' and Posner's three determinants of market power show that Verizon Yellow Pages directories have no market power in New Hampshire and meet any reasonable standard of competitiveness.

In his Surrebuttal Testimony, Dr. Taylor maintained that Staff's testimony regarding competition was flawed in numerous respects. He concluded that VIS faces significant competition in the Yellow Pages business, competition that has increased since the emergence of electronic-based competition such as the Internet.

In addition, he argued that irrespective of the exact degree of competition in the Yellow Pages business, it would be bad public policy to use the revenues from one company in a market that is open to competition in order to support prices in a different market. In his view, flowing revenues from VIS to subsidize local service would distort VIS's incentives in the directory publishing business, effectively taxing a firm in an unregulated industry open to competition. Dr. Taylor maintained that the more competitive the Yellow Pages business is, the more is the harm resulting from such a practice; however, even if VIS faced little or no competition in the Yellow Pages business, Dr. Taylor maintained that the policy would still distort outcomes (*i.e.*, prices and output) in the Yellow Pages business. More important

according to Dr. Taylor, the practices of imputation helps support and preserve the distortion in the prices of basic service, and this inefficiency is not affected by the degree of competition that VIS faces in the Yellow Pages business.

Regarding the similarities and differences between imputation and transfers discussed by Mr. Schlegel, Dr. Taylor said that a tax on VIS's revenues or earnings would reduce the after-tax net contribution to Verizon from VIS investment and, at the margin, projects that would just justify investment funding without the tax would not be funded if the tax were in place. He maintained that an otherwise identical Yellow Pages company not subject to the tax would make the investment, and VIS would not.

According to Dr. Taylor, a similar effect occurs, in the long run, with imputation. He explained his reasoning as follows:

> Under rate of return regulation of telephone service, Verizon NH's prices are set in the expectation that the regulated firm will just be able to earn its authorized rate of return. Imputation from VIS increases, dollar-for-dollar, the net revenue of Verizon NH (the regulated telephone company), and, in a rate case or in the long run, Verizon NH's revenue requirements would be lower (all else equal) and its prices would be reduced (or set lower than otherwise) to reduce revenue by the amount of the imputation. From the perspective of Verizon (the holding company), the long run effect of imputation is thus to yield aggregate revenues that would be lower, all else equal, by the amount of imputation. Hence, the return to Verizon from investments in VIS's activities would be lower due to imputation, just as in the tax case. And the fact that no other supplier of local advertising services faces such an imputation requirement means that competition in those markets will be distorted and inefficient if VIS is required to impute earnings to Verizon local exchange services.
>
> Under the imputation rules, some of the revenues (and profits) from VIS are used to support basic service, and this transfer of revenues—whether it is an actual transfer of funds or simply an accounting entry—means that, in the long run, the parent organization must treat those imputed revenues as a reduction in the earnings that it would otherwise receive." William E. Taylor Surrebuttal Testimony at 5.

In answer to Mr. Koppelman, Dr. Taylor said that, whether VIS has been able to make its Yellow Pages business grow has no bearing on whether this distortion has had an impact on the VIS business. He said many firms and industries that are taxed have healthy growth rates, but few economists would argue that this means that taxes are not distorting market outcomes in those industries. Dr. Taylor maintained that in any event, VIS is losing market share and thus not growing as fast as its competitors, none of whom impute revenue into a subsidized telephone service.

Dr. Taylor maintained that the Commission should attempt to achieve telecommunications policy goals at the lowest possible cost to society. He said, for this reason, the elasticity of demand for a service that is being taxed to support basic exchange services is relevant because it goes to the issue of the efficiency losses caused by the regulation. According to Dr. Taylor, economic principles teach that a tax on a service with a high elasticity of demand brings greater distortions in an economy than a tax on a service with a low elasticity of demand and thus imposes smaller losses in economic welfare on consumers and producers.

Dr. Taylor insisted that new competition from electronic based service providers and the Internet has increased the competition faced by VIS since divestiture. Dr. Taylor said that increased competition facing VIS in local advertising markets means that the welfare losses from a distortionary imputation policy have increased since divestiture. In his view, the practice of imputing Yellow Pages revenues and the associated cross-subsidy could have been a reasonable public policy in 1984, but the welfare losses from such policies have increased as competition in both local advertising and local telephone markets has increased.

Dr. Taylor said his argument that imputing revenues from VIS to subsidize local services is bad public policy because it helps to perpetuate distorted local service pricing, is

different from saying that imputation is a subsidy. According to Dr. Taylor, his Rebuttal Testimony implies that imputing VIS revenues to VNH regulated services enables and helps perpetuate a rate design that subsidizes local service or, at a minimum, that prices local service below economically efficient levels. Dr. Taylor averred that pricing services below cost violates basic economic principles and results in society using too many scarce resources. He said that by setting prices closer to cost, this inefficiency is reduced, irrespective of any other distortion in the market. In Dr. Taylor's view, given the competitive telecommunications market that exists in New Hampshire, some positive spillover effects of reducing or eliminating the price distortion in basic service are that competitors are provided with improved signals to enter and compete for the provision of basic services.

Dr. Taylor disagreed with the view that, if the Commission chooses to set more efficient rates for local phone service in the future, imputation can continue. He said if Verizon's local telephone service remains rate-of-return-regulated, then any movement towards more efficient pricing of local telephone service will reduce the amount of Yellow Pages imputation consistent with the revenue requirement. Dr. Taylor also asserted that Mr. Schlegel had misapplied the economic theory of fundamental fairness Mr. Schlegel referred to in his Reply Testimony.

Dr. Taylor argued that while the greater the degree of competition there is for Yellow Pages advertising, the greater is the welfare loss that results from imposing imputation, he did not agree with Mr. Koppelman that the precise degree of competition is a key point in this proceeding. Dr Taylor argued that even if the issue of imputation is conditioned on whether competition has increased since divestiture, it defies credulity to assert that the existence of the Internet has had no impact on the Yellow Pages business. He asserted that even articles cited by

Mr. Schlegel in his analysis assert that the Internet is a substitute for Yellow Page advertising. Dr. Taylor contended that Mr. Koppelman had incorrectly established as the standard whether competition for Yellow Pages has increased since divestiture.

According to Dr. Taylor, the TAct requires that Verizon and other Local Exchange Carriers (LECs) make their directory listings available to all directory publishers under the same rates, terms and conditions. While, prior to the TAct, LECs maintained a greater amount of discretion to determine access to directory listings. He said from an economic perspective this means that the barriers to entering the directory business have decreased, which means, other things being equal, that the competitiveness of the market has increased.

Dr. Taylor went on in his Surrebuttal Testimony to criticize many aspects of the analyses of Mr. Schlegel and Mr. Koppelman regarding the definition of the relevant product market and whether VIS has market power in that market. Dr. Taylor did agree with Mr. Schlegel that the relevant geographic market is less than the entire state.

Donna M. Loftus, the director of marketing for VIS' northeast region with a background in marketing, offered Surrebuttal Testimony seeking to show that the Yellow Pages industry is facing ever increasing competition from both Yellow Pages publishers as well as other media. She recounted a number of examples of what she called competitive activities, concluding that:

> [e]veryday our salespeople meet and talk with business owners about their advertising needs to support their business goals. Everyday, our salespeople face competition from newspapers, television, cable, radio and other yellow pages publishers. In addition to discussing what yellow pages has to offer versus other media, VIS' salespeople must also work diligently to convince businesses that our products have value in the marketplace relative to other yellow pages publishers. In the best of times, this is a complicated and tough sales call and made more challenging with increased competition. In addition, at this time the economy is less than robust, and as a result this competitive arena of selling advertising becomes even more difficult as businesses look to tighten their belts.

> Despite Mr. Schlegel and Mr. Koppelman's theoretical claims, the yellow pages industry, including the markets in New Hampshire, are highly competitive. In fact, industry publications estimate that in 2003, independent publishers such as Yellow Book and White Directory will post high single- to low double-digit revenue growth. Today, competition for directory advertising revenues is not only vibrant and growing in markets like New York City and Washington, DC but also in markets like Nashua and Portsmouth, NH." Donna M. Loftus Surrebuttal Testimony at 6-7.

In its Post Hearing Brief, VNH contended that even if it were legally permitted, it would be bad policy to impute directory revenues from a competitive unregulated business to a competitive regulated business. VNH advanced four reasons for its contention.

First, VNH contended that by effectively transferring net revenues from an unregulated business, the Commission would significantly diminish the incentive for that business, *i.e.*, VYPC's Yellow Pages business, to operate in the most efficient, competitive manner possible[33] because any net revenues obtained from operating at higher levels of efficiency would be confiscated.

Second, VNH contended that imputation would help to perpetuate and support the cross subsidization of basic local exchange service at a time when cross subsidization is contrary to and creates an obstacle to helping the Commission achieve its goal of promoting local exchange competition. VNH said unduly low basic local exchange prices discourage competitors from entering the market and distort market outcomes. In this regard, VNH claimed that the TAct requires that the current system of implicit subsidies be removed and replaced with explicit subsidies that are competitively neutral and that distort market outcomes as little as possible. In addition, according to VNH, imputation is necessarily inconsistent with the

[33] Dr. Taylor had asserted that diverting returns to subsidize local service distorts Verizon's incentives in the directory business to expand its markets, reduce its costs and develop innovative services for its advertising customers. William E. Taylor Rebuttal Testimony at 5.

Commission's efforts to establish prices for VNH's retail services at or above Total Service Long Run Incremental Cost, with the result that there will be direct harm to the competitive market that the Commission is trying to promote. On this point, VNH concluded that what may have been good public policy in 1984 is no longer good policy given the significant changes that have occurred in the telecommunications and directory publishing industries in the last 20 years and Staff and OCA wish the Commission to ignore those changes.

Third, VNH contended that, to the extent the Commission wants to continue the cross subsidization of basic local exchange, the use of revenues from VYPC is particularly costly and inefficient because VYPC operates in an unregulated competitive market. VNH asserted that imputation distorts market outcomes in a much greater way compared to collecting revenues from a market that is less competitive and where the elasticity of demand is lower.

Finally, VNH contended that if the Commission is prepared to impute revenues, then by extension it would also be required to impute losses to ratepayers from the regulated enterprise when it fared less well. VNH charged that Staff consistently evaded answering questions about the possibility of imputing losses during discovery, and as evidenced by Mr. Antonuk's "careful avoidance" of any discussion of imputing a negative loss in his response to a question from the bench on valuing future directory operations in a competitive market.

VNH continued to press this point in its Post Hearing Reply Brief. VNH said that both Staff and OCA refused to concede that if net revenues turned negative and VYPC experienced a loss, the Commission would be required to impute the losses to VNH as well. According to VNH, this highlights the lack of principle in their position which is essentially a "heads I win, tails you lose" situation that has no basis in law or sound regulatory policy.

VNH said ratepayers pay for service and have no rights or equity interest in the assets of the utility because rates are based on and are designed to recover only the original cost of those assets. In addition, VNH said that, in the case of goodwill, no cost at all is charged to ratepayers and there is even less basis to argue that ratepayers have any rights to the asset. Finally, VNH argued that having been protected from marketplace and financial risks associated with directory publishing operations, New Hampshire customers of the regulated company are not now entitled to the fruits of that investment.

VNH also argued that Staff continues to argue incorrectly that there is no conflict between imputation and a subsidy-free rate design. According to Dr. Taylor, it is not possible to eliminate all subsidies from rates, *i.e.*, to price such services at or above Total Service Long Run Incremental Costs (TELRIC), and still impute directory revenues without creating an over-earnings situation for a rate of return regulated company.

4. Challenge to Commission's Statutory Authority to Order Imputation

In its Prehearing Brief, VNH argued that RSA 366 does not give the Commission the legal authority to assert its jurisdiction over Verizon Yellow Pages, either directly or indirectly by imputing Yellow Pages revenues to VNH. According to VNH, if the Commission finds that an affiliate contract filed under RSA 366:3 is unreasonable, it can only disallow payments made by the utility to the affiliate under that agreement pursuant to RSA 366:5 and 7. VNH argued that in the agreements before the Commission in this proceeding, there are no payments being made by VNH to Verizon Yellow Pages; rather payments are being made to VNH. VNH concluded there is nothing for the Commission to disallow, and nothing in RSA 366 gives the Commission the authority to reach out to an unregulated entity like Verizon Yellow Pages and apply its revenues to satisfy the regulated company's revenue requirement.

RSA 366:5 provides:

> The commission shall have full power and authority to investigate any such [public utility-affiliate] contract, arrangement, purchase, or sale and, if the commission after notice and hearing shall find any such contract, arrangement, purchase, or sale to be unjust or unreasonable, the commission may make such reasonable order relating thereto as the public good requires. In any such investigation, the burden shall be on the public utility and affiliate to prove the reasonableness of any such contract, arrangement, purchase, or sale with, from, or to an affiliate. If the public utility shall fail to satisfy the commission of the reasonableness of any such contract, arrangement, purchase, or sale, the commission may disapprove the same and disallow payments thereunder or such part of any such payment as the commission shall find to be unjust or unreasonable. No payment disallowed by the commission shall be capitalized or included as an operating cost of the public utility in the fixing of rates or as an asset in fixing a rate base. If in any such investigation the public utility or affiliate shall unreasonably refuse to comply with any request of the commission for information with respect to relevant accounts and records, whether of such public utility or any affiliate, any portion of which may be applicable to any transaction under investigation, so that such parts thereof as the commission may deem material may be made part of the record, such refusal shall justify the commission in disapproving the transaction under investigation and disallowing payments in pursuance thereof.

RSA 366:7 provides:

> In any proceeding whether upon the commission's own motion or upon complaint involving the rates or practices of any public utility, the commission may disallow the inclusion in the accounts of a public utility of any payments or compensation to an affiliate for any services rendered, or property furnished, under existing contracts or arrangements with an affiliate unless such public utility shall establish the reasonableness of such payment or compensation.

VNH argued that the first sentence of RSA 366:5 should not be read so broadly that the remainder of the section as well as RSA 366:7 become meaningless. VNH concluded that Staff's suggestion that this Commission can assert jurisdiction over the revenues of an unregulated entity such as Verizon Yellow Pages by imputing those revenues to VNH is without any basis in the law and is contrary to the authority delegated to the Commission under RSA 366.

In its Prehearing Reply Brief, VNH maintained that Staff's statutory construction argument would make the specific remedies created by RSA 366:5 and 366:7 entirely superfluous verbiage in violation of basic tenets of statutory construction, citing *Appeal of Reid*, 143 N.H. 246, 252 (1998). VNH contended that none of the cases cited by Staff involved the imputation of revenues from another entity, particularly revenues from an entity conducting an unregulated business. VNH asserted that Staff's imputation proposal encourages the Commission to do indirectly what it lacks the authority to do directly.

VNH claimed the publication of the listings directory and associated Yellow Pages is not a telecommunications service and stated that Staff concedes in its brief that "yellow pages advertising rates, terms, and conditions *have never been and are not now regulated by the Commission.*" According to VNH, Staff asserts that the Commission has jurisdiction to impute directory publishing revenues due to the existence of the requirement under Puc 405.04 that VNH provide a listings directory, a requirement created by the Commission itself. VNH submitted that the revenues at issue in this case come not from listings, but from the advertising sold by Verizon Yellow Pages in publishing the directory. According to VNH, the Commission's efforts to extend its reach to such an unregulated enterprise – based on a requirement created by the Commission in the first place rather than based on any legislative direction – would constitute a jurisdictional leap without lawful basis.

VNH argued that a Commission determination to impute the revenues of an unregulated business would be as unfounded as the Commission's past attempts to extend its reach to enterprises not covered by its statutory powers, citing *Appeal of Zimmerman*, 141 N.H. 605 (1997); *Appeal of Omni Communications*, 122 N.H. 860, 863 (1982) ("the legislature did not intend to place all companies and businesses somehow related to railroads, telephone, telegraph,

light, heat, and power companies under the umbrella of the PUC's regulatory power."); *see also In re Jack O'Lantern*, 118 N.H. 445, 448 (1978) ("[a]n agency may not add to, change, or modify the statute by regulation or through case-by-case adjudication").

Responding to Staff's imputation argument based on the authority granted to the Commission under RSA 378:8, VNH argued that Staff's reliance is misplaced because the subject of affiliate agreements is specifically and comprehensively addressed in RSA 366; according to VNH, having addressed the subject thoroughly and separately, there is no basis for Staff's assumption that the legislature intended to address the subject again through the general provisions of RSA 378:7. VNH asserted that RSA 366:7 makes clear that the Commission's authority in a rate proceeding with regard to affiliate agreements is limited to disallowing any payments or compensation by a public utility to an affiliate for any services rendered or property furnished.

Finally, VNH argued that Staff's reference to the enforcement powers of the Commission under RSA 366:6 is inapplicable to this case because that statute is aimed at situations where there is a serious threat to the ability of the utility to provide service or otherwise fulfill its obligations, not one simply involving a situation where a company's rates were previously found to be just and reasonable and the Commission is investigating whether company revenues should be credited with amounts earned by an affiliate.

In its Post Hearing Brief, VNH asserted that RSA 366 does not provide a basis for revenue imputation because the only remedy specified in RSA 366:5 and 7 is the disallowance of payments made under an affiliate agreement. VNH contends that these statutes are not intended to reach a transaction, such as the 2000 DPA, in which a regulated utility receives a service from an affiliate but makes no payments at all.

In addition, VNH asserted that the Commission does not have jurisdiction over either the revenues or operations of VYPC, which is, according to VNH, an entity recognized by the Commission as an unregulated enterprise. According to VNH, Staff and OCA suggest that the mere fact that VYPC previously had a revenue sharing arrangement in place with the regulated company means that the Commission can indefinitely treat VYPC's revenues as if they continue to be shared with its regulated affiliate outside of that agreement. VNH also reiterated its argument that RSA 366 does not provide a basis for the imputation of revenue because it is not intended to reach a transaction in which a regulated utility receives a service from an affiliate but makes no payments at all to the affiliate.

VNH further argued that imputation of revenues from an unregulated affiliate to a regulated affiliate would lead to an unauthorized expansion of the Commission's jurisdiction. According to VNH, Mr. Antonuk argued that the Commission could and should ensure that VYPC maximizes its revenues. VNH contended that this approach demonstrates the underlying fallacy of imputing revenues at all. VNH argued that if the Commission has authority to investigate whether an unregulated affiliate has maximized its net revenues for the benefit of its regulated affiliate, the Commission would also need the authority to investigate issues such as the prudence of management decisions and operations of the "unregulated" company, the proper cost of capital for the "unregulated" company, the prudence of capital investments and prices charged, and would require the Commission to be able to audit the unregulated company's books and records and conduct other discovery. According to VNH, the power to impute revenues would constitute nothing less than the nearly unlimited power to regulate an unregulated business, including the directory advertising contracts that the New Hampshire Supreme Court has found were not undertaken as part of the regulated company's duties as a public utility, citing

PK's Landscaping, Inc. v. New England Telephone Co., 128 N.H. 753 (1986). VNH concluded that the legislature has not granted such authority to the Commission.

In its Post Hearing Reply Brief, VNH reiterated that the Commission would be required to impute losses to VNH if VYPC experienced a loss. VNH argued that the refusal of Staff and OCA to concede that point demonstrates that the Commission lacks authority to impute positive net revenues.

5. Imputation Methodology and Accounting Treatment

VNH's arguments pertained to the reasonableness of the 2000 DPA and the impropriety and illegality of ordering imputation at all. VNH did not challenge the validity of Staff's recommended imputation methodology except in one respect—the calculation of the amount to impute assuming Staff's recommended methodology was used. VNH stated that Staff used an average ratio and applied that ratio to future New Hampshire Yellow Pages revenues. VNH pointed out that in 1996; NIRC changed its method of revenue and expense recognition to "point of publication," which resulted in abnormally high revenues recorded in account 5230 for the year 1996. By including the impact of this accounting anomaly, VNH maintained that Staff's calculation of the annual amount to impute during the years 1999-2002 was overstated by approximately $3 million. *See* Kevin O'Quinn Rebuttal Testimony at 2 and Surrebuttal Testimony, Attachment 1. According to VNH, the correct average ratio figure should be 36 percent instead of the 41 percent recommended by Staff. *See* Kevin O'Quinn Surrebuttal Testimony, Attachment 1. On January 1, 2003, VNH changed its accounting method again, from "point of publication" to amortization, which was essentially the method in effect before 1996. Day 2 Tr. at 80-81. In view of this, VNH agreed that any accounting method for imputing revenues should be consistent. *See* Day 2 Tr. at 84.

VNH contended that imputation should not occur on VNH's financial books. According to Mr. O'Quinn, under appropriate accounting principles, in order to record a revenue transaction on the books of a company, it must be earned and realized or realizable but since imputation does not involve a transfer of funds to VNH, the revenue has not been earned and realized or realizable. VNH thus concluded that there is no valid accounting basis to record a transaction in the existing or subsidiary records. VNH maintained that an imputation should simply be treated as an adjustment to the Earnings Statement filed with the Commission and a reconcilable difference when compared to the actual books of VNH. Kevin O'Quinn Surrebuttal Testimony at 7-8; *see also* Day 2 Tr. at 63, 76-77.

At hearing, Mr. O'Quinn testified that any imputed amounts should not flow through account 5230, which is part of the FCC Part 32 Uniform System of Accounts for Telecommunications Companies (USOA) and the N.H. Code of Administrative Rules, Puc 406.03, because the USOA incorporates Generally Accepted Accounting Principles (GAAP) and imputation is not an accounting principle or allowed under GAAP. Day 2 Tr. at 50, 53, 63-64, 76-77. Mr. O'Quinn testified that the Commission's PART Puc 406 accounting rules are consistent with the FCC Part 32 accounting rules and he reiterated that imputation is neither earned nor realized. Day 2 Tr. at 50, 64.

Mr. O'Quinn stated that nothing in the letter dated October 9, 2003, filed with the FCC by the Federal-State Joint Conference on Accounting Issues (Joint Conference) in WC Docket 02-269 and related FCC regulatory action[34] addresses imputation. He also said that the Joint Conference's statement regarding the need for distinct and detailed accounts in situations involving imputation of directory revenues is inconsistent with the principles on which FCC Part

[34] The letter recommended that the FCC not adopt its proposal to consolidate Directory Revenues Account 5230 into Miscellaneous Revenues Account 5200. At the time of the Commission hearings, the FCC had not yet taken action on the merits of the Joint Conference recommendation.

32 accounting are based. Day 2 Tr. at 65-66. Mr. O'Quinn contended that an FCC Memorandum Opinion and Order issued in 1994, *In the Matters of Local Exchange Carriers' Permanent Cost Allocation Manuals for the Separation of Regulated and Nonregulated Costs*, DA 94-933 (August 22, 1994)[35] was consistent with his views. Finally, Mr. O'Quinn indicated that the Commission's discussion about the need for a State specific accounting system to preserve the Commission's independence in setting intrastate accounting and ratemaking authority, set forth in *Uniform System of Accounts for Telecommunications Companies*, Order No. 18,990 in DRM 87-233, 73 NHPUC 34 (1988), did not cause him to change his views. *See* Day 2 Tr. at 68-77.

6. Civil Penalty

In its Prehearing Brief at 23-26, VNH argued it should not be penalized for its failure to timely file the 1999 Amendment and the March 8, 2000 affiliate agreements. VNH argued that its failure to strictly comply with the filing requirements of RSA 366:3 resulted, not from any intentional misconduct, but rather from a lack of communication due in part to knowledgeable personnel retiring or leaving Verizon and documents being moved as part of corporate restructuring. VNH claimed that the impact of eliminating the directory revenue sharing provision was fully disclosed to the Commission and Staff when VNH submitted its monthly and quarterly financial reports in 1999 and 2000. According to VNH, although Staff was aware of the directory revenue levels being reported and had the new agreements in hand, at no time did Staff raise any issues concerning the elimination of directory revenue sharing, the

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[35] In Paragraph 7, the FCC stated, "[t]he accounting treatment for revenues derived from an affiliate's provision of yellow pages directory publishing services requested by North Carolina and Tennessee is inconsistent with our accounting rules. The revenues associated with the publication of yellow pages directories by an affiliate may not be recorded on the carrier's books. States, however, may have the authority to impute revenues related to affiliate publishing of yellow pages directories for state ratemaking purposes. If they have such authority, states must exercise this authority without the use of Part 32 accounts."

adoption of a fee-for-service rate structure, or VNH's compliance with RSA 366. VNH further contended that the impact of the 1999 Amendment terminating the revenue sharing provision of the 1991 DLA was fully disclosed in the publicly available and audited 1999 NET Form 10-K report filed with the Securities and Exchange Commission. VNH concluded that the Commission and Staff received and had available extensive information of the sort that (and indeed in greater detail than) RSA 366 was designed to provide and VNH came into full compliance with RSA 366 on March 8, 2000.

VNH said it wanted to assure the Commission that it takes very seriously its obligations under RSA 366. VNH said it has adopted new procedures to better ensure that it meets all of its reporting obligations concerning affiliate transactions, as described in Mr. Nestor's Direct Testimony. According to VNH, these new procedures seek to centralize the management of contracts between it and its affiliates in a single Verizon Affiliate Interest Compliance Office and it will be the responsibility of this office to ascertain the regulatory compliance requirements during the drafting stage of such new affiliate agreements and to coordinate with the appropriate state regulatory personnel to ensure that the state filing requirements are met. VNH said it believed these new processes will help ensure compliance of future affiliated agreements with state filing requirements, such as RSA 366.

VNH argued it would be inappropriate for the Commission to single out VNH for an assessment of penalties for failure to comply in a timely fashion with the filing requirements of RSA 366. VNH alleged that numerous utilities have in the past failed to timely file their affiliate agreements or, in some cases, have failed to file them at all. VNH said it is aware that Staff conducted a review of all affiliate contracts in New Hampshire in September 2000 to ensure compliance with RSA 366. VNH averred that despite the fact that numerous utilities

failed to submit their affiliate contracts in accordance with the statute, the Commission did not undertake any regulatory action or seek financial penalties. VNH contended that having reviewed the affiliate agreements in 2000 for compliance purposes without raising any issue with VNH, it would be unfair for the Commission to use this proceeding to impose penalties or to single out VNH for non-compliance of those agreements.

In its Post Hearing Reply Brief responding to Staff's recommendation to impose a civil penalty for VNH's failure to file the 1999 Amendment, VNH reiterated that it would be unfair and inappropriate for the Commission to impose a civil penalty on VNH. VNH argued that the 1999 Amendment has no bearing on the outcome of this case due to its replacement by the 2000 DPA; that VNH's failure to file the 1999 Amendment and timely file the 2000 DPA was unintentional and resulted from personnel changes and processes for which VNH has taken corrective action and no party has submitted evidence otherwise; VNH's 54-day delay in filing the 2000 DPA was plainly inadvertent, was *de minimis* in nature and is not relevant to whether the agreement itself is reasonable; that the evidence showed that the Commission conducted a review of the filing status of all affiliate agreements in the fall of 2000 and the Commission did not raise any issue regarding the status of the 2000 DPA at that time or take any enforcement action against any utility that had late filed an affiliate agreement. VNH concluded that it would be unfair and inappropriate for the Commission to single VNH out for any penalty, particularly given that, according to VNH, the evidence indicated that the Commission and Staff had been informed that the new agreement was on file and were aware of its terms.

In addition, VNH argued that it has fully complied with the condition in Order No. 17,744, requiring NET to provide the Commission with information pertinent to any changes in the terms and conditions of the agreements filed with the Commission in 1984 and the

experience of NET with those agreements. VNH said it complied by filing monthly, quarterly and annual financial reports and by filing the 1991 DLA. VNH also asserted that there is no reason to believe that the condition in Order No. 17,744 was intended to apply to changes and experience after Order No. 20, 074 was issued in 1991, given the fact that Order No. 20,074 did not refer to Order No. 17,744, issued in 1985.

B. Office of Consumer Advocate

OCA argued on a number of grounds that the 2000 DPA is unjust and unreasonable and disputed VNH's reasons for entering into it. In its Post Hearing Brief, OCA concluded that there is no basis in law or policy for VNH to retain the profits from its New Hampshire Yellow Pages advertising, that the value of the Yellow Pages advertising business was developed with ratepayer funds, and the value of Yellow Pages advertising continues to be dependent on the still-dominant customer base of VNH. OCA further maintained that the 2000 DPA is unjust and unreasonable because it removes the lucrative profits of the Yellow Pages advertising operation from ratepayers and transfers those profits to the shareholders. According to OCA, the Commission must impute Yellow Pages revenues to VNH and use that imputation for future rate cases in order to remedy this unfair arrangement.

1. OCA Chronology and Background[36]

OCA stated that Judge Greene's 1982 MFJ decision recognized the importance of the large Yellow Pages subsidy to local telephone service rates and left Yellow Pages and its contribution associated with the Bell operating companies even though Yellow Pages was not a natural monopoly and in fact was already a competitive market in 1982. According to OCA, NET transferred its directory publishing business to NIRC in 1984 in exchange for receipt of the

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[36] OCA provided a chronology in its Prehearing Brief at 3-5 and its Post Hearing Brief at 2-7 from which this description is based. Background information in OCA's Briefs that is also included in the descriptions of the positions of VNH and/or Staff is not always included here in the interest of brevity.

margin, *i.e.*, revenues less expenses, including a rate of return, which NET would have received had it continued to own the publishing business. OCA described Order No. 19,188 (September 28, 1988)[37] in which the Commission authorized NET to expand its marketing of White Pages to third parties and found that "the revenues from such marketing efforts will contribute toward the public good by diminishing the revenue burden on local rates" consistent with previous rulings minimizing local rates by inclusion of directory revenues in NET's revenue requirement.

OCA stated that the result of the 1991 agreements was that NIRC retained the exclusive right to publish the telephone directory for NET as well as the exclusive right to bundle the Yellow Pages with the telephone directory. OCA further stated that under the 1991 agreements, NET continued to receive all of the Yellow Pages revenues less expenses including a rate of return.

OCA stated that in 1992 NIRC established a new, wholly owned subsidiary, NYNEX Technologies Company (NIT), to handle electronic publishing while print directories for NET continued to be provided by NIRC. OCA also averred that Bell Atlantic provided electronic publishing through another subsidiary, Bell Atlantic Electronic Publishing and print directories through the departments in its telephone companies.

According to OCA, the TAct: (i) preserved the MFJ's arrangement regarding directory publishing by allowing the BOCs to continue their directory publishing and Yellow Pages advertising activities; (ii) supported the conclusion in the MFJ that directory publishing was competitive and responded to complaints that the BOCs were obstructing access to listing information, by requiring equal access on equal terms to subscriber listing information; and (iii) continued the restriction on electronic publishing until February 8, 2000, by restricting the BOCs' electronic publishing activities until electronic publishing became more fully

[37] *New England Telephone & Telegraph Company, Inc.*, 73 NH PUC 390 (1988).

competitive. OCA described a 1994 FCC Memorandum Opinion and Order stating in part, "if a carrier provides services to its directory publishing affiliate and receives compensation . . . it may record all such revenues in its Part 32 accounts." [38] In this decision, the FCC also stated that "[t]he revenues associated with the publication of Yellow Pages directories by an affiliate may not be recorded on the carrier's books" but went on to say that "[s]tates, however, may have the authority to impute revenues related to affiliate publishing of Yellow Pages directories for state ratemaking purposes." *Id*

OCA stated that on January 1, 1997, NYNEX transferred ownership of NIT from NIRC to NYNEX Corporation to qualify NIT as a separated affiliate under section 274(i)(9) of the TAct so that it could continue to engage in electronic publishing pursuant to section 274(a).[39] Further, OCA averred that on August 14, 1997, as a result of the Bell Atlantic/NYNEX Merger, NIRC changed its name to Bell Atlantic Yellow Pages Company, Inc. (BAYPC), and NIT changed its name to Bell Atlantic Electronic Commerce Services, Inc. (BAECS). OCA pointed out that the Maine Commission was informed of BAYPC's notice of termination dated December 29, 1997, as was statutorily required, and the Rhode Island Commission was also informed by means of an informational letter dated February 9, 1998,[40] even though Rhode Island has no statutory filing requirement. OCA contrasted the lack of notice to the New Hampshire Commission with how these other Commissions were treated.

OCA stated that the 1999 Amendment and 2000 DPA and 2000 LLA continued to give BAYPC an exclusive right to publish directories and bundle them with Yellow Pages, but did not provide for any sharing of revenues with the regulated telephone company. OCA pointed

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[38] *Local Exchange Carriers' Permanent Cost Allocation Manuals for the Separation of Regulated and Nonregulated Costs*, FCC Docket, Rcd 476185 (AAD 92-22 through 92-35)
[39] OCA also pointed out that VNH's Yellow Pages publishing affiliate was re-merged with its electronic publishing affiliate in October 2000.
[40] Ex. 42.

out that the Commission took no action to either approve or disapprove the 2000 DPA and 2000 LLA when they were filed on March 8, 2000, and thus allowed them to go into effect. OCA stated that beginning in January 1999 NET filed monthly and annual reports with the Commission which "evidenced the substantially reduced revenues in account 5230"[41] although according to OCA, the Commission did not discover the revenue shift until it received the Liberty Consulting Group Financial Audit Report in September 2002. OCA noted that based on the limited data made available to Liberty Consulting Group, the estimated revenue impact was a loss to VNH of $24 million in 2000.

2. Impact of the TAct and FCC Regulations Implementing the TAct on the Directory Publishing Business and the Relationship between NET and NIRC

In OCA's view, VNH's arguments based on sections 222(e), 254 and 274 are red herrings. OCA cited to decisions of a number of courts and regulatory commissions which have required imputation of revenues from Yellow Pages publishing affiliates to incumbent telephone companies since passage of the TAct. OCA said none of those tribunals found that sections 222(e), 254 or 274 prohibited such imputation.

a. Section 222(e) of the TAct[42] and the Issue of VNH's Right to Compensation from its Directory Publishing Affiliate

OCA argued that section 222(e) does not address publishing arrangements nor does it prohibit revenue sharing. According to OCA, if in fact section 222(e) required VNH to offer all parties identical publishing arrangements, VNH would have to offer any third party publisher the right to combine its directory advertising and publication efforts with the VNH White Pages directory in the same manner as the publishing affiliate does. OCA pointed out that

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[41] OCA Prehearing Brief at 5.

[42] This summary is primarily based on OCA's Prehearing Brief at 8, Post Hearing Brief at 15 and Post Hearing Reply Brief at 3-6 unless otherwise noted.

there is no evidence in the record that Verizon has offered such a publishing arrangement to any non-affiliated party. OCA maintained that section 222(e) merely deals with BOCs' obligations to share subscriber listings information on equal terms. OCA asserted that VNH was wrong in arguing that the FCC's directive implementing section 222(e)[43] prohibits Yellow Pages revenue imputation. OCA declared that the directive does not even address the issue. OCA concluded that the Commission is free to require VNH and its publishing affiliate to share Yellow Pages revenue.

OCA disputed VNH's assertion that VYPC obtains no value from its relationship with VNH other than the subscriber listings under the 2000 DPA. According to OCA, VNH asserted that since the 2000 DPA no longer grants an exclusive right to solicit Yellow Pages advertising from VNH customers, no value is granted to the publishing affiliate. OCA maintained that this assertion ignores the obvious, namely that the publishing and advertising arrangement between them is exclusive even though the 2000 DPA does not say so explicitly. OCA pointed out that only one directory publisher is needed to provide the tariffed directory service and that VNH has assigned that regulatory duty to its publishing affiliate. OCA further argued that the publishing affiliate has control over the terms and prices of advertising in its directory, including the right to exclude others from placing advertisements in its directory.

According to OCA, because VNH and VYPC are under the common control of the holding company, Verizon Communications, VNH has every incentive to maximize the profits to its affiliate and VNH produced no evidence that the 2000 DPA had been offered to other, unrelated parties. On this basis, OCA concluded it is unlikely that VNH would offer the same lucrative publishing and advertising opportunity to third parties. OCA argued that as a practical matter only VYPC may claim that it is affiliated with VNH when it solicits Yellow

[43] *Third Report and Order*, CC Docket No. 96-115, released September 9, 1999 (*Third Report*).

Pages advertising from VNH customers and that the directory advertising being sold will be included in the directory VNH provides to all of its telephone customers.

OCA further contended that the fact that the directory is no longer called "official" does not mean that VYPC receives no value from its association with VYPC. OCA pointed out that VYPC and VNH share a common name and logo and stated that in consumers' eyes the two companies are one and the same. According to OCA, the link is further supported by the fact that White Pages and Yellow Pages appear in one publication and by Verizon's own advertising. OCA maintained that Verizon does not need to use the phrase "official" directory to make the connection for consumers.

OCA described two other ways in which VNH provides value to its directory publishing affiliate. First, according to OCA, VNH benefits from the "network" effect which Staff witness Mr. Schlegel testified about: more advertising means more references by end users and thus more advertising and increased profits for the directory affiliate. Given the "network" effect, OCA contended that there is a close nexus between the customer base, the size of a Yellow Pages customer and the amount of advertising and revenues an advertiser realizes. Second, OCA maintained that there is overwhelming evidence that VNH and Verizon both recognize the value of the unique affiliation with the regulated VNH customer base and reputation. OCA stated that the Yellow Pages are widely circulated, reliable and enduring as evidenced by the fact that in the Concord area they have been available for over 100 years and are distributed every year to practically every home and business in the area.

b. Section 254 of the TAct[44]

OCA asserted that VNH's arguments with respect to section 254 of the TAct are a creative attempt to construe revenue imputation as a "contribution to universal service" which finds no support in FCC decisions. OCA contended section 254(f) requires that VNH contribute to universal service but there is nothing in the statutory language that prohibits imputation of Yellow Pages revenues and contended further that this section deals specifically with telecommunications carriers and not with directory publishers.

c. Section 274 of the TAct[45]

OCA pointed out that under section 274 of the TAct; BOCs were free to engage in electronic publishing in either of two ways, through a separated affiliate or through an electronic publishing joint venture operating in accordance with section 274. OCA contended that the revenue sharing arrangement between NIRC and NET did not violate section 274 of the TAct because VNH was not part of an electronic publishing joint venture and was already complying with section 274 by conducting its electronic publishing through NIT as a separated affiliate. Furthermore, OCA pointed out that section 274 sunset on February 8, 2000, a month before the 2000 DPA and 2000 LLA were filed with the Commission and, consequently, section 274 no longer prohibits VNH's use of any affiliate arrangement that the Commission deems appropriate.

3. Economic Policy Arguments

In its Post Hearing Brief, OCA pointed out that even though Judge Greene acknowledged that competitors to BOCs existed, Yellow Pages were currently earning "supra-

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[44] This summary is primarily based on OCA's Prehearing Brief at 8-9 and Post Hearing Brief at 16 unless otherwise noted.
[45] This summary is primarily based on OCA's Prehearing Brief at 8 and Post Hearing Brief at 16-17 unless otherwise noted.

competitive profits." According to OCA, the record in this proceeding demonstrates that, despite the passage of time and significant Federal legislation, not much has changed in the Yellow Pages industry. OCA said that Mr. Schlegel's estimate of Verizon's share of the Yellow Pages print market in New Hampshire, together with the very high revenue share of incumbents such as VNH nationally; do not support the conclusion that the directory advertising market is fully competitive. OCA maintained that if competition in the Yellow Pages market were truly robust, VYPC could not have shown the type of gross revenue growth in New Hampshire from 1995 to 2003, while maintaining supra profits approaching 50 percent of gross revenues in 2002 and 2003, and would not have been able to increase Yellow Pages advertising prices year after year from 1998 through 2002, with the increase from 2001 to 2002 approaching 5 percent.

OCA said there is no need to demonstrate Verizon's market power in order to support Yellow Pages revenue sharing requirements. Relying on Mr. Schlegel's testimony, OCA argued that the record supports a finding that Verizon holds market power and that the Yellow Pages directory advertising business in New Hampshire is not competitive. OCA said that the lack of product substitution with those of other print media is evident from both Yellow Pages customer statements and Verizon's own advertising claims. In addition, OCA said the Eleventh Circuit Court of Appeals had agreed with Mr. Schlegel that the market for BOC Yellow Pages is limited to all Yellow Pages print publishers. OCA found further evidence of market power, beyond the market share estimate provided by Mr. Schlegel, in both usage advantages and pricing disparities between VYPC and its competitors.

OCA argued that because Verizon Yellow Pages enjoys market power in New Hampshire, VNH's claims that imputation would create market distortions in the Yellow Pages publishing market are baseless. According to OCA, in a non-competitive Yellow Pages market,

distortions in favor of the dominant provider are irrelevant.[46] OCA maintained the same argument applies with respect to VNH's claims of distortions to the local exchange market, which is, according to OCA, still dominated by VNH and subject to price regulation. OCA said that if and when the local exchange market has reached the point where it is appropriate to consider the impact of regulated rates on competition, the Commission may then consider potential market distortions. OCA said that is not within the scope of this docket and no record exists in this proceeding to conduct that analysis.

In its Post Hearing Reply Brief, OCA stated that imputation is an equitable policy which provides a way to preserve the value of the associated directory business for ratepayers. OCA argued that policies established in 1982 and through the TAct continue to be applicable today because the Yellow Pages industry has remained substantially unchanged. OCA concluded that as long as the Commission finds that a contribution of Yellow Pages advertising revenues to VNH is reasonable and promotes the public good, it may and should impute the revenues in order to continue its existing and equitable policy.

4. Commission's Statutory Authority to Order Imputation

In its Prehearing Brief, OCA argued that the Commission has the authority to require VNH to impute Yellow Pages revenues to its regulated telephone operations under its plenary ratemaking powers over public utilities set forth in RSA 378:8 and supported by *State v. New England Telephone & Telegraph Company*, 103 N.H. 394 (1961). OCA pointed out that VNH's rates are set through traditional rate of return regulation and the Commission has traditionally considered Yellow Pages costs and revenues as part of the ratemaking process in setting basic telephone rates, citing *New England Telephone & Telegraph Company*, 65 NH PUC

[46] In addition, OCA contended that there will be no distortion of Yellow Pages profits because Verizon will retain all of those profits in its publishing operations; according to OCA, imputation will only affect the level of regulated rates.

564, 578 (1980). OCA asserted that the TAct did not prohibit continued state regulation of the directory and Yellow Pages publishing activities of the BOCs, any more than it prohibited local regulation of basic telephone service even after it has been declared competitive. In addition, OCA contended that the Commission has authority under RSA 366:5 to order modification of any affiliate agreement determined not to be in the public interest, including the 2000 DPA.

RSA 378:8 provides:

> Whenever the commission shall be of opinion, after a hearing had upon its own motion or upon complaint, that the rates, fares or charges demanded or collected, or proposed to be demanded or collected, by any public utility for service rendered or to be rendered are unjust or unreasonable, or that the regulations or practices of such public utility affecting such rates are unjust or unreasonable, or in any wise in violation of any provision of law, or that the maximum rates, fares or charges chargeable by any such public utility are insufficient, the commission shall determine the just and reasonable or lawful rates, fares and charges to be thereafter observed and in force as the maximum to be charged for the service to be performed, and shall fix the same by order to be served upon all public utilities by which such rates, fares and charges are thereafter to be observed. The commission shall be under no obligation to investigate any rate matter which it has investigated within a period of 2 years, but may do so within said period at its discretion.

In its Post Hearing Brief, OCA argued that simply because a utility conducts a specific unregulated activity does not mean that the revenues from that activity cannot be used for ratemaking, citing, as an example, *State ex. rel. Util. Comm'n v. Carolina Telephone and Telegraph Co.*, 61 N.C. 42, 300 S.E. 2d 395 (1983). In addition, OCA argued that despite utility attempts to transfer publishing assets, profits from an affiliate's Yellow Pages operations are utility assets and subject to regulation, and may be imputed to determine telephone rates. OCA concluded that the Commission may impute Yellow pages revenues in determining rates as part of its ratemaking authority and in order to properly balance ratepayers and shareholders interests. In its Post Hearing Reply Brief, OCA reiterated that the Commission has the requisite statutory

authority to find that the 2000 DPA is unreasonable and to impute the Yellow Pages revenues to VNH.

5. Imputation Methodology and Accounting Treatment

OCA did not offer its own recommended imputation methodology. In its Post Hearing Brief at 14, OCA supported the revenue imputation recommended by Staff, stating that the revenue imputation recommended by Staff balances utility and ratepayer interests by allowing the utility to cover its costs of directory publishing and to earn a reasonable portion of its profits as well.

6. Civil Penalty

In its Prehearing Brief, OCA stated it would not address the legal issue of whether fines against VNH are appropriate. OCA maintained that adjusting VNH's revenues by imputation is the most critical issue presented in this docket. OCA recommended that the Commission pursue penalty issues in a separate docket so as not to divert time and attention away from the imputation issues. In OCA's view, VNH's failure to file a copy of the 1999 Amendment was a violation of RSA 366:3. According to OCA, although fining VNH for this omission may provide some incentive for the utility to conduct itself differently in the future, other regulatory responses, such as annual outside audits of VNH and more detailed reporting requirements, including New Hampshire specific balance sheets and cash flow statements, may be more effective.[47] OCA contended that when a utility has made changes in its affiliate contracts that cause a profound impact upon regulated revenues, without meeting its burden of insuring that the Commission fully understands the revenue impact of those changes, the

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[47] VNH objected to OCA's recommendations for increased supervision of VNH, *see* Kevin O'Quinn Rebuttal Testimony at 5-7, and OCA did not further pursue this matter.

appropriate regulatory response is to assume that this type of behavior will continue. Given this fact, the Commission must increase its supervision of such a utility.

C. Destek Networking Group

Destek supported the positions of the OCA and Staff.

D. Commission Staff

Staff argued on a number of grounds that the 2000 DPA is unjust and unreasonable and disputed VNH's reasons for entering into it. Staff argued that the 2000 DPA should be disapproved and that imputation should be ordered as a reasonable remedy within the Commission's statutory authority.

1. Staff Chronology of Events[48]

Staff disputed VNH's characterization of the 1984 DPA and the proceeding in DE 84-12. Staff stated that under the 1984 DPA, NIRC obtained NET's exclusive right, during the term of the agreement, to contact subscribers of NET and others for the purpose of soliciting and obtaining directory advertising, and NIRC was to pay NET an annual publishing payment in exchange for the right to publish the directories for NET. In addition, Staff pointed out that NET was to provide NIRC with Yellow Pages billing and collection services and subscriber listings in return for specified compensation from NIRC. Staff noted that at the hearing on the 1984 DPA, the Commission was made aware that NET had transferred all its directory employees to NIRC and said VNH agreed that these employees took with them their Yellow Pages job knowledge, their established customer relationships, accounts, contacts and leads, and their knowledge of systems, procedures and promotional strategies and materials. Staff contended that, for

[48] This summary provided is primarily based on Staff's Post Hearing Brief at 3-7 and Post Hearing Reply Brief at 2-4 unless otherwise noted.

regulatory purposes, the 1984 NET-NIRC transaction should not be characterized as a complete or permanent transfer of all of NET's directory assets and operations to NIRC.

Staff asserted that the purpose of the 1984 transaction, as expressed in the 1984 DPA, NET's supporting testimony and the Commission's order, was to authorize and require NIRC to publish directories and conduct the Yellow Pages business on behalf of NET for a limited time in exchange for the publishing fees and other payments which were established and represented as compensation for the right to perform that activity and for other services rendered by NET. Staff pointed out that Verizon witnesses agreed the 1984 DPA was not a purchase and sale agreement for the transfer of a business or business assets; that NET presented no evidence to the Commission of the fair market value of the Yellow Pages business or related business assets; and that NET never requested the Commission's approval of a transfer of the Yellow Pages business under RSA 374:30, nor did the Commission grant such an approval. Staff stated that the 1984 DPA was an affiliate services contract required to be filed with the Commission under RSA 366:3. According to Staff, NET provided no statement of any compensation, whether book value, going concern value or something else, agreed to be paid to NET for a permanent business or assets transfer. Furthermore, Staff noted Mr. O'Quinn agreed that the 1984 DPA could be characterized as an agreement in which NIRC took over the management of the Yellow Pages business during the term of the agreement.[49] Staff argued that this was how the New York Public Service Commission had analyzed a similar agreement between New York Telephone (NYT) and NIRC under which NIRC was said to be charging NYT the portion of the system profits that NIRC did not return to NYT as Yellow Pages contribution.

[49] VNH took issue with this statement, saying Staff overlooked his clarifying statement on redirect examination that the transaction was a complete operational transfer. VNH Post Hearing Reply Brief at 9-10.

Mr. Antonuk testified that the Commission's authority to apply directory margins or contribution to local service revenue requirements predated the MFJ and was explicitly confirmed by the MFJ, and in no way depended on the terms of any affiliate agreements. He likened the 1984 DPA and 1991 DLA agreements to a license or lease type of arrangement and not to a sale or other permanent disposition. He noted that upon termination of a license or a lease, unless otherwise expressly provided for, the rights granted to the licensee or lessee reverts back to the licensor or lessor, not to the licensee or lessee. Staff concluded that NET did not permanently and irrevocably relinquish to NIRC its rights to the Yellow Pages as a business opportunity in the 1984 DPA or the 1991 DLA and that NET never relinquished its rights to the contribution from the Yellow Pages business temporarily being conducted on its behalf by NIRC until the 2000 DPA was entered into.

According to Staff, although BAYPC notified NET on December 29, 1997, that it was terminating the 1991 DLA effective January 1, 1999, it did so without informing the Commission. Staff pointed out that the 1999 Amendment was never filed with the Commission and argued that it is presently unenforceable as a matter of law under RSA 366:4. Staff argued that failure to file the 1999 Amendment within 10 days was a clear violation of RSA 366:3 for which a civil penalty should be imposed.[50]

Mr. Antonuk raised an issue regarding BAYPC's withdrawal on December 24, 1998, of its December 29, 1997, notice of termination and the new notice of termination of the 1991 DLA, as amended, effective January 1, 2000. He questioned whether the amended 1991 DLA was enforceable under RSA 366:4 because the 1999 Amendment was never filed with the Commission. He then questioned how the termination of the amended 1991 DLA could have any greater effect (or enforceability) than an unenforceable amended 1991 DLA. He said if the

[50] Staff Post Hearing Brief at 24-25.

amended 1991 DLA was unenforceable, then arguably at least, the termination of the 1991 DLA was also unenforceable.[51]

Staff also contended that NET's late filing of the 2000 DPA and LLA meant they were unenforceable in New Hampshire unless the Commission approves a late filing under RSA 366:4 and that failure to file them in a timely fashion was a violation of RSA 366:3.

Staff argued that the 2000 DPA is unjust and unreasonable because it does not provide for payment of any publishing fees related to directory advertising by BAYPC and VYPC and it reflects the give-away of the Yellow Pages business and associated publishing rights and revenues generated by the business. According to Staff, this constitutes unreasonable compensation to the publishing affiliate. Staff maintained that this is inconsistent with the result of an arm's-length transaction and is detrimental to the interests of VNH's ratepayers.[52] Staff stated that imputation is an appropriate remedy.

2. Impact of the TAct and FCC Regulations Implementing the TAct on the Directory Publishing Business and the Relationship between NET and NIRC

Staff argued that VNH's arguments do not support the reasonableness of either the decision to terminate the 1991 DLA or the terms and conditions of the 2000 DPA and do not prohibit Commission-ordered imputation.

a. Section 222(e) of the TAct[53] and the Issue of VNH's Right to Compensation from its Directory Publishing Affiliate

Staff urged the Commission to reject VNH's section 222(e) arguments. Staff stated that the issues in this docket have nothing to do with the terms on which VNH provides

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[51] In response, VNH pointed out that in any event the 2000 DPA was executed and filed and it would not make sense to have two conflicting agreements operating at the same time.
[52] *See e.g.,* Staff Post Hearing Brief at 1; Staff Post Hearing Reply Brief at 4.
[53] This summary is primarily based on Staff's Prehearing Brief at 6-10, Post Hearing Brief at 1-9, 12-13 and Post Hearing Reply Brief at 4-6 unless otherwise noted.

subscriber listings to others; rather, the issues in this docket relate to a different matter, the publishing arrangements between the regulated telephone company and its directory publisher affiliate, including the exploitation of VNH's subscriber list information, for purposes of producing Verizon's Yellow Pages and the appropriate compensation therefor. Staff pointed out that NET had a non-discrimination policy since divestiture and all that was required for NET to comply with section 222(e) and the FCC's rules implementing section 222(e) was to adjust the rates charged in the relevant 1991 affiliate agreement. Staff maintained that VNH has provided no analysis or citations to authority, and Staff could find none, for VNH's assertion that NET no longer had any right to grant "special" rights to BAYPC.

Staff disputed VNH's assertion that VYPC obtains no value from its relationship with VNH other than the subscriber listings under the 2000 LLA. For example, in its Prehearing Brief at 7-10, Staff supposed that VNH was arguing that because of the emergence of competition in the directory publishing business and the requirements of Section 222(e) and the FCC's *Third Report*, the rights or assets VIS obtains from VNH are no different from the access to directory listings now available to all directory publishers. In response, Staff submitted that VIS did not develop its directory advertising business by its own initiative, skill, investment or risk-taking in a competitive market. According to Staff, it inherited this business from the entity that was the sole provider of local telephone service, and which owned the underlying customer databases and had established business relationships with virtually all of the potential advertisers in the Yellow Pages. Staff said that, pursuant to the 1984 DPA and the 1991 DLA, NIRC used the benefits of these assets and the rights to these relationships retained by NET after divestiture. Staff maintained that VIS continues to enjoy a unique and direct benefit by being associated with VNH's regulated telecommunications services which justifies the payment to their owner, VNH,

of a portion of the revenues enjoyed by VIS, either explicitly or by imputation. According to Staff, the value which differentiates VIS's Yellow Pages from other directories is this connection with VNH, the "long-time permanent resident of the community." Staff added that the distribution of the classified advertising with the necessary white pages with the blessing of, and in association, with VNH sets them apart from any other classified advertising efforts in this state. Staff distinguished mere access to directory listings from the award of the right to fulfill the regulatory obligations to publish and distribute directories in the name of the local telephone company, and the access, relationships, reputation and name recognition that this right brings with it. Staff argued that the 2000 DPA recognizes none of this, and that, in essence what Verizon and VIS have accomplished through the clever crafting of the 2000 agreements is the completion of the transfer of the Yellow Pages from the operating company to the affiliated publishing company, which was begun with the 1984 DPA. According to Staff, this is accomplished by avoiding any mention of the rights that had been retained by the operating company since divestiture, and the suggestion that these changes are due to developments in the law and in the market. Staff submitted that this transfer is not reasonable and must be remedied.

Staff also pointed to market evidence reviewed by Dr. Rysman which shows the value of a directory business to be enhanced by affiliation with the local telephone company. Staff argued that NIRC and now VYPC have relied on the right to solicit directory advertising and publish telephone directories on behalf of the regulated telephone company. Staff urged that along with that right, NIRC and now VYPC have obtained other unique benefits and advantages from their relationship with the regulated telephone company which they have used to promote and develop the highly successful Verizon Yellow Pages business over the years.

According to Staff, these have included: a (i) a trained, knowledgeable workforce, established customer relationships and business strategies in 1984; (ii) the ability for a period of time to designate the telephone directories as the official directories of the telephone company; (iii) the ability to use the telephone company name, slogans and marks and their association with the well established telephone company; (iv) the reputation of the regulated telephone company for permanence and reliability; and (v) billing and collection services provided by NET which reinforce the connection to the regulated telephone company. Staff did not concede that VNH must currently own assets benefiting VYPC before imputation can be ordered. Staff contended that these kinds of advantages and benefits have lasting value. Mr. Schlegel testified that a "network effect" occurs in the directory advertising business, in which more advertising means more references by consumers and in turn more advertising and higher revenues. Staff claimed that such advantages have created and helped maintain the revenue stream which Verizon's shareholders, but not ratepayers, benefit from under the 2000 DPA and the Commission should protect ratepayers by disapproving the 2000 DPA and by ordering imputation.

Staff also disputed the validity of VNH's claim that because the name Verizon is a new one created by the holding company and provided from the "top down" to its subsidiaries, VNH's ratepayers have not paid for any value associated with the name and are not entitled to the benefits associated with the name. According to Staff, there is nothing magical about the name Verizon and the Verizon logo as such; what is important is that the association of the name with the regulated telephone company and its reputation has substantial value for the directory publishing business.

Staff said the record demonstrates that VYPC and its predecessors have promoted the Yellow Pages product for a long time by emphasizing the association of Yellow Pages with

the regulated telephone company and that VIS continues to do so to the present day. As support for this contention, Staff introduced excerpts from Concord area telephone directories. These directories indicated that for several years before 1991, NET's telephone directories were advertised on the front cover as "The Official Directory of New England Telephone." In addition, both before and after 1991, the directories included advertisements linking each member of the NYNEX family of companies and their products and services with the Bell name and symbol, which was said to signify the "highest quality communications goods and services" and "100 years of Bell tradition and commitment to quality." According to Staff, these messages further reinforce the association between the directories and the venerable, regulated telephone companies in the NYNEX family and their reputation. Among the advertised advantages of Verizon's Yellow Pages for 2000-2001 were permanence (Yellow Pages "have been in homes and businesses throughout the region for over 100 years"), circulation (Yellow Pages "are distributed to virtually every home and business in your market") and reliability (Yellow Pages "are delivered every year, year in and year out, to virtually every home and business, with an unsurpassed record of 100 years of reliable delivery"). Verizon's current New Hampshire directories proclaim on the cover that it is "YOUR DIRECTORY FOR OVER 100 YEARS!". Staff stated that the only directory publisher to which these claims apply is the regulated telephone company.

According to Staff, there is no indication in the record that Verizon's name and logo connotes in the popular view a Verizon company other than VNH and it is not credible that consumers see the Verizon name and logo and view them as referring to VYPC as opposed to related products under a single umbrella.

Regarding VNH's argument that its ratepayers have never paid for the efforts of the holding company and its unregulated subsidiaries to develop any goodwill that may be

associated with the common corporate name and therefore they should not realize any of the associated value, Staff asserted ratepayers have in fact paid rates that have allowed the regulated telephone company, regardless of its name and logo, to boost its reputation and customer identification which VYPC uses to its advantage in promoting Yellow Pages. Staff further averred that the image enhancement expenses of NET disallowed by the Commission in DR 89-010[54] were expenses incurred directly by NET for promoting NET's brand identity and were unrelated to the promotion of the Yellow Pages business. Staff noted that, in any event, to the extent NIRC incurred expenses for promoting the Yellow Pages product and/or the NET name in connection with the product in a test year, the ratepayers would in effect have paid the expenses through the operation of the revenue sharing formulas in effect under the 1984 DPA and the 1991 DLA unless the Commission had disallowed them as being unreasonable in a ratemaking proceeding; however, the Commission would not likely have disallowed such expenses if they would benefit ratepayers through receipt of larger Yellow Pages margins.

Finally, Staff pointed out that the FCC rules implementing section 222(e) were a response to complaints by independent directory publishers that incumbent local exchange carriers were continuing to engage in unfair and anti-competitive list information practices. Staff contended that given Verizon's long-standing practice of not discriminating against non-affiliated publishers with respect to subscriber list information, this concern did not apply to VNH, but argued that rules intended to protect the competitive interests of independent publishers should not be viewed as granting a windfall to shareholders at ratepayers' expense as would occur unless imputation is ordered.

[54] VNH cited such disallowance for the specific proposition that having allocated to shareholders the expense of developing goodwill, it would be unreasonable to claim that any value associated with the name belongs to ratepayers.

b. Section 254 of the TAct[55]

In Staff's Prehearing Brief, Staff advanced three arguments as to why section 254 of the TAct is not sufficient justification for termination of the license fee in the 1991 DLA and its complete replacement by the fee for service provisions of the 2000 DPA and 2000 LLA. First, Staff said that Mr. Nestor's Direct Testimony proceeded on the incorrect premise that revenue sharing payments to VNH are a subsidy to universal service that conflicts with the FCC's requirement that subsidies to universal service be explicit. Staff argued that if revenue sharing is a subsidy because it results in local exchange rates being set below cost due to the receipt of revenues other than the rates themselves, it is not a subsidy prohibited by the FCC, citing to the *Local Competition Order*. Second, Staff maintained that imputation does not involve a subsidy at all since imputation is compensation for the assets that VIS is able to enjoy because of its connection with VNH. Staff claimed that these assets belong to VNH and as they have been and continue to be paid for by VNH ratepayers, the ratepayers deserve to be credited for their use. Third, Staff maintained it was premature to argue that its rates would be subsidized as a result of imputation because the Commission has not ever determined whether to begin a new rate investigation or reach a determination on rate design.

In its Post Hearing Brief at 13-15, Staff noted that the Commission's 1985 and 1991 orders regarding the directory publishing agreements, as well as the Commission's finding in Order No. 19,188 that "revenues from [subscriber listings] marketing efforts will contribute towards the public good by diminishing the revenue burden on basic local rates," were not expressly based on the subsidy/affordability-for-all-Americans rationale[56] of the MFJ. Rather,

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[55] This summary is primarily based on Staff's Prehearing Brief at 10-12 and Post Hearing Brief at 13-15 unless otherwise noted.
[56] Judge Greene wrote that the evidence presented in the case before him indicated that the loss of the Yellow Pages subsidy to local telephone rates would reduce the number of households with telephones and increase the disparity

according to Staff, these orders stand for the simple proposition that revenue sharing results in just and reasonable rates, which would be fully consistent with the principle of providing services at "just, reasonable and affordable rates" as set forth in section 254(b)(1). Further, Mr. Antonuk testified that the FCC's *Universal Service Order* preserves the Commission's discretion in matters related to ratemaking.

Staff contended that directory revenues are not a universal service funding mechanism and that imputation would not violate the Federal policy requirements. In this regard, Staff said that even VNH agreed imputation as such is not a subsidy, although Dr. Taylor did say that imputation is "a *source* of and contributor to the local service subsidy that exists in VNH's rate design."[57] Thus, according to Staff, rate design, and not the fact that imputation would reduce the amount of the revenue requirement, is the key to determining whether a subsidy exists. Mr. Schlegel testified that the issues of subsidies do not come into play until the Commission decides to investigate VNH's rates in a rate design process. He also maintained that the Commission could remove every single subsidy on the regulated side in New Hampshire and keep the imputation fully in place and thereby ensure no conflict between imputation and a subsidy-free rate design. Staff reiterated that imputation is a fair way of compensating ratepayers for the support they provide to the Yellow Pages business and therefore could not be a subsidy.

Staff also maintained that VNH cannot argue imputation would constitute an unlawful "implicit subsidy" under the *Universal Service Order* and at the same time disavow any reliance on this definition. Staff said that the *Universal Service Order* at footnote 15 generally defines "implicit subsidy" as a situation where "[a] single company is expected to obtain

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between low income and well off citizens in terms of the availability of telephone service, a result avoided by his ruling.

[57] *See* Surrebuttal Testimony of William Taylor at 8.

revenues from sources at levels above 'cost' (*i.e.*, above competitive price levels) and to price other services allegedly below cost." Staff pointed out that Mr. Nestor said that VIS and VNH were two separate companies and he was unwilling to say that Yellow Pages revenues were obtained from sources at levels above competitive price levels as required by the definition.[58] Finally, Staff noted the footnote containing the definition adds that such intra-company subsidies are typically regulated by states.

Staff challenged the applicability of the remaining policy principles set forth in the *Universal Service Order*. Staff contended that imputation is not in any way inequitable to, nor does it discriminate against, VNH or its directory publishing affiliate. As support for this contention, Staff stated that the history of the Yellow Pages business in New Hampshire shows clearly that these companies are not similarly situated to any other directory publisher in New Hampshire. According to Staff, the fact that imputation would only apply to VIS and not to all independent publishers is therefore no ground for claiming unlawful discrimination.

Staff further maintained that VNH has not explained how the technological neutrality concept is violated by imputation or why a state assessment methodology not based on end user telecommunications revenues would be "inconsistent with the Commission's rules to preserve and advance universal service" within the meaning of section 254(f).

Finally, Staff contended that VNH's section 254 arguments represent only Mr. Nestor's creative interpretation of section 254 and the *Universal Service Order*. Staff argued that neither section 254 nor the *Universal Service Order* prohibit imputation or state that directory revenues are a universal service funding mechanism, and VNH has not produced any opinion or advice from the FCC in support of its position. Staff cited to decisions of public

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[58] *See* Day 1 Tr. at 111-117.

service commissions and courts in other states which have uniformly rejected arguments based on section 254.

c. Section 274 of the TAct[59]

Staff maintained that the requirements of section 274 of the TAct have little or no bearing on the considerations that must be taken into account in determining the reasonableness of an affiliate contract under RSA 366:5. According to Staff, the interest which VIS and VNH (through its agreement to the new compensation arrangements in the 2000 DPA) sought to protect and promote was VIS's competitive position, the results of which provide a benefit only to shareholders, not ratepayers. Staff maintained that no regard is expressed in VNH's discussion concerning what rights or assets of VNH were sacrificed through the reformulation of these contracts, how these assets may have been protected through some alternative reformulation, or the resulting impact upon ratepayers. Staff further posited that use of a separate non-telephone company affiliate for electronic publishing might have yielded a revenue stream to VNH in substantial excess of that provided by the 2000 DPA, contrary to the concerns expressed by VNH. Staff also pointed out that the section 274 restrictions sunset a month before the 2000 DPA was filed. Staff concluded that section 274 was not a legally compelling reason for terminating the 1991 DLA and entering into the 2000 DPA; rather, the reasons were economic and only from the perspective of VIS.

3. Economic Policy Arguments

In her Direct Testimony responding to VNH's direct testimony, Staff witness ChristiAne G. Mason maintained that VNH had not supported its argument concerning competition in the directory publishing business with sufficient empirical data.[60] Staff witnesses

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[59] This summary is primarily based on Staff's Prehearing Brief at 4-6 unless otherwise noted.
[60] Direct Testimony of ChristiAne G. Mason at 13.

Chris M. Schlegel and Lawrence N. Koppelman provided Reply Testimony to Dr. Taylor's Rebuttal Testimony. Mr. Schlegel, a Staff economist, concluded that imputation is justified irrespective of the state of competition in the directory publishing and telecommunications markets. Although he maintained Dr. Taylor's competition testimony is not relevant to the central question of whether imputation should be ordered, he addressed the issue of competition, concluding that VIS has market power in the relevant market.

Regarding the issue of imputation, Mr. Schlegel disputed Dr. Taylor's assertion that imputation will hurt both the advertising and the local exchange market because the imputation is a tax. According to Mr. Schlegel, VIS would only be subject to an imputation rule, not a transfer, since under imputation VIS does not transfer any amount of assets or revenues to VNH.

Mr. Schlegel further argued that imputation is not a subsidy, contrary to Dr. Taylor's assertion. Using Dr. Taylor's definition of subsidy, *i.e.*, "[a] service is said to be receiving a subsidy if total revenues from selling the service are less than the service's Total Service Long Run Incremental Cost," Mr. Schlegel averred that whether or not imputation is in fact a subsidy depends on the specific use to which the imputation is put. He added that since the imputation is not applied to any specific service but added to the overall revenue requirement, there is no evidence that imputation satisfies Dr. Taylor's definition of a subsidy.

Mr. Schlegel also argued that removing one "distortion" from an otherwise distorted market generally does not allow the analyst to speculate very much as to what the effect would be on overall welfare or competition in the remaining market would be. He maintained that pricing in the local exchange market is now distorted by a host of other policies that are not strictly concerned with competition, value-of-service pricing being one example. In Mr.

Schlegel's view, because one or more distortions remain, reducing the "subsidy" by permanently suspending the imputation has ambiguous effects on welfare and competition. He said that, at a minimum, an otherwise distorted market does not allow Dr. Taylor to argue that the removal of the imputation practice would necessarily bring more efficiency. Mr. Schlegel asserted that the question of efficient pricing in local telecommunications markets is better addressed separately from the question of whether imputation should be ordered. In addition, he said that if the Commission chooses to set more efficient rates for local telephone service in the future, Yellow Pages imputation can continue and still produce subsidy free local telephone rates.

Mr. Schlegel argued that competition is not a sufficient or necessary condition or economic reason for the removal of Yellow Pages revenues from VNH. He said that revenues in the intraLATA market are earned in an arguably competitive market but this would provide no basis for the removal of these revenues only to make them available to the shareholders. Mr. Schlegel denied that discontinuance of imputation without adequate compensation is justified on economic policy grounds. According to Mr. Schlegel, Dr. Taylor said that ratepayers do not own VNH's assets in any sense. Mr. Schlegel commented that by this argument any portion of VNH's revenue requirement could be removed and offered to shareholders without compensation, which would clearly be inappropriate. In addition, Mr. Schlegel argued that, from an economic perspective, the lack of imputation would violate the notion of fundamental fairness. Mr. Schlegel noted that the tradeoff between fairness and efficiency remains but there is no certainty that less fairness will result in more efficiency in a market that would remain distorted after the permanent removal of imputation.

Regarding the issue of the level of competition in the advertising market in which VIS participates, Mr. Schlegel said that by definition competitive industries cannot earn supra-

competitive profits. Based on the record in the MFJ and his own analysis, Mr. Schlegel concluded that the Yellow Pages market has likely been non-competitive for well over a decade.

Mr. Schlegel said that the relevant geographic market is local and not statewide. Mr. Schlegel concluded that the relevant product market for Yellow Pages publishing is Yellow Pages publishing. Employing criteria identified by Dr. Taylor for determining the relevant product market, Mr. Schlegel argued that statements of purchasers of Verizon Yellow Pages advertisers show they do not regard other media like radio and newspapers as useful substitutes and that their statements do not treat other local directories published in the same area as Verizon's directories as sufficiently good substitutes even when the alternative directory offers advertisements at lower rates.

In addition, Mr. Schlegel argued that Yellow Pages serves a separate reference guide function than other media serve. He distinguished between directional and creative media. He said directional media such as Yellow Pages serve to provide consumers at the purchasing stage with the necessary information to buy the products for which a given want exists, while creative media attempt to create or stimulate those wants. Regarding the perceptions of the advertisers themselves, Mr. Schlegel argued that statements provided during discovery indicate that VIS is not concerned with competing directories.

Mr. Schlegel disputed Dr. Taylor's support for his assertion that the prices of different media appear to move together, suggesting that the media view each other as competitors in the same market. He said that Dr. Taylor did not in fact provide a correlation between Yellow Pages and other media, that Dr. Taylor had not measured the variables for a correlation analysis at the same time and that some of the variables are not available for a comparison across all time periods. Mr. Schlegel also argued that if different media were in fact

in the same relevant market and had equivalent amounts of comparable characteristics, then their prices should have converged. Mr. Schlegel maintained that the prices have not converged and thus they are not substitutes. Finally, he argued that the fact that money is being spent on all media means that companies are willing to pay for the specific attributes of each medium, which reveals nothing about whether two different media are substitutes.

Regarding the issue of the measure of market power in the relevant product and geographic market, Mr. Schlegel estimated that the lower bound of VIS' market share in New Hampshire is 70% based on the number of distributed directories. According to Mr. Schlegel, this figure does not take into account the success of the publication as measured by usage or revenue figures.

Mr. Schlegel contends that Dr. Taylor's conclusion that the Yellow Pages market is competitive is contradicted by direct market evidence, including the findings by Dr. Mark Rysman regarding: (i) network economies exhibited by the Yellow Pages market,[61] (ii) substantially higher average household references for directories published by telephone companies compared to independent publishers, substantially larger directories of telephone companies compared to those of independent publishers and substantially higher advertising prices in telephone companies, directories, (iii) stronger demand for directories published by telephone companies and (iv) price discrimination by RBOC Yellow Pages publishers. Mr. Schlegel maintained that such conditions are unlikely to occur in competitive markets.

Mr. Schlegel asserted that Staff's analysis of pricing and market structure for VIS in New Hampshire confirms Dr. Rysman's results. He said an analysis of Yellow Pages pricing

[61] As described by Mr. Schlegel, more advertising leads to more end user usage which in turn leads to more advertising, which has allowed RBOC publishers to sell larger quantities at higher prices. He stated the network effect works in reverse for entrants: less advertising (relative to the bigger RBOC books) leads to less usage which in turn leads to less advertising.

data in New Hampshire reveals that the average rates VIS charges, as measured per one thousand distributed books, are more than twice as high as those of alternative directories published in the same distribution area, while at the same time, VIS is able to sell much larger quantities of advertisements. In addition, he argued that VIS's rates indicate VIS is able to practice price discrimination consistently throughout its distribution area.

Mr. Schlegel also disputed Dr. Taylor's approach to the determination of the relevant market under the Merger Guidelines. According to Mr. Schlegel, the evidence showed that RBOCs practice price discrimination, which is not only additional evidence that the Yellow Pages market is not competitive but also changes the definition of the relevant market in the Merger Guidelines.

Finally, Mr. Schlegel asserted that application of the Merger Guidelines standard by authorities on competition and courts support Staff's conclusions. Among other cases, he described a 1997 decision by the Canadian Competition Tribunal[62] which involved the issue of competition in the Yellow Pages business using the Merger Guidelines standard for determining the relevant geographic and product market. According to Mr. Schlegel, the decision is consistent with conclusions that: (i) purchasers of advertising do not perceive Yellow Pages to be readily substitutable, but rely instead on the reputation of Verizon to deliver a product that has higher advertiser concentration and therefore higher reference value and (ii) the presence of niche market players is not evidence that VIS lacks market power. Mr. Schlegel described another case, *Ad-Vantage Telephone Directory Consultants, Inc. v. GTE Directories Corporation*, 849 F.2d 1336, 1342 (11th Cir. 1987) which found that the market for Yellow Pages advertising is a distinct market.

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[62] *In The Matter Of An Application By The Director Of Investigation And Research Under Sections 77 And 79 Of The Competition Act*, R.S.C. 1985, c. C-34, CT – 94 / 3, issued February 26, 1997.

Mr. Koppelman, a management consultant with a background in economics,[63] also testified in prefiled Reply Testimony regarding the issues of economic policy and competition raised by Dr. Taylor. Addressing the issue of whether imputation would distort the local advertising markets and Verizon's incentives to compete in the directory advertising market, he said Dr. Taylor does not support his recommendations with facts but only by other argument. Mr. Koppelman maintained that until Verizon unilaterally changed the status of the margin contribution of Yellow Pages directories, this "distortion" was in effect for decades and, in spite of the effect of this "tax," Verizon and its predecessors have continued to make their Yellow Pages directory businesses grow and they have surely been innovative. According to Mr. Koppelman, Dr. Taylor does not show that, since VNH stopped reporting the revenues of Yellow Pages advertising, VIS has made its business grow and innovate in New Hampshire more than it did before because of this new, greater incentive. Mr. Koppelman said the BOCs cared about the profits they made in the Yellow Pages business because they kept most or all of those profits. Mr. Koppelman maintained that utilities always have an incentive to maximize their profits, whatever their treatment, because between rate cases they get to keep them, even if rates are reduced because a company is earning more than the allowed return on equity, as soon as those rates are set, there continues an incentive again to make as much money as possible. Mr. Koppelman also contended that the issue is not relevant to the Commission because it is not the Commission's charge to worry about the future growth of VIS.

Regarding Dr. Taylor's arguments about the negative effects of imputation on telecommunications services markets, Mr. Koppelman said that VNH's rates in New Hampshire already include the contribution from Yellow Pages advertising, the element which Dr. Taylor

[63] Mr. Koppelman also served as the project manager for Liberty Consulting Group's Financial Audit of VNH dated September 6, 2002.

claims is a distortion, but Verizon has likely not complained about this before nor have its competitors in New Hampshire. Mr. Koppelman said he did not believe Verizon intended to help those competitors. In addition, Mr. Koppelman said that any implication that the local exchange market is not now competitive is unsupported and contrary to what he understands the situation to be. Mr. Koppelman maintained that VNH is free to argue in a rate case for a redesign that causes the least harm to competition from the use of the cross subsidy available from the Yellow Pages margins.

Mr. Koppelman contended that Dr. Taylor's argument about minimizing economic-welfare losses by only "taxing" services whose price elasticity of demand is low is incorrect. According to Mr. Koppelman, the price elasticity of demand for Yellow Pages advertising is in fact low, as indicated by the data on price increases for Yellow Pages data, instead of being high as Dr. Taylor argues is likely. Mr. Koppelman added that Dr. Taylor's argument is irrelevant because it is not the Commission's job to manage the market for advertising services in New Hampshire.

Mr. Koppelman supported Mr. Schlegel's analysis that the market in which Yellow Pages directories compete do not have the competitive characteristics claimed by Dr. Taylor. Mr. Koppelman maintained that VNH has presented no information regarding whether the level of competition in the Yellow Pages business has materially changed since the 1980s. According to Mr. Koppelman, if the level has not materially changed, then an important premise behind the decision to stop revenue sharing is invalidated. In addition he said that VNH had offered no witness to support a contention that new, tougher competition has hurt Verizon's Yellow Pages directories.

Mr. Koppelman said that the Yellow Pages industry in the United States and in New Hampshire was remarkably healthy. He pointed to the increase in VIS's revenues in New Hampshire as specific evidence contradicting the conclusion that competition in the Yellow Pages business suggests a change from the traditional treatment of directory advertising margins. Based on data regarding the mean ratio of purchase prices for directory businesses to long term EBITDA, (earnings before interest, taxes, depreciation and amortization,) Mr. Koppelman concluded that buyers of directories expect the businesses to continue producing strong and growing profits for many years and do not expect a significant risk of margin erosion from competition of any sort. In Mr. Koppelman's view, Verizon's return on investment in the directory business of more than 100 percent is a powerful indicator of the lack of competition.

Mr. Koppelman said that Yellow Pages directories are a unique product and advertisers know there is little in the way of substitute products that provide the same convenience and permanence of reference as a Yellow Pages directory. He said advertisers know that Yellow Pages are effective, which is why they pay higher prices year after year to advertise, and make a large, un-cancelable commitment for a whole year. To a limited degree, Mr. Koppelman agreed that the media view each other as competitors but he said Dr. Taylor had offered very little data and analysis on this point. Although he also agreed that advertisers view different media as substitutes and make decisions on how to allocate their advertising expenditures using their judgments of relative value, he said that that misses the key point, which is that the Yellow Pages directories are especially valuable advertising media because of their reference value.

According to Mr. Koppelman, the existence of competing print directories in New Hampshire shows only that there is some fringe activity in the Yellow Pages directory market.

He said Dr. Taylor's observation was based on the number of competitors to VIS's directories, not on how big they are or how many are distributed, and he said that Dr. Taylor did not address how successful they are as competitors against VIS. Mr. Koppelman maintained that the real issue is not whether competitors are trying to compete. He said that although it is not surprising to see other books, it is also not surprising that they provide no significant threat to advertising rates or revenues for VIS in New Hampshire. He said that barriers to initial entry in the directory business may be low but that does not mean there are low barriers to success. Based on data regarding the distribution of directories in New Hampshire[64] by VIS as compared to other directory publishers, Mr. Koppelman concluded that VIS's New Hampshire Yellow Pages directories have no price or revenue-threatening competition in the relevant market. As further support for his position, he contended that pricing data which compares the prices VIS charges for directory advertising in New Hampshire with other directory publishers and VIS's ability to increase the prices it charged for advertising show that VIS has an abundance of pricing power in New Hampshire.

In its Post Hearing Brief, Staff argued that Dr. Taylor's policy prescriptions are entirely theoretical and are not supported by data or analysis. Staff said that the economic theories on which Dr. Taylor's argument rests existed in 1984 and 1991, yet NET and NIRC embraced revenue sharing then without any reservations. Staff pointed out that according to NET, the Yellow Pages business was competitive in 1984 and was expected to become much more so; further, NET gave increased competition as the primary reason for conducting the business through an affiliate under a revenue sharing arrangement.

Staff contended that VNH is not a credible witness for competition. Staff pointed out that neither VIS nor Verizon Communications, Inc., has appeared in this docket to validate

[64] He said that distribution means coverage and translates into revenues.

the distortions and inefficiencies Dr. Taylor discusses, and no independent Yellow Pages publisher or competitive local exchange carrier has appeared in this docket to support VNH's policy arguments. Staff maintained that several cases and orders from other states have rejected Dr. Taylor's policy arguments, citing *Re Cincinnati Bell Telephone Company*, Case No. 98-292, 190 P.U.R.4th 585 (Kentucky Public Service Commission January 25, 1999); *Re U S WEST Communications, Inc.*, UT 125 and UT 80, Order No. 00-191, PUR Slip Copy, 2000 WL 562288 (Oregon Public Utilities Commission, April 14, 2000); and *US West Communications, Inc. v. Washington Utilities & Transportation Commission*, 134 Wash.2d 74, 949 P.2d 1337 (1997).

Staff noted that Mr. Schlegel agrees that the level of competition is not relevant to the issues in this docket but he draws a different conclusion from Dr. Taylor—namely, that imputation is justified regardless of the level of competition. Staff also maintained that competition has been found to be immaterial in other cases.

Staff argued that VNH is attempting to overturn a Commission policy recognizing that revenue sharing is in the public interest, a policy which has been in effect for approximately eighteen years. Staff maintained that the burden is on VNH to show that the current Commission policy is clearly wrong. Staff submitted that on the record in this docket VNH has failed to show that any important economic policy considerations require the Commission's long standing policy to be overturned.

Staff said that given the apparent agreement of Dr. Taylor and Mr. Schlegel that policy considerations do not depend on the level of competition in the Yellow Pages market, the Commission is not called on in this docket to make an in-depth analysis of the level of competition. However, Staff argued that if the Commission disagrees and desires to decide the question, the Commission should find that: (i) the relevant market, *i.e.,* Yellow Pages, is not

competitive in fact; (ii) VIS dominates the Yellow Pages market in terms of market share; (iii) to the VIS and the directory publishing business have been profitable for many years; and (iv) VIS has market power in the relevant market.

4. Commission's Statutory Authority to Order Imputation

In its Prehearing Brief, Staff contended that RSA 366:5 grants the Commission authority to impose the remedy of imputation. Referring to the first sentence of RSA 366:5, Staff asserted that this language is broad in scope and purpose, giving the Commission "full power and authority" to fashion a remedy. Staff said the only limitations are that such order may only be imposed "after notice and hearing," that it be "reasonable," and that it be designed to satisfy the "public good." Staff maintained the authority to order certain specific (though not exclusive) remedies is provided in the third and fourth sentence of RSA 366:5, stating that the Commission may disapprove any affiliate arrangement which the utility fails to prove is reasonable, and may disallow any payments pursuant to the contract. According to Staff, RSA 366:6[65] and 366:7 provide additional specific remedies.

Staff submitted that the Commission's authority to remedy an unreasonable affiliate contract is not limited to the specific remedies provided in the third and fourth sentence of RSA 366:5 and in RSA 366:6 and 366:7. According to Staff, an interpretation of these sections that would so limit the Commission is not supported by the explicit language of RSA 366:5 or by accepted rules of statutory construction.

[65] RSA 366:6 provides, "[i]f as a result of an investigation in accordance with RSA 366:5 the commission shall find that any public utility is making any payment or about to make any payment or doing or about to do any other thing which substantially threatens or impairs the ability of the public utility to render adequate service at reasonable rates or otherwise to discharge its duty to the public, the commission may apply to the superior court for an order directing the public utility to cease making any such payment or doing such other thing; and, thereupon, the court shall make such order as the public good may require."

Staff advanced six specific arguments in support of its position. First, Staff said that there is no language indicating that the listed remedies are exclusive. Second, Staff argued it is not "reasonable" to limit the Commission to the severe remedy of disapproval of an unjust affiliate agreement in its entirety, as proved by the fourth sentence of RSA 366:5, where it finds itself able to fashion a more reasonable remedy, such as the imputation of revenues, as Staff recommends in this instance.

Third, Staff maintained that imputation, where supported by the facts and required by the public good, is a "reasonable" remedy well within the "full power and authority" of the Commission to order, and has been applied often in setting rates, citing *New England Tel. & Tel. Co. v. State,* 98 N.H. 211, 97 A.2d 213 (1953) (approved use of imputed capital structure rather than actual capital structure in determining cost of capital) and *Granite State Telephone, Inc.*, 73 NH PUC 152, Order No. 19,057 (April, 1988) (when determining tax expenses, the tax calculation was performed using an imputed interest deduction to give the ratepayers the benefit of a portion of the investment tax credit.) In addition, Staff said although it recognized that Yellow Pages advertising rates, terms, and conditions have never been and are not now regulated by the Commission, the fact that a specific activity of a utility is not regulated does not mean that the expenses and revenues from that activity cannot be included in determining the rate structure of the utility. Staff pointed out that the revenues from directory advertising have historically been included in ratemaking determinations in this state.

Fourth, Staff said the general rationale for the Commission's authority to review transactions between affiliated companies is fear of collusion in the absence of arm's-length dealings. According to Staff, it does not matter under these statutes whether the utility paid the affiliate too much money for too little service or property, or whether (as Staff alleges here) the

utility gave the affiliate something of far greater value than the affiliate paid for in return; the effect in either situation is to give to the shareholders of the affiliate something of value at the expense of the ratepayers of the utility. Staff concluded that RSA 366:5 broadly authorizes the Commission to investigate "any such contract," and, in order to be effective, the power to fashion a remedy must be equal to the task.

Fifth, Staff maintained that imputation is also consistent with the Commission's general rate setting authority provided in RSA 378:7. Staff submitted that the new contractual arrangements are an "unjust or unreasonable" "practice" which directly impacts rates. According to Staff, RSA 378:7 authorizes the Commission to determine the "just and reasonable" rates, and imputation is a necessary remedy to achieve that result.

Sixth, Staff argued it must be recognized that the imputation of revenues recommended by Staff would be only one step in a rate setting process. Staff said the New Hampshire Supreme Court has long recognized that the Commission has considerable discretion in setting rates, and is not bound by law to the service of any single formula or a combination of formulas, citing *New England Tel. & Tel. C. v. State*, 95 N.H. 353, 64 A.2d 9 (1949) ; *Chicopee Mfg. Co. v. Public Service Company*, 98 N.H. 5, 93 A.2d 820 (1953) (the dominant standard of New Hampshire statutes is that rates shall be just and reasonable.) Staff contended that since New Hampshire statutes do not provide a formula for the Commission to follow in setting rates, it is not warranted to reject one unless it plainly contravenes the statutory scheme of regulation or violates the law in some other respect. According to Staff, to the extent that VNH were to challenge the imputation on grounds that it would lead to a confiscation of property, such a determination cannot be made piece-meal and must wait for the rate-setting process to conclude.

Staff concluded by citing *Campaign for Ratepayers Rights,* 145 N.H. 671, 766 A.2d 702 (2001) ("[t]he Constitution is only concerned with the end result of a rate order.")

In its Prehearing Reply Brief, Staff maintained that both Staff and VNH support their respective arguments on one of the more important guiding constructs of statutory interpretation, namely the principle discussed in *Appeal of Reid*, 143 N.H. 246, 252 (1998) that "all of the words of a statute must be given effect and that the legislature is presumed not to have used superfluous or redundant words." Staff argued that the plain meaning of this section would provide the Commission with the requisite authority to impute revenues as recommended by Staff, and that the listing of certain specific remedies should not be interpreted as prohibiting others, particularly where there is broad and general language providing for remedial authority "as the public good requires," unless a clear intent to do so is manifest in the statute. Staff submitted that such specific intent is lacking in RSA 366:5, and therefore it should be read broadly. Staff also maintained that its arguments as to the meaning of this section are more consistent with the above-cited principle of statutory interpretation than VNH's, as Staff's would not require an interpretation of the statute that necessarily ignores one of its provisions, which is to be avoided. According to Staff, the latter remedies within RSA 366:5 and 366:7 may be read consistently with the initial broad authority as examples of specific remedial measures and VNH's interpretation would require a tortured reading of the statutory language in order to be consistent with the latter specific provisions.

In its Post Hearing Brief, Staff stated that the Commission does not, and has not in the past, regulated Yellow Pages contract rates and terms and that VYPC is not a public utility as defined by New Hampshire statutes; however, Staff argued that this does not mean that Commission-ordered imputation is not authorized by New Hampshire law. Staff pointed out that

Yellow Pages costs and revenues have been historically included in ratemaking determinations by the Commission, both before divestiture when Yellow Pages was operated as an "in-house" function of NET and afterwards when the revenue sharing agreements were in effect. According to Staff, imputation does not mean that the Commission must now expand its existing jurisdiction or regulate matters that it did not regulate in the past. Staff asserted Dr. Taylor's comment that imputation might mean the Commission would begin regulating the terms and conditions of Yellow Pages advertising is an imaginary horrible.

In addition, Staff contended that imputation is a straightforward, narrowly tailored remedy which allows the Commission to uphold the interests of VNH's ratepayers without affecting or jeopardizing VNE's rights or the enforceability of the 2000 DPA in other states or the prerogative of other states to act as they see fit. Staff concluded that imputation is a reasonable, lawful remedy employed by many other states, citing numerous orders and court cases from across the country.

5. Imputation Methodology and Accounting Treatment

In its Post Hearing Brief, Staff maintained that in the absence of more accurate information from VNH and VYPC, its recommended imputation methodology with safeguards is the best currently available approximation of reasonable amounts to impute. According to Staff, the goal of Staff's imputation methodology is to approximate the margins, including the continuing growth in directory revenues, had the 1991 DLA not been terminated. Staff stated that the methodology is intended to protect the regulated entity and its ratepayers by capturing the growth in the Yellow Pages business and ensuring the revenue flow to the regulated entity. In her Direct Testimony, Ms. Mason stated that in the case of VNH the imputation adjustment effectively recombines the operating results of VIS-NH and VNH and prevents VNE from

transferring earnings from the regulated utility to a non-regulated affiliate, which, if such transfer were allowed, would have the effect of understating earnings. According to Staff, there is no dispute that the directory business has consistently produced high margins and that it has been growing its revenues year over year.

Ms. Mason stated in her Direct Testimony at 14-18 that an average of $27.5 million per year was being booked to the intrastate operations of VNH during the years 1996-1997 when the 1991 DLA was in effect while under the fee for service arrangement in effect during the years 1999-2002 an average of only $3.3 million was booked to intrastate operations. Ms. Mason testified that another way to consider the impact of the 2000 DPA and 2000 DLA in the aggregate was that VNH would have underreported its intrastate operations by $97.6 million during the years 1999-2002 if Liberty Consulting Group's recommendation (in the absence of better information) to impute $24.4 million for 2001 had been followed. According to Ms. Mason, the value of Yellow Pages operations booked to PART Puc 406.03 account 5230 in 1997 by VNH was $21 million as reflected in DE 97-180.

Staff developed an average relationship ratio based upon historical un-audited VNH directory revenue and VIS-NH gross revenue for the years 1995-1998, which was then applied to VIS-NH's year-end gross revenues for years 1999 forward, to determine the recommended current year imputed revenues. Staff's data showed that, while revenue sharing under the 1991 DLA was in effect, VNH was receiving approximately 41 percent of VIS-NH revenues, compared to an average of less than one percent under the fee for service arrangement. Applying the 41 percent ratio to VIS's unadjusted gross revenues would result in imputed directory revenues ranging from $25.1 million in 1999 to $27.4 million in 2002. Staff asserted

that $27.4 million appeared to be a reasonable amount to apply for 2002, based on the information made available to Staff by VNH.

In order to obtain the necessary information for imputation using Staff's formula, Ms. Mason recommended that VNH report its affiliate VIS-NH's gross revenues attributable to New Hampshire directories as part of its annual reporting requirements by establishing a memorandum account.

Ms. Mason also testified that the 1999 Amendment and termination of the 1991 DLA impacted the apportionment of the utility assessment fees, charged annually to all utilities, beginning in 1999.[66] According to Staff, in addition to determining a beginning baseline amount for imputed revenues, the imputation methodology can be used to determine what VNH's gross utility revenues for each year, beginning with 1999, would have been for determining the assessment in accordance with RSA 363-A:2 (Supp.)

RSA 363-A provides a procedure for calculating and collecting annual assessments on public utilities to recover the Commission's expenses. RSA 363-A:2 (Supp.) provides in part,

> [t]he assessment shall be calculated by using the gross utility revenue of all public utilities and 33 percent of the gross utility revenue of rural electric cooperatives for which a certificate of deregulation is on file with the commission and allocating the expenses of the commission to each utility in direct proportion as the revenues relate to the total utility revenues as a whole. Each such expense allocation shall be assessed against each public utility and rural electric cooperative with a certificate of deregulation on file with the commission in an amount equal to its proportionate share.

RSA 363-A:3 (Supp.) requires the Commission to calculate the amount to be assessed. RSA 363-A:4 (Supp.) contains a procedure enabling a public utility to file with the Commission an

[66] *See* ChristiAne G. Mason Direct Testimony at 26 and Day 4 Tr. at 17.

objection to an assessment based on a claim that it is "excessive, erroneous, unlawful, or invalid."

Staff urged that any imputation methodology followed by the Commission should be accompanied by safeguards to protect the validity of the imputation methodology chosen and the integrity of the underlying data. As an example of the need for safeguards, Staff noted VNH's change in revenue recognition in 1996 and the subsequent, opposing change in revenue recognition in 2003. Staff urged that safeguards should include normalizing revenue flows for these types of changes in accounting recognition, strict reporting requirements, and full auditing rights. In Staff's view, the Commission should not hesitate to use its broad power of investigation under RSA 366:5 as appropriate to protect ratepayer interests.

Staff recommended that the Commission immediately impose Staff's recommended imputation methodology while also reserving all its rights to: (i) obtain all information deemed appropriate for purposes of implementing imputation; (ii) revisit, refine or otherwise modify the imputation methodology in the future; and (iii) undertake any further proceedings deemed necessary to protect ratepayer interests.

In its Post Hearing Brief at 15-17, Staff urged that imputation to PART Puc 406.03 account 5230 is consistent with Commission precedent and applicable accounting principles. Staff maintained that the Commission's decision to adopt the *Uniform System of Accounts for Telecommunications Companies*, 73 NH PUC 34 (1988), *supra* makes clear that in New Hampshire a strict GAAP approach is not appropriate; a state specific system is necessary to preserve the Commission's independence in setting intrastate accounting and ratemaking policy, and the Commission reserves the right to review any accounting matter further should it become an issue in a ratemaking proceeding. Staff maintained further that the statutes

authorizing the Commission to establish a system of records and accounts to be used by public utilities for their business in New Hampshire, and RSA 374:13 in particular, do not prevent VNH from complying with any requirements of the FCC or the Securities Exchange Commission (SEC) in terms of reporting in accordance with GAAP.

Staff urged the Commission to utilize the New Hampshire rules as intended and require VNH to book imputed revenues to PART Puc 406.03 account 5230 regardless of whether such treatment would be strictly consistent with GAAP or FCC requirements. According to Staff, this would allow the Commission to meet the most basic objective of utility ratemaking by accurately monitoring the total amount of revenues for the purposes of ratemaking and determining the appropriate level of assessments due from VNH.

Staff argued that the Joint Conference confirmed in WC Docket 02-269 that distinct and detailed accounts are necessary for the accounting of revenues arising from imputation of directory publishing revenues. Staff stated that the Joint Conference further recommended that the FCC Part 32 account 5230 be designated for this purpose. According to Staff, this recommendation supports Staff's recommendation to book imputed revenues to PART Puc 406.03 account 5230. Staff maintained that the Commission's accounting policy and the goals of separate, distinct and detailed accounting for intrastate ratemaking purposes are mirrored and supported by the Joint Conference. Staff argued that VNH has not pointed to any FCC order which precludes the Commission from accounting for imputed revenues as Staff suggests. Staff maintained that Mr. O'Quinn's arguments regarding the proper accounting treatment for imputation are flawed and are in direct conflict with the Commission's goals in establishing and maintaining its own accounting system.

6. Civil Penalty

In its Post Hearing Brief, Staff recommended that VNH be assessed a civil penalty for failure to file the 1999 Amendment with the Commission as required by RSA 366:3. RSA 365:41 authorizes civil penalties against public utilities for violation of any provision of Title 34 or the failure to observe any order of the Commission. According to Staff, NET's failure to file the 1999 Amendment is a clear violation of RSA 366:3 and constitutes a violation of Order No. 17,744 requiring NET to "provide the Commission with information pertinent to any changes in the terms and conditions of the agreements with affiliates."

Staff argued that not only did NET not file the 1999 Amendment as required, it failed to bring the 1999 Amendment to the attention of the Commission in any other way reasonably calculated to inform the Commission of its existence and the significant change in the relationship between NET and BAYPC. Staff also noted that NET did not inform the Commission of any of the contract termination notices preceding the 1999 Amendment. In addition, Staff noted that NET did not bring the 1999 Amendment to the Commission's attention in its March 8, 2000 cover letter or mention that revenue sharing was not provided for under the 2000 DPA. Staff further pointed out that NET did not take the opportunity afforded by Minot Hill's data requests in 2000 regarding its 1999 operating results to inform the Commission of the 1999 Amendment; instead, NET chose to give narrow answers to his questions.

According to Staff, these circumstances do not appear to be an isolated instance of lack of responsiveness. Staff stated the Vermont Public Service Board described Bell Atlantic's renewal of the 1991 DLA without seeking Board approval and its failure to provide a copy of the Directory License Agreement despite requests from the Board. Staff argued that if VNH wishes to operate strictly according to legal requirements, it is not unreasonable for VNH to be held strictly accountable for non-compliance with legal requirements.

Staff argued that non-compliance due to the oversight caused by an individual's departure from NET soon after the 1999 Amendment was signed[67] does not excuse the failure to file the 1999 Amendment. Finally, Staff argued the failure to file the 1999 Amendment was not harmless because it meant that NET has paid less in assessments and while other utilities have paid more.

III. COMMISSION ANALYSIS

A. History of the Relationship between the Regulated Telephone Company and its Directory Publishing Affiliate

In order to decide the issues raised in this docket, it is necessary to analyze the events leading up to the 2000 DPA. More than one hundred years ago, a telephone company predecessor of Verizon began publishing telephone directories in New York State.[68] According to VNH, the directories were initially composed of the White Pages, that is, alphabetical listings of subscribers and their telephone numbers. In addition, the directory advertising portion of the telephone book, commonly referred to as the Yellow Pages, began to appear in telephone directories "a very long time ago."[69] Directory advertising involves the sale of advertising to businesses by the publisher which then publishes the advertising in the telephone directories distributed along with the White Pages to all its customers. The White Pages and Yellow Pages segments have traditionally been published and printed as a single book in most locales. While the Yellow Pages have included business advertising, they typically include business listings

[67] Day 2 Tr. at 16-17.
[68] *See* Testimony of Donna J. Loftus, Day 1 Tr. at 149-150 and Ex. 31. Except where otherwise noted, references to telephone books or telephone directories refer to the directories published directly or indirectly by the regulated telephone company.
[69] *See* Day 1 Tr. at 150.

arranged by classified headings as well.[70] In recent years at least, directory advertising has not been confined to the Yellow Pages; it now appears in the White Pages and even on the covers of the telephone directories. The Yellow Pages have been and are a prominent and vital part of the telephone book. For example, the Concord, New Hampshire telephone book was titled for a number of years, “NYNEX YELLOW PAGES/Concord Area with White Pages.” Ex. 30. As another example, measured by the volume of pages, the Yellow Pages comprise roughly two thirds of Verizon’s 2003-2004 Concord telephone directory and White Pages comprise the other third.

It is undisputed that, before 1984, NET compiled, published and distributed telephone directories “in-house” and Yellow Pages operations and revenues belonged entirely to the regulated telephone company. During this time, the revenues and costs related to telephone directories, including Yellow Pages, were reflected in NET’s New Hampshire revenue requirement and directory assets were included in rate base. Telephone directories, including both White Pages and Yellow Pages, were (and are) commonly viewed as integral to providing telecommunications services to ratepayers.[71] Indeed, in this docket Staff witness John Antonuk testified that directory revenues arise from operations deemed to be integrally related to the

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[70] *See* Ex. 16 at 6, 219.

[71] *See e.g., Re US West Communications, Inc.*, Docket No. 95-049-05, 165 P.U.R.4th 235 (Utah Public Service Commission, November 6, 1995); *US West Communications, Inc. v. Public Service Commission of Utah*, 998 P.2d 247, 250-251 (Utah 2000); *State Utilities Commission v. Southern Bell Telephone and Telegraph Company*, 307 N.C. 541, 299 S.E.2d 763, 766 (N.C. 1983); *New England Telephone and Telegraph Company*, Docket No. 4874/4875, 62 P.U.R.4th 503 (Vermont Public Service Board, October 5, 1984); *Re New England Telephone and Telegraph Company*, Docket Nos. 5700/5702, 157 P.U.R.4th 112 (Vermont Public Service Board, October 5, 1994); *Re Cincinnati Bell Telephone Company*, Case No. 98-292, 190 P.U.R.4th 585 (Kentucky Public Service Commission, January 25, 1999); *Re Pacific Northwest Bell Telephone Company dba US West Communications*, UT 85, Order No. 89-1807, 110 P.U.R.4th 132 (Oregon Public Utilities Commission, December 29, 1989); *Re Pacific Bell*, Decision 02-10-020, PUR Slip Copy, 2002 WL 31398657 (California Public Utilities Commission, October 3, 2002). VNH concedes that telephone directories are a very useful and beneficial component in providing basic telephone service to the public, *see* Day 2 Tr. at 40-41, and VNH has provided no evidence that the experience in New Hampshire regarding the close connection between telephone service and telephone directories is significantly different than elsewhere in the United States.

provision of local service and they rely on assets and operations that are integrally related.[72] Although the Yellow Pages business was open to competition and was not a regulated monopoly, its revenues and costs were "above the line" entries in NET's regulated books of account.

VNH agrees that the Yellow Pages business was a legacy of the monopoly position of the regulated telephone companies. *See* Day 2 Tr. at 43; Day 4 Tr. at 220. By the early 1980s, at least, it had become a highly profitable business. All parties to the AT&T divestiture litigation presided over by Judge Greene conceded that the telephone companies' Yellow Pages operations were then earning "supra-competitive" profits.[73] VNH also agrees that NIRC did not establish the directory advertising business by its own initiative, skill, investment or risk-taking in a competitive market and that it inherited the business from the dominant provider of local telephone service, which owned the underlying database and had established business relationships with virtually all the potential Yellow Pages advertisers.[74]

As part of the MFJ, Judge Greene removed the previously announced prohibition on the BOCs' publication of the printed Yellow Pages directories because he concluded that such prohibition would not serve the public interest.[75] The ruling caused the Yellow Pages print business to remain with the BOCs, such as NET, instead of being transferred to AT&T.[76]

Judge Greene gave several reasons for the decision to remove the prohibition.[77] First, he said that because the Yellow Pages were earning supra-competitive profits, there was no

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[72] John Antonuk Reply Testimony at 9-13. Specifically he said the connection is the use of the same directory through which the telephone company publishes, or causes a contracted party to publish, the White Pages.
[73] *United States v. American Telephone and Telegraph Company, supra* at 193. In this Federal anti-trust litigation, Judge Greene approved the divestiture by AT&T of its twenty two local telephone operating companies, including NET and New York Telephone (NYT), as of January 1, 1984. NET emerged from the divestiture as a subsidiary of one of the seven newly formed regional holding companies, NYNEX Corporation, which also held NYT.
[74] Testimony of John F. Nestor III, Day 2 Tr. at 44-45.
[75] He retained the prohibition on the production of electronic versions of the Yellow Pages by the BOCs. *Id.* at 189-190, 193-194.
[76] *Id.* at 194.
[77] *Id*. at 193-194.

reason to believe that the advertising prices charged by the BOCs were artificially low as the result of a subsidy from local exchange service. Second, he predicted that the BOCs would have little or no ability to discriminate against competitors in the printed directory market since access to the local exchange network was not required for production of a printed directory. Thus, he said a prohibition would not have a pro-competitive justification and, instead, would be anticompetitive because: (i) transfer of the production of the Yellow Pages from a number of smaller entities to one nationwide company, AT&T, would be the type of concentration anathema to the antitrust laws and (ii) possession of the franchise would give AT&T a substantial advantage over its competitors in the electronic directory advertising market. He also said that, Yellow Pages provided a large "subsidy" to local telephone rates which would most likely continue if the BOCs were permitted to publish the Yellow Pages, and the loss of the "subsidy" would result in large rate increases. He said this could reduce the number of homes with telephones and increase the disparity, in terms of the availability of telephone service, between low income and well-off citizens, a result "clearly contrary to the goal of providing affordable telephone service to all Americans."[78] Finally, he indicated that where the Federal interest embodied in the antitrust law was not furthered by the prohibition, continuing it would be an impermissible intrusion by the court on state regulation. In effect, the MFJ recognized the value of the Yellow Pages enterprise to the BOCs and established NET's rights to the revenues derived from the Yellow Pages business subject to supervision and regulation by the states.

On January 6, 1984, as the divestiture process was being implemented, NET filed four contracts between itself and various NYNEX subsidiaries pursuant to RSA 366:3, including

[78] *Id*. at 194.

the 1984 DPA dated as of January 1, 1984.[79] The Commission opened Docket No. DE 84-12 to review and consider them.

The parties agreed in the 1984 DPA that NIRC would produce, publish and distribute Telephone Directories[80] in accordance with the agreement and NIRC "would have the exclusive right of [NET] during the term of [the agreement] to contact subscribers of [NET], and all others, for the purposes of soliciting and obtaining Directory Advertising to appear in all Telephone Directories published hereunder."[81] NIRC was to pay NET an annual publishing payment consisting of a base fee calculated in accordance with certain workpapers dated December 21, 1983,[82] as adjusted for growth and price level changes and grossed up to reimburse NET for revenue related taxes on the basis and at the rates in effect for 1983.[83] Under Article 3, section 3.8, Telephone Directories compiled, printed and published by NIRC under the agreement were to be owned by NIRC and copyrighted in its name, and, except as otherwise provided, the risk of loss from the production, publication and distribution of Telephone Directories was to be borne by NIRC. In addition NET was to provide NIRC with billing and collection services for directory advertising as its agent[84] at NET's cost[85] and NET was to provide NIRC with subscriber listing information at the same rates charged to other businesses buying such information from NET.[86] The term of the agreement was for five years, with

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[79] *See* Ex. 16 at 2-46.
[80] Telephone Directories were defined to include both White Pages and Yellow Pages, whether or not bound together. *See* Article I, section 1.1: B, D, E and I.
[81] Article 2, sections 2.1 and 2.2.
[82] According to NET's testimony at the hearing on the contracts, the base fee applicable to the 1984 payment was to be NET's pre-divestiture 1983 net operating revenues from directory advertising less an "allowed" return on rate base. *See* Tr. of Hearing on April 10, 1984 at 14-21.
[83] *See* Appendix A, A.1.
[84] *See* Article 5 and Appendix D. The parties agreed that NET's normal monthly subscriber bills would contain any applicable directory advertising charges listed separately and included in the total amount due. *See* Appendix D, 1(b). NET in turn would periodically remit to NIRC the amounts billed to customers subject to certain adjustments. *See* Appendix D, 1(f).
[85] *See* Appendix A, A.2.
[86] *See* Appendix A, A.3..

automatic one year renewals subject to termination by either party on one year's notice.[87] NYT had a similar agreement with NIRC.[88]

According to NET,

> [t]he basic concept is to structure an arrangement which will allow [NIRC] to successfully meet the competitive challenge in the advertising marketplace while assuring a continued flow of contribution to NET and NYT…Because of the guarantee in the Agreement, NET need not be concerned with the growth of competition in the marketplace, both for traditional directories and for new products, or with the financial risks involved in meeting this competition." Exhibit 16 at 74; *see also* pages 70-71 (affirming that increasing competition in Yellow Pages advertising was the primary reason for establishing an affiliate to publish directories).[89]

NET assured the Commission that the transactions made under the 1984 DPA would be "a proper subject of scrutiny by the Commission in future ratemaking proceedings."[90]

The Commission stated in an order regarding the 1984 DPA that the costs associated with the affiliate agreements during the 1983 test year had been found to be "appropriate" and "reasonable" in a separate ratemaking docket, DR 84-95, and therefore had been allowed in rates. *New England Telephone and Telegraph Company*, Order No. 17,744, 70 NH PUC 630, 631 (1985). However, the Commission cautioned that additional experience with the agreements or other information developed in the course of future proceedings might warrant different findings and conclusions. The Commission warned that it would continue to monitor the relationship between NET and its affiliates, and "[i]f information comes to our attention warranting further action, we retain the flexibility to initiate an investigation pursuant to, *inter alia*, RSA 366:5 and, after notice and opportunity for hearing, to take such actions as are appropriate pursuant to, *inter alia*, RSA 366:6 and 7." *Id*. Because the costs of the contracts had

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[87] Ex. 16 at 15.
[88] Ex. 16 at 26.
[89] In light of VNH's initial claims in this docket that increasing competition justifies the cessation of revenue sharing, it is ironic if not paradoxical that both NET and NIRC were apparently content for many years with conducting the Yellow Pages business through a directory affiliate under revenue sharing arrangements.
[90] *See* DE 84-12 Prefiled testimony of John H. Hann at 4.

been included in rates, the Commission closed the docket, stating that no further action was necessary under RSA 366. Finally, the Commission ordered NET to "provide the Commission with information pertinent to any changes in the terms and conditions of the agreements with affiliates and the experience of the Company with those agreements." *Id*. The Commission gave income derived from Yellow Pages as an example of relevant updated information and noted that if that income had been significantly underestimated, it would be appropriate to consider further regulatory measures. *Id*.

The parties disagree about the proper characterization of the 1984 DPA and its implications for the decision we make in this docket. VNH contends that payments to NET under the 1984 DPA compensated NET for the transfer of the directory assets and operations that occurred when NIRC was created and that the telephone company has been sufficiently compensated for the transfer under the 1984 DPA and under a subsequent Directory License Agreement entered into by NET and NIRC dated as of January 1, 1991 (1991 DLA) and described below. On the other hand, Staff contends that, under the 1984 DPA, the annual publishing payment was made in exchange for the right to publish the directories for NET and that the purpose of the 1984 transaction, as expressed in the 1984 DPA, NET's supporting testimony and the Commission's order, was to authorize and require NIRC to publish directories and conduct the Yellow Pages business on behalf of NET. Staff contends that the 1984 transaction as presented to the Commission did not constitute the complete, permanent transfer of NET's directory publishing business to NIRC for regulatory purposes.

Public service commissions in other states have viewed the 1984 DPA and comparable agreements in different ways. For example, based on the record before it, the Vermont Public Service Commission stated that NET had agreed to transfer the directory

advertising assets, *i.e.*, the software systems used to support the compilation and advertising activities, the trained and experienced personnel, the building in Lynn, Massachusetts, the Bell logo, affiliation with NET, and the customer contracts and contacts, to NIRC in return for a stream of payments for an initial five year period. *See New England Telephone and Telegraph Company*, Docket No. 4847/4875, 62 P.U.R.4th 503, *supra (*Vermont Public Service Board, October 5, 1984). In that case the NET witness said he did not know what the policy of NET or NYNEX was with respect to the continuation of revenue from Yellow Pages advertising to NET after the expiration of the original contract. The Board stated:

> Though the short-run revenue flow from [NIRC] to NET cannot be described as grossly inadequate, or on its face unfair, if viewed solely in light of the existing directory activities of NET, the contract between NET and [NIRC] is not in the long run interest of NET or its ratepayers because it deprives NET of lines of revenues and new opportunities only to benefit NYNEX. We do not approve of this contract or the subsidiary arrangement. If we had the jurisdiction we would void the contract and require the return of all assets and personnel to NET.

The Vermont Board accepted the calculation of the revenue effect of Yellow Pages using test year costs and revenues of the operations when they were in NET. However, NET was told that in the next rate case the Board would require NET to indicate to what degree it is appropriate to impute to it additional revenues to compensate NET "for the deterioration of the directory service assets over the period of this contract." *Id.*

In its analysis, the Board referred to a decision by Judge Greene dated July 26, 1984 in which he commented,

> [w]hen the Court required AT&T to turn over its Yellow Pages operations to the Operating Companies, it assumed that the revenues from directory advertising would continue to be included in rate base of the Operating Companies, providing a subsidy to local rates. Yet the Regional Holding Companies, or some of them, have breached that understanding by forming affiliates to conduct Yellow Pages operations. Instead of funneling Yellow Pages revenues to the Operating Companies, they have created separate subsidiaries to handle their directory publishing operations which do *not* feed the revenues from these operations into

> the rate base. *U.S. v. Western Electric Co.*, 592 F.Supp. 846, 865-866 (D.D.C.1984).[91] Judge Greene predicted that "it is likely that the competitive ventures of the Regional Holding Companies, which rely in a number of ways on the funds generated by the ratepayers, will not share the profits from these ventures with the ratepayers." *Id*. at 866.

Based on its analysis of a directory publishing agreement similar to the 1984 DPA and the testimony of NYT witnesses, the New York Public Service Commission viewed the structure of the relationship differently. It found that "the directory business *belongs* to New York Telephone but that [NIRC] will manage it for five years" and that "[i]n return for the provision of this service, NIRC is in effect charging New York Telephone the portion of the system profits it is not returning" to NYT.[92] *New York Telephone Company*, Case 28860, Opinion No. 86-10, 73 P.U.R.4th 537, 26 N.Y.P.S.C. 1183 (1986); *In re New York Telephone v. Public Service Commission of New York*, 72 N.Y.2d 419, 425, 530 N.E.2d 843, 534 N.Y.S.2d 136 (1988). The New York Public Service Commission disapproved the directory publishing agreement, ruling that it had authority under a New York statute to disapprove "management, construction, engineering, or similar" contracts and that the directory publishing agreement was not in the public interest. The New York Court of Appeals upheld the New York Public Service Commission's decision. *Id*.

As described in *Re US WEST Comm., Inc.*, Docket No. UT-980948, 14th Suppl. Order, PUR Slip Copy, 2000 WL 1451454 (Washington Utilities and Transportation Commission, July 27, 2000), in late 1983, Pacific Northwest Bell (PNB), a local operating

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[91] In a footnote, he wrote, "[t]hus NYNEX has guaranteed to provide its regulated telephone companies with only a publishing fee—a fixed dollar amount—from its Yellow Pages revenue. That company contends that the telephone affiliates will benefit from this arrangement because the publishing costs associated with the Yellow Pages will be shifted to the separate subsidiary, and these affiliates, as well as the ratepayers, will be insulated from the risks of the directory publishing business, possible financial loss, and any fluctuation in the economy. But the revenues from Yellow Pages have always far exceeded the costs of publication. Moreover, if there ever should come a time when these operations are not profitable, the Regional Holding Companies could simply discontinue them. In short, the NYNEX arrangement does not assist the ratepayers; it assists only NYNEX." *Id*.

[92] The system profits NIRC retained were the directory advertising profits in excess of the annual directory publishing fee paid by NIRC to NYT.

company that eventually became US West Communications, Inc., requested the Washington Utilities and Transportation Commission (WUTC) authorize PNB's transfer of certain Yellow Pages-related physical assets to a directory publishing affiliate without compensation and approve an inter-company arrangement whereby PNB authorized the directory publishing affiliate to publish telephone directories for PNB in exchange for what was described in the request as a guaranteed stream of payments to PNB. Both requests were approved, with ratemaking treatment reserved on the financial consequences of the transfer.

US West Communications, Inc., argued that the entire directory business was transferred to the directory publishing affiliate with the transfer of the physical assets in 1984. In 2000, the WUTC rejected the argument and concluded that the relationship created by the new publishing arrangement for regulatory purposes was not a sale or other permanent transfer but, instead, the transfer of certain assets along with a series of licenses and a series of agreements for a term of years. The WUTC found that PNB had represented that the transaction was a temporary outsourcing or lease of the publishing function under a publishing agreement in exchange for a fee. The WUTC also found it would be clearly improper to consider the publishing fees to be payment for a capital asset that had been transferred because the purpose of the 1984 transaction, as expressed in the supporting documents and in its orders, was to "authorize and require [the directory publishing affiliate] to publish directories and conduct the classified advertising business for PNB for a limited period of time in exchange for the publishing fees [which] were established and represented as compensation for the rights to perform that activity and for other services rendered by PNB." *Id*.

In the present docket, VNH witness Kevin O'Quinn described the 1984 DPA in different ways. In his prefiled Rebuttal Testimony at page 5, he said "NIRC compensated [NET]

through revenue sharing in order to reflect the value of NIRC's exclusive right to produce Yellow Pages directories in the name of NET, including its New Hampshire operations." In the next sentence, he described the compensation received by VNH as being for the "transfer of the assets and operations to the directory affiliate." At hearing he agreed with Staff on cross examination that the 1984 DPA could be characterized as an agreement in which NIRC took over the management of the Yellow Pages business during the term of the agreement and that NET did not receive the portion of the system profits that NIRC did not return to NET as contribution. Subsequently, he reaffirmed on redirect examination the position he had taken in his prefiled testimony, namely that the Yellow Pages business was completely transferred to NIRC.[93]

VNH agrees that on its face the 1984 DPA is not in the form of a purchase and sale of a business, *see* Day 1 Tr. at 178, nor is it in the form of a proposed plan of corporate restructuring evidencing the permanent, final disposition of the Yellow Pages directory advertising activities and operations for regulatory purposes. To the contrary, NET's exclusive grant to NIRC of the right to contact subscribers and others for the purposes of soliciting and obtaining directory advertising to appear in telephone directories published under the 1984 DPA was expressly limited to the period the 1984 DPA was in effect. In addition, the fact that, for a period of time before the 1991 DLA took effect, the covers of the directories announced to the world that they were "The Official Directory of New England Telephone"[94] is inconsistent with a sale or other permanent disposition of the Yellow Pages directory advertising operations.

It is true the record in DE 84-12 contains a few scattered references to a corporate restructuring occurring behind the scenes to accommodate implementation of the 1984 DPA,

[93] *Compare* Day 1 Tr. at 184-185 with Day 3 Tr. at 67-68.
[94] *See* Day 2 Tr. at 118; *see also* Ex. 31 (1990-1991 Concord Area telephone directory) at 1.

such as the transfer of employees and the handling of accounts receivable and prepaid expenses. However, NET presented the 1984 DPA to the Commission as an affiliate services agreement filed pursuant to RSA 366:3 for the purpose of preparing, publishing and distributing telephone directories for NET.[95] NIRC's publication of Yellow Pages advertising for NET clearly fell within the scope of these services and NET drew no distinction in its presentation to the Commission between publication of telephone directories and the sale of advertising for publication. NET did not present any details, such as accounting documentation, consistent with a sale or other permanent disposition and VNH has not done so in this docket. It would indeed be an extraordinary transaction for a sale or other permanent disposition of a capital asset to be compensated based on installment payments in a number and amount to be determined by either party in the future, yet that in effect is what VNH would have us conclude about the transaction in 1984.[96] Furthermore, NET did not request Commission approval of the 1984 DPA as a transfer of the Yellow Pages business in the public interest pursuant to RSA 374: 30.

RSA 374:30 requires the Commission to find that a public utility's transfer or lease of its franchise, works or system or part thereof exercised or located in New Hampshire, or contract for the operation of its works and system located in New Hampshire, is in the public good and shall make an order assenting thereto. Under RSA 374:31, any such attempted transfer, lease or contract shall be void unless the same shall have been approved by the Commission. NET did not request the Commission to make a finding that the transfer of the Yellow Pages business or related assets was in the public good as pursuant to RSA 374:30 nor did the Commission make such a finding or grant such approval.

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[95] *See* prefiled testimony of John H. Hann, Ex. 16 at 51 and hearing testimony of Mr. Hann, Ex. 16 at 126-127.

[96] In this analogy, the number of installments would be determined by whether or not either party terminated the 1984 DPA and the amount of those installments would be determined by whether the parties agreed upon a modified payment arrangement replacing the payment formula of the 1984 DPA.

As Staff points out, NET introduced no evidence of the fair market value of NET's Yellow Pages business or assets and provided no indication to the Commission of any compensation, whether book value, going concern value or something else, agreed to be paid to NET for a permanent business or asset transfer, which would normally be produced if approval of a transfer were being requested. Under the circumstances, there is no basis for accepting VNH's characterization of the 1984 transaction.

In Order No. 17,744, the Commission did not acknowledge the transaction as a sale or other permanent disposition of the Yellow Pages business; it did not characterize the 1984 DPA one way or another. Neither did the Commission approve the permanent, final transfer of the Yellow Pages business nor is the relinquishment of NET's right to revenues derived from Yellow Pages. The Commission expressly put NET on notice that it retained the flexibility to take future regulatory action regarding, among other things, income derived from Yellow Pages.

We find that the 1984 DPA and related transactions were not a sale or other permanent disposition of the Yellow Pages business for regulatory purposes, nor did the transactions accomplish the relinquishment of NET's right to the value derived from Yellow Pages for regulatory purposes. Under these circumstances, we conclude that the 1984 DPA and the transactions related to it do not in any way limit us from exercising the full extent of our discretion to investigate the 2000 DPA in accordance with our authority under RSA 366:5.

VNH argues that too much time has passed for Staff to assert that the transfer of Yellow Pages assets was illegal. Likewise, according to VNH, it is too late to argue that the transfer did not occur, or to challenge whether the payments and mutual rights established by the 1984 DPA were sufficient consideration for the assets transferred as part of that transaction.[97] We find no merit to this argument. *See Fitchburg Gas and Electric Light Company v.*

[97] VNH Post Hearing Reply Brief at 2-3.

Department of Telecommunications and Energy, 440 Mass. 625, 635-636, 801 N.E.2d 220 (2004) (court refused to apply principles of governmental estoppel in favor of utility where that would undermine legal requirements intended to protect the public interest); *Town of Seabrook v. Vachon Management, Inc.*, 144 N.H. 660, 665-668, 745 A.2d 1155 (2000) (court refused to apply doctrine of equitable estoppels and laches against municipality to bar enforcement action); *Healy v. Town of New Durham*, 140 N.H. 232, 239-243, 665 A.2d 360 (1995) (court said the law does not favor application of estoppel against municipalities, especially when a valuable public interest may be jeopardized; court refused to apply estoppel or laches to bar enforcement action); *Public Service Company of New Hampshire*, 76 NH PUC 619, 621 (1991) (Commission denied governmental estoppel claim by Biomass Producers).

In the prefiled testimony of Mr. O'Quinn, VNH raised the issue of whether the 1984 transaction was a transfer for which adequate consideration was paid, and Staff responded. Much of the record before the Commission in DE 84-12 was introduced in evidence in this docket and was accessible to VNH. The issue was further explored at the hearing in this docket. Thus we find that the issue is highly relevant to the question of the justness and reasonableness of the 2000 DPA and that VNH is not prejudiced by our consideration of the 1984 transaction here.

NET and its successors are sophisticated businesses operating in a regulated environment; they are on notice of their statutory responsibilities and of the Commission's rules. Contrary to VNH's suggestion,[98] the 1984 DPA did not provide the basis for a permanent sale or restructuring of NET's Yellow Pages business on the compensation terms included in the agreement. Moreover, the Commission did not "approve" the 1984 DPA in Order No. 17, 744 and the "entire transaction" was not "laid out for the Commission," at least as a sale or other

[98] VNH Post Hearing Reply Brief at 2.

permanent disposition in exchange for the publishing payments included in the 1984 DPA. It is inaccurate to imply, as VNH does, that the 1984 DPA "occurred in response to a federal court order."[99] NET represented to the Commission in 1984 and again in 1991 that the publishing agreements were for the purpose of producing and publishing directories *for* NET, a representation that is inconsistent with a sale or other permanent disposition of the Yellow Pages business.

The 1984 DPA remained in effect for seven years, from January 1, 1984 through December 31, 1990, when it was superseded by several new agreements, including the 1991 DLA.[100] During this period and until January 1, 1999, when revenue sharing payments to NET ceased, revenue sharing payments to NET were accounted for as "above the line" revenues in NET's regulated books of account. Since these reported revenues were net of the expenses NIRC incurred in conducting Yellow Pages operations, NIRC's costs were already accounted for in the revenues reported by NET for Yellow Pages operations. Aside from the revenues retained by NIRC, the revenue impact for both NET and ratepayers from 1984 through 1998 was not fundamentally different from that existing before 1984 when Yellow Pages operations were conducted directly by NET. In filing the 1991 agreements with the Commission pursuant to RSA 366:3, NET stated, "[i]n essence, the new Directory License Agreement and the related Agreements set forth the terms applicable to the publishing of directories on NET's behalf by NIRC." Ex. 16 at 210.

The 1991 DLA recited that NET and NIRC wished to terminate the 1984 DPA; that NIRC desired to obtain from NET "the exclusive right to solicit Directory Advertising … using the name of the Telephone Company and the exclusive right to designate the Directory

[99] VNH Post Hearing Reply Brief at 3.
[100] Related agreements included Subscriber Listing License Agreement for Printed Telephone Directories, Billing and Collection Agreement, Listings Database Services Agreement, and Directory Advertising Agreement.

Company's Telephone Directories … as the 'official' Telephone Directories of the Telephone Companies"; that NIRC also desired to obtain from NET an agreement to refrain from competing with NIRC in the solicitation of Directory Advertising and in the publication and distribution of Telephone Directories; and that NET was willing to grant such rights in exchange for NIRC's payment of a license fee and NIRC's promise to meet NET's regulatory obligations to publish White Pages and certain other listings.[101] Notwithstanding the non-compete provision, the 1991 DLA provided it was not to be construed as precluding NIRC from publishing telephone directories during the term of the Agreement which were not designated as "official" directories of NET, from publishing directories other than telephone directories, or from "continuing in" the commercial advertising and directory publishing business after expiration or termination of the Agreement. Article 6, section 6.2, Ex. 16 at 225. Like the 1984 DPA, the 1991 DLA defined Telephone Directories to include both the White Pages and Yellow Pages, whether or not bound together. Article 1, sections 1.2, 1.4 and 1.8.

The 1991 DLA changed the formula for calculating publishing payments, now called an annual license fee, by NIRC to NET. In accordance with Appendix A of the 1991 DLA, the payment was first calculated for 1991. This payment was to be equal to all of the earnings from "Traditional Directory Operations," *i.e.*, earnings from print directories, for 1991 less an amount based on a rate of return equal to the composite allowed pretax rate of return on investment of NET times NIRC's investor supplied capital for Traditional Directory Operations. Next, the 1991 payment was defined as a percentage of NIRC's "contribution," meaning the earnings from telephone directories before taxes and interest expense, for Traditional Directory Operations. Finally, in each succeeding year of the 1991 DLA, the same percentage would be applied to the contribution for that year to calculate the payment to be made by NIRC to NET.

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[101] Ex. 16 at 216-217; *see also* Articles 2-5, Ex. 16 at 220-224.

Under Article 10, section 10.8, telephone directories published and distributed by NIRC under the 1991 DLA were to be copyrighted in the name of NIRC. As with the 1984 DPA, the term of the 1991 DLA was for five years, with automatic one year renewals subject to termination by either party on one year's notice.[102]

Staff submitted a memorandum to the Commissioners dated February 28, 1991, recommending approval of the 1991 DLA and related agreements. In support of the recommendation, the memorandum stated that the net revenue effect of the new agreements would be an estimated incremental increase of $12.88 million in revenues to NET relative to payments made under the 1984 DPA.[103] Without holding a hearing on the agreements, the Commission issued Order No. 20,074, dated March 6, 1991, and revised March 15, 1991. The Commission found that, pursuant to RSA 366:3, the 1991 DLA and four related agreements were "just and reasonable" and approved them. *New England Telephone Company*, 76 NH PUC 130, 131 (1991). The Commission also determined that its approval was subject to further review following the New York Public Service Commission investigation in Dockets 90-C-0912 and 91-C-0102 of the NYNEX corporate structure.[104] *Id*.

In effect, Order No. 20,074 acknowledged that the provisions of the 1991 DLA, and the payment formula in particular, were deemed to be fair and reasonable to NET under the circumstances at the time. However, the Order did not purport to limit the regulatory flexibility which the Commission expressly retained in Order No. 17,744, and indeed could not have done so consistent with the Commission's statutory duties and prerogatives. In addition, the 1991 DLA did not purport to relinquish NET's right to the revenues derived from Yellow Pages, nor did it indicate that the licensing fees were being made in consideration for the relinquishment of

[102] Article 6, section 6.1, Ex. 16 at 225.
[103] Ex. 16 at 289.
[104] No further review of the 1991 DLA was undertaken in accordance with this provision.

NET's right to the revenues derived from Yellow Pages or the transfer of the Yellow Pages business from NET to NIRC. While the Commission's approval of the 1991 DLA can be understood as a signal that the Commission would not object to termination of the 1991 DLA if accomplished in accordance with its terms, the Commission's approval clearly did not give NET and NIRC and their successors the unfettered right to decide for themselves, free of regulatory oversight by this Commission, the terms of any subsequent replacement agreements. Order No. 20,074 did not foreclose the Commission's authority to review future publishing arrangements, including the terms of payment provided in such arrangements. In addition, Order No. 20,074 discloses no intention or understanding by the Commission that the payments to NET under the 1991 DLA would be the last payments to NET in respect to Yellow Pages operations or that termination of the 1991 DLA would accomplish the final determination of the value of a transfer to NET.

The record reveals that in 1992 NIRC established NYNEX Information Technologies (NIT), a wholly owned subsidiary, to provide electronic publishing services.[105] The TAct became effective in February 1996. On January 1, 1997, NIRC transferred ownership of NIT directly to NYNEX Corporation in compliance with section 274 of the TAct.[106] Later in 1997, the merger between NYNEX and Bell Atlantic was completed. *See New England Telephone and Telegraph Company dba NYNEX*, Order No. 22,484 in DR 96-220, 82 NH PUC

[105] *See* Direct Testimony ChristiAne G. Mason, page 9.

[106] *See* Direct Testimony of ChristiAne G. Mason at 9; s*ee also* testimony of John F. Nestor III, Day 1 Tr. at 55-56. Mr. Nestor confirms that "Verizon" [*sic*] separated the electronic publishing activity from print directory activity and assigned these activities to separate affiliates as of January 1, 1997, thus bringing "Verizon" into compliance with section 274 without further action. *Id*. According to Mr. Nestor, this still left "Verizon" subject to objectionable joint marketing limitations and restrictions which he describes in his Direct Testimony at 8-9. There he concludes that "in order to remain competitive in the directory publishing marketplace, VIS chose to terminate the 1991 Directory Licensing Agreement in 1997." VNH states that its Yellow Pages publishing affiliate was re-merged with its electronic publishing affiliate in October 2002. Ex. 11.

30 (1997). As a consequence, NIRC was renamed Bell Atlantic Yellow Pages Company and NET began to do business as Bell Atlantic.

BAYPC sent a letter to NET dated December 29, 1997, notifying NET that BAYPC was terminating the 1991 DLA effective January 1, 1999, pursuant to Article 6.1. The letter stated that,

> [t]he consumer, competitive, technological and legal environment for directory and directory-related information services has changed dramatically since the Directory License Agreement was created. In particular, the Telecommunications Act of 1996 requires important changes in the relationships between telecommunication service providers and directory providers.

The letter expressed anticipation that BAYPC and NET would work together to reach new agreements that "will best meet the needs of customers and our respective companies in the context of this new environment." This letter was not filed with the Commission nor was the Commission otherwise informed at the time of the termination of the 1991 DLA.

On December 23, 1998, BAYPC and NET executed an Amendment to Directory License Agreement (1999 Amendment) for effect on January 1, 1999. The 1999 Amendment stated that the provisions of the 1991 DLA remained in effect, with certain exceptions: the term "Directory Company" was redefined to mean BAYPC; the exclusive license referred to in Article 2 and NET's non-competition obligation in Article 3 were restricted to Maine's and BAYPC's obligation to make revenue sharing payments to NET was limited to Maine. With the 1999 Amendment, Yellow Pages revenue sharing associated with NET's New Hampshire's operations ceased,[107] and it has never resumed. NET never filed the 1999 Amendment with the Commission nor did NET otherwise inform the Commission of the modification until Staff learned of it during discovery in this proceeding.

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[107] The last annual license fee payment made to NET associated with New Hampshire operations was $21.8 million for 1998.

We find that the 1999 Amendment was a modification of an affiliate contract described in RSA 366:3 and should have been filed with the Commission. Therefore, NET's failure to file the 1999 Amendment was a violation of its statutory duty under RSA 366:3 and it is unenforceable under RSA 366:4.[108] VNH argues that the amendment of the 1991 DLA is irrelevant because the 1991 DLA is no longer in effect at all, having been replaced by the 2000 DPA, and the issue before the Commission is whether the 2000 DPA is reasonable. VNH also contends that the failure to file the 1999 Amendment was unintentional and resulted from personnel changes and processes for which VNH has taken corrective action. We find that neither of these arguments constitutes grounds for finding that the amendment was legally effective. In addition, failure to comply with RSA 366:3 and the resulting unenforceability of the 1999 Amendment are relevant to several issues within the scope of this docket, which are discussed below, including the issues of whether the 1991 DLA was validly terminated, whether the utility assessments for 1999 should be revised, and whether a civil penalty should be imposed. VNH's explanation for not filing the 1999 Amendment and its impact on the issue of civil penalties is also considered below.

VNH also suggests that the Commission received periodic financial information from NET during 1999 and 2000 from which a diligent Staff analyst could have deduced that revenue sharing had been terminated.[109] However, such general financial information is not a substitute for the specific information required to be filed by the statute. Staff analysts are not expected to cure a utility's lack of compliance with filing requirements. Full and accurate

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[108] RSA 366:4 provides that any contract or arrangement not filed with the Commission pursuant to RSA 366:3 shall be "unenforceable in any court in this state and payments thereunder may be disallowed" by the Commission unless the Commission approves the later filing thereof in writing.

[109] *See* VNH Prehearing Brief at 8, 24-25; Post Hearing Brief at 18-21; Testimony of John F. Nestor III, Day 4 Tr. at 158; Testimony of Kevin O'Quinn, Day 1 Tr. at 44-47 and Day 4 Tr. at 159-161.

disclosure of all required information is necessary; without it, the regulatory process would cease to function in a meaningful way.

On December 24, 1998, the day after the 1999 Amendment was executed, BAYPC wrote to NET that BAYPC's first notice of termination dated December 29, 1997, was being withdrawn. The letter also notified NET that BAYPC was terminating the 1991 DLA, as amended by the 1999 Amendment, effective January 1, 2000, pursuant to Article 6.1 of the DLA. Once again, this letter was not filed with the Commission nor was the Commission otherwise informed at the time of the purported termination. There is reason for concluding that this second notice of termination of the 1991 DLA is invalid as a result of the 1999 Amendment. As further discussed below, however, we need not resolve that issue.

On January 1, 2000, BAYPC confirmed in a letter to NET that pursuant to discussions between BAYPC and NET, BAYPC agreed to extend the termination date of the 1991 DLA until March 31, 2000, with the understanding that the new Directory Publishing Agreement between BAYPC and NET would be retroactive to January 1, 2000, once approved. It is not clear whether the approval referred to is regulatory approval of the new agreement or approval of the new agreement by NET. Once again, this letter was not filed with the Commission nor was the Commission otherwise informed at the time of the extension of the termination. As we interpret it, the letter deals with more than a termination of the 1991 DLA according to its terms; it constitutes a modification of the terms of an affiliate contract which was required to be filed with the Commission pursuant to RSA 366:3. Accordingly, we conclude that NET's failure to file the January 1, 2000, letter violated its statutory duty under RSA 366:3 and it is therefore unenforceable under RSA 366:4. For this reason and because the attempted

termination dated December 24, 1998, was ineffective to terminate the 1991 DLA, we find the extension of the termination was also ineffective for regulatory purposes.

On March 8, 2000, NET, doing business as Bell Atlantic-New Hampshire, filed with the Commission the 2000 DPA, the 2000 LLA, and an associated listings letter accompanied by a cover letter. The letter stated that under the 2000 DPA directories will continue to be provided in accordance with applicable Commission rules and New Hampshire consumers will see “no change in regulated directory services.” The letter also describes how the 2000 LLA and associated listings letter were developed to comply with new regulatory requirements, and in particular section 222(e) of the TAct. In this regard, the letter notes that Bell Atlantic New Hampshire “already makes subscriber listings information available to non-affiliated parties under terms and conditions identical to those offered to BAYPC.”[110] The letter does not mention BAYPC’s attempts to terminate the 1991 DLA or the 1999 Amendment. It does not mention that revenue sharing would no longer exist under the new arrangements nor describe the potential for rates for local exchange service to be increased in the future as a result. In describing certain aspects of the new arrangements but failing to describe the single most important feature of the new arrangements, the lack of revenue sharing, the letter’s potential for creating confusion about the status of revenue sharing is obvious.

The 2000 DPA and the 2000 LLA were executed by BAYPC on December 30, 1999, and by NET on January 14, 2000, for effect on January 1, 2000, while the associated listings letter was dated January 1, 2000. According to the terms of the 2000 DPA, BAYPC agreed to fulfill NET’s regulatory obligations with respect to the publishing and distribution of telephone directories, including “publication of subscriber listings, publication of light faced

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[110] VNH states that its policy since divestiture was to offer listings to independent directory publishers at the same rates as its directory affiliate. Direct Testimony of John F. Nestor III at 7 (footnote 1).

listings in the Yellow Pages for business subscribers, delivery of directories to customers, and publication of certain other information." Article 2, section 2.1. BAYPC was authorized to "sell advertising in any section of the Telephone Directories and the Telephone Company will have no rights or interest in any revenues received by [BAYPC] in connection with the sale or other marketing of Directory Advertising." Article 2, section 2.4. The parties agreed that Telephone Directories published and distributed by BAYPC would be copyrighted as appropriate by BAYPC. Article 2, section 2.10. The term of the agreement was for two years, with automatic one year renewals subject to termination by either party on one year's notice. Article 3, section 3.1. Under Article 3, section 3.4, the 2000 DPA did not preclude BAYPC from conducting a commercial advertising and directory publishing business or other business(es) during the term of the agreement or after expiration or termination of the agreement, including publishing directories for those areas where NET and Other Telecommunications Providers are authorized to provide intraLATA exchange service. Article 8, Section 8.1 states that the agreement "contains the entire understanding of the parties and supersedes any and all prior written and oral communications to the extent that they related in any way to the subject matter hereof."

The 2000 DPA and 2000 LLA were not filed within 10 days after the date on which they were executed or the agreements entered into as required by RSA 366:3. Accordingly, we must decide whether to allow their late filing under RSA 366:4 and, if so, how the filing impacts the effectiveness of the 1991 DLA. We will allow the late filing as authorized by RSA 366:4 because no harm appears to have resulted to the interests of ratepayers or others from the somewhat untimely filing in this instance. We will also accept the retroactive effective date of January 1, 2000, for reasons of administrative convenience.[111]

[111] Our decision should be understood as applying only to the circumstances of this case and we will not allow circumvention of the statutory requirements through a combination of a late filing and a purported retroactive

The cover letter to the Commission filed with the 2000 agreements on March 8, 2000, reflects NET's intent that the 2000 DPA, the 2000 LLA and the associated listings letter supersede and replace the 1991 DLA and 1991 Subscriber Listing License Agreement for Printed Telephone Directories. This intent is further reflected in the "entire agreement" provision common to both the 2000 LLA and 2000 DPA.[112] Under these circumstances, we conclude that regardless of whether the 1991 DLA was validly terminated pursuant to the notice of termination dated December 24, 1998, the now validated filing of the 2000 DPA accomplished the same result.[113]

In summary, because the 1999 Amendment is unenforceable in New Hampshire under RSA 366:4 and the 1991 DLA was not validly terminated before 1999, revenue sharing payments under the 1991 DLA with respect to New Hampshire Yellow Pages operations were improperly terminated during calendar year 1999. We further conclude that VNH did not, nor could it unilaterally relinquish on its behalf, or on behalf of ratepayers, the value derived from

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effective date. We note this problem is avoided altogether by inclusion of a provision described below in connection with new agreements filed with the Commission in DA 04-087 which adjusts the effective date of an affiliate contract for the date of filing or approval.

[112] *See* Article 8, section 8.1 of the 2000 DPA and in Article 9, section 9.3 of the 2000 DLA

[113] We note that the three agreements filed on March 8, 2000 have in turn been replaced by a Directory Publishing Agreement and a Listings License Agreement executed on May 11, 2004 and filed with the Commission on May 20, 2004 in connection with Docket No. DA 04-087. Both agreements were nominally effective on January 1, 2003; however, they are to become effective on the date of filing and/or approval if under applicable law they are required to be filed with and/or approved by a governmental entity, including a state public utility commission. Under this provision, they would become effective in New Hampshire on May 20, 2004. Article 3, section 3.2 of the Directory Publishing Agreement and Article 8, section 8.2 of the Listings License Agreement.

The cover letter filed on May 20, 2004 assures the Commission that there are no material differences between the new Directory Publishing Agreement and Listings License Agreement and the 2000 DPA and 2000 LLA. Indeed, there is no change at all to the provision in Article 2, section 2.4 stating in effect that VNE has no right or interest in Yellow Pages revenues. According to VNH, the primary purpose of the new agreements is to standardize the relevant directory contracts across the Verizon footprint and generally update the language in the prior contracts.

Even though new agreements have recently been filed with the Commission, we will proceed to decide the issues in the present docket on the basis of the 2000 DPA and 2000 LLA. The issues raised in the present docket are important and the new agreements do not render a decision in this docket moot. In addition, too much time and effort by all parties has been expended in this docket to warrant the abandonment of this docket in favor of considering the same issues in DA 04-087.

Yellow Pages publication nor the right to contribution arising from such opportunity, both by the factual history of the transaction and as a matter of law.

B. Value of Association Between VNH and VYPC for Yellow Pages Business

VNH claims that the only potential argument for requiring VYPC to compensate VNH for publishing a telephone directory would be that, by agreeing to publish and distribute its own directory in accordance with standards set by VNH, VYPC receives some additional value from VNH over and above what it would otherwise have on its own after purchasing subscriber listings. We disagree for two separate reasons.

First, VNH's claim appears to rest on an assumption that NET's Yellow Pages business was transferred permanently to NIRC and/or NET's right to contribution from Yellow Pages operations was permanently relinquished to NIRC and that NET was paid full value for such a transfer or relinquishment of rights. As discussed above, we do not think either assumption is true in New Hampshire for regulatory purposes. Although the Yellow Pages business is being and has been operated by the directory publishing affiliate since divestiture, the Yellow Pages business opportunity and the right to contribution arising from such opportunity still inure to the benefit of the regulated telephone company and in turn to its ratepayers for such purposes.

Second, VNH argues that VYPC does not receive additional value from VNH over and above what it would otherwise have on its own after purchasing subscriber listings and therefore VNH is not entitled to any compensation from VYPC. We disagree. The evidence demonstrates that there has been and there continues to be significant value flowing to the Yellow Pages business, and thus to NIRC and its successors and their shareholders, derived from its association with NET and its successors for which the regulated telephone company and its

ratepayers deserve to be compensated. Indeed, that is the basis for the 15 years of revenue sharing that took place. We conclude that such compensation is earned by NET and its successors.

VNH would apparently suggest that the value to the directory publishing affiliate be reflected in an asset listed on VNH's balance sheet before it can be recognized as deserving of compensation. *See, e.g.*, Kevin O'Quinn Surrebuttal Testimony at 2-4. We disagree because accounting rules alone are not determinative of the issue of justness and reasonableness when evaluating the relationship among VYPC, VNH and New Hampshire ratepayers pursuant to RSA 366:5. Further, VNH has not proved that the value of the advantages and benefits granted in the past by NET to NIRC was fully paid on a current basis during the term of the 1984 DPA and the 1991 DLA so that no further compensation is owed for advantages and benefits granted in the past or due in the future.

We note VNH's agreement that the Yellow Pages business was a legacy of the monopoly position of the regulated telephone company. VNH further agrees that in 1984 NIRC inherited an established Yellow Pages business developed by NET, a business so successful it was earning "supra competitive" profits, according to Judge Greene.[114] Trained and knowledgeable NET Yellow Pages employees were moved to NIRC, together with established customer relationships and business strategies, among other assets. The practice of publishing White Pages and Yellow Pages in the same book under the NET name and logo and distributing the book to all telephone subscribers continued after 1984. Under the 1984 DPA, NIRC obtained NET's exclusive right during the term of the agreement to contact telephone subscribers and others for the purpose of soliciting and obtaining directory advertising to appear in the telephone

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[114] The business has remained highly profitable to this day. *See* Laurence N. Koppelman Reply Testimony at 19-20 and Day 3 Tr. at 104, 109-111.

directories to be published under the agreement. Further, NET provided billing and collection services to NIRC, further reinforcing the link between NET and NIRC to advertisers with invoices from NET containing both telephone and directory advertising charges.

Even before the 1991 DLA went into effect, the telephone directories were being published as “The Official Directory of New England Telephone,” a message, first, that it is New England Telephone’s directory and, second, that it is an “official” directory. The message makes no distinction between the White Pages and the Yellow Page portions of the directory, and we find no basis for concluding that consumers or advertisers would have drawn such a distinction on their own. Under the express terms of the 1991 DLA, NET’s name could be used in soliciting directory advertising and its name, slogans and marks could be used in publishing the directories. The 1990-1991 NYNEX Yellow Pages and White Pages for the Concord area, Exhibit 31, is one example of how NET’s names, slogans and marks were used to promote the Yellow Pages. An advertisement includes NET and NIRC as being in the same NYNEX family of companies, all linked to the Bell reputation, and in particular the 100 year old Bell traditions of quality and service. In addition, billing and collection services have continued to be provided to NIRC and its successors but not to any independent publishers. *See* Ex. 19.

The publishing affiliate has continued to promote the association between the regulated telephone company, its name recognition and dominant market position, and the Yellow Pages directory listing. For example, among the advertised advantages of Verizon’s Yellow Pages in the Concord Area telephone directory for 2000-2001 were permanence (Yellow Pages “have been in homes and businesses throughout the region for over 100 years”), circulation (Yellow Pages “are distributed to virtually every home and business in your market”) and reliability (Yellow Pages “are delivered every year, year in and year out, to virtually every

home and business, with an unsurpassed record of 100 years of reliable delivery"). As another example, Verizon's current New Hampshire directories state on the cover that it is "YOUR DIRECTORY FOR OVER 100 YEARS!" VNH concedes that the only directory publisher to which these claims apply is the regulated telephone company. The regulated telephone company, supported by the rates charged consumers, has provided the level of service over a period of time that allows these kinds of advertising claims to be made.

VNH states that Staff and OCA object to the 2000 DPA because VYPC has the right without any grant from VNH to use the Verizon name, something for which no compensation is owed. That statement does not accurately capture the arguments, however. We do not understand Staff to be arguing that use of the Verizon name as such in connection with the telephone directories is important in determining whether VYPC realizes value from its association with VNH. Instead, Staff is arguing that the association with the telephone directory of the name of the regulated telephone company (whatever that name may be) and its reputation for permanence, reliability and the like, with the telephone directory has substantial value for the Yellow Pages business being conducted by VYPC, none of which is reflected in the 2000 DPA. Staff is further arguing that since VNH's ratepayers have paid for the services upon which such reputation is based, they deserve to obtain their fair share of this value.

NYNEX followed a common branding strategy and Verizon is following another common branding strategy. We agree with Staff that there is no indication in the record that Verizon's name and logo connotes in the popular view in New Hampshire a Verizon company other than VNH. We also agree with Staff that it is not credible that New Hampshire consumers see the Verizon name and logo and view them as referring to VYPC (as opposed to related products under a single umbrella). Especially in light of the history of the Yellow Pages

business and the efforts to promote and advertise Yellow Pages and telephone directories, it is fair to conclude that the Verizon name and logo, when affixed to the telephone directories published on behalf of the regulated telephone company, will be readily identified by the consumer and advertisers as representing the regulated telephone company. It is also fair to conclude that the reputation of the regulated telephone company benefits the Yellow Pages business operated by VYPC.

VNH argues that it does not have a unique right to use the Verizon name and logo and that the Verizon name and logo are new. Consistent with the above discussion, these arguments are not persuasive because there is value to VYPC derived from its association with VNH. In addition, no persuasive evidence has been presented that the value of the association between the regulated telephone company and Yellow Pages was extinguished as a result of the Verizon name and logo change.

VNH further contends that its customers have never paid for the efforts of Verizon Communications and its unregulated subsidiaries to develop any goodwill that is arguably associated with the common name. VNH concludes that having allocated to shareholders the entire expense of developing any goodwill associated with the Verizon name, it would be unreasonable and legally unsupportable to claim now that any value associated with that name belongs to the ratepayers. VNH gives as an example an NET rate case, DR 89-010, in which the Commission approved a stipulation settling revenue requirement issues. In that case Staff filed testimony stating that promotional advertising costs related to attempts to improve the public opinion of the company should be borne by the stockholders and not by the ratepayers because this type of advertising does not: (i) provide a material benefit to ratepayers or (ii) inform consumers of, or stimulate the use of, products and services and (iii) does not provide

information customers need in order to use the telecommunications network effectively. The Commission approved a stipulation settling revenue requirement issues, including a revenue requirement calculation that excluded certain unspecified expenses for promoting NET's brand identity. *See New England Telephone and Telegraph Company*, Order No. 19,747, 75 NH PUC 147 (1990).

We are not persuaded by this argument. First, the example given of expenses related to image enhancement expenses of NET is not apposite to the case of expenses of the holding company and its unregulated subsidiaries. The name and logo change from Bell Atlantic to Verizon and the common branding of products and services under the Verizon umbrella are strategies initiated by Verizon Communications, not VNH or this Commission. Simply because the holding company determined to implement these strategies is not a reason for depriving VNH and its ratepayers of the value VYPC derives from the association.

In addition, although we certainly agree that ratepayers should not be expected to pay for the expenses of the holding company and its unregulated subsidiaries for the development of goodwill associated with a common name and logo, the value of concern to us in this docket is not the value of the name and logo as such, but the value of what the name is identified with, i.e. the regulated telephone company and its reputation. The payment formula in both the 1984 DPA and the 1991 DLA allowed NIRC and BAYPC to pay Yellow Pages promotional expenses from Yellow Pages revenues before remitting the net amount to NET; in this way NET's ratepayers would have absorbed, *i.e.*, paid, the promotional expenses had there been a rate case during the relevant period. Nor would there be reason for the Commission to have disallowed reasonable Yellow Pages promotional expenses on the basis of the rationale offered by Staff in DR 89-010, assuming that such expenses would have benefited ratepayers.

Finally, we are mindful that VNH's ratepayers have paid for services and products that enable VYPC to advertise the reputation of the Yellow Pages for permanence, circulation and reliability.

In its prefiled testimony, VNH offered the examples of the sale of QwestDex, Qwest Communications' directory services affiliate, to an unaffiliated group for $7 billion, and the success of Verizon's SuperPages telephone directories in areas where Verizon is not the incumbent local exchange carrier as proof that there is little value to the connection between being the long term resident of the community and the success of the Yellow Pages.[115] Mr. Koppelman filed Reply Testimony asserting the significance of the fact that the new owners of Qwest's directory publishing business kept the name Qwest for its directories and as its identity when contacting potential advertisers despite the fact that Qwest's brand value had to have been diminished by the company's well publicized financial and service problems. Regarding the success of Verizon's directories in areas where it is not the incumbent local exchange carrier, Mr. Koppelman also stated that, based on the evidence, the Verizon mark appears to be meaningful to the marketability of Yellow Pages directories to advertisers and the association of the mark between the incumbent telephone companies and the directories helps in that marketing, thereby increasing the value of the directories to Verizon.

In light of the numerous examples introduced by Staff of promotional efforts attempting to capitalize on the connection, we find VNH's arguments based on the QwestDex and Verizon examples to be unavailing. Further, we find VNH's remaining arguments regarding the Verizon name and logo similarly unpersuasive and we decline to accept them.

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[115] *See* William E. Taylor Rebuttal Testimony at 14.

The evidence in the record before us is consistent with the conclusion of the Oregon Public Utility Commission regarding a publishing agreement comparable to the 1991 DLA that the publishing agreement

> itself represents that there is a value in being able to use the [telephone company's] name, logo, and similar indicia of its reputation in the marketing of the directories, including the Yellow Pages. For this value, the publishing fee is ostensibly being paid. But the Commission believes that the thing of value which . . . makes these Yellow Pages different and much more valuable than others, is their connection with the local exchange telephone company, no matter what its name happens to be. The local exchange company is the long-time permanent resident of the community which provides the local telephone service. The distribution of the classified advertising with the necessary white pages by, with the blessing of, or in association with the local exchange company sets them apart from any other classified advertising efforts.

Re Pacific Northwest Bell Telephone Company dba U S West Communications, 110 P.U.R.4th 132, *supra*, quoting from Order No. 88-488 at 7.

We agree with the OCA that, even if the 2000 DPA no longer expressly grants VYPC an exclusive right to solicit Yellow Pages advertising from VNH customers for the telephone directories published under the Verizon name and logo, that does not mean that no value is obtained by VYPC from the association with VNH. For practical purposes, the publishing and advertising arrangement between them is an exclusive one. No evidence was introduced that VNH is prepared to launch a new publishing and advertising venture, that VNH ever considered offering to independent publishers a publishing arrangement as an alternative to the 1991 DLA or the 2000 DPA, or that having two companies in an enterprise under common control might make economic sense for the enterprise as a whole.

For all these reasons, we find that VNH's lack-of-value-of-association argument does not justify the termination of the 1991 DLA or VNH's acceptance of the wholly inadequate and insufficient compensation terms of the 2000 DPA.

C. Justness and Reasonableness of 2000 DPA and Imputation as a Remedy

Under the 2000 DPA, VNH does not presently garner any value from the Yellow Pages operations. Based on the historic compensation paid to VNH and its predecessors, which in turn inured to the benefit of ratepayers and the fact that VNH has shown no reasoned basis, or sufficiently changed circumstances, for terminating such payments, there are no grounds for concluding such a result is just and reasonable.

The 2000 DPA contravenes the established policy of this Commission regarding revenue sharing of Yellow Pages profits. Moreover, as further discussed below, it is not justified or required by any changed circumstances since the 1991 DLA became effective, including the enactment of the 1996 TAct and FCC regulations implementing the TAct. VNH has not provided us with any citations to authority demonstrating that the 2000 DPA is reasonable or that comparable agreements have been found to be reasonable in other jurisdictions. In addition, the 2000 DPA is not justified by public policies applicable to telecommunications or directory advertising markets or by the state of competition in those markets. Accordingly, we find that the Yellow Pages business opportunity and the right to contribution in connection with such opportunity should continue to inure to the benefit of VNH's ratepayers for regulatory purposes.

The 2000 DPA does not secure for the benefit of ratepayers any of the value of the Yellow Pages business opportunity, the right to contribution, or the association between VNH and VYPC; rather the value flows entirely to the benefit of shareholders. The financial result for ratepayers under the 2000 DPA is inconsistent with the result of an arms length transaction and, to the extent it affects the interests of New Hampshire ratepayers, NET's entry into the 2000 DPA arguably constitutes imprudent management. VNH has not met its burden of proof under RSA 366:5 regarding the justness and reasonableness of the 2000 DPA. For these

reasons and the reasons discussed elsewhere in this Order, we find that the provision in the 2000 DPA denying VNH any right or interest in Yellow Pages revenues is unjust and unreasonable.

As discussed further below, we conclude that imputation is a lawful action we may take to remedy the defects we have found in the 2000 DPA. Imputation is a narrowly tailored remedy which avoids potential disruptions to VNH and the policies of other states from the possible extra-territorial effect of a Commission order disapproving the 2000 DPA in its entirety.[116] Imputation is a reasonable means of making VNH and ratepayers whole and we find that imputation is consistent with the public good. Imputation does not impose a new regulatory policy. It is a well-accepted regulatory response to unilateral actions of the telephone company and its directory affiliate which we impose in order to maintain adherence to our well-established policy regarding revenue sharing between the telephone company and its directory affiliate. Imputation accomplishes nothing more than what the companies have done for many years.

D. Commission Authority to Order Imputation

VNH's argument that the Commission lacks the authority under New Hampshire law to impute Yellow Pages revenues is based in part on certain principles of statutory construction and in part on the scope of the Commission's jurisdiction. In order to consider VNH's argument in context, we begin by reviewing the relevant text of RSA 366.

RSA 366:3 provides:

> The original or a verified copy of any contract or arrangement and of any modification thereof or a verified summary of any unwritten contract or arrangement, the consideration of which exceeds $500, hereafter entered into between a public utility and an affiliate providing for the furnishing of managerial, supervisory, construction, engineering, accounting, purchasing, financial, or any other services either to or by a public utility or an affiliate shall be filed by the public utility with the commission within 10 days after the date on

[116] We note that VNH stated at the Prehearing Conference in this docket that the Commission does not have the authority to undo an affiliate contract, particularly one which is interstate in nature. Tr. of Prehearing Conference, October 23, 2002, 13-14.

> which the contract is executed or the arrangement entered into. The commission may also require a public utility to file in such form as the commission may require full information with respect to any purchase from or sale to an affiliate, whether or not made in pursuance of a continuing contract or arrangement.

Under this statute, a public utility is required to file with the Commission all contracts, arrangements and modifications thereof, or summaries of unwritten contracts or arrangements, the consideration for which exceeds $500, entered into between the utility and an affiliate, as defined in RSA 366:1,II, which provides "for the furnishing of managerial, supervisory, construction, engineering, accounting, purchasing, financial, or any other *services either to or by a public utility or an affiliate* (emphasis added)." This filing requirement applies to contracts, arrangements and modifications entered into after the effective date of the statute, which was June 19, 1933. *See* Laws of 1933, Ch. 182:2.[117]

RSA 366:5 authorizes the Commission to do a number of things. In the first sentence, the Commission has "*full* power and authority" (emphasis added) to investigate the contracts and arrangements described in RSA 366:3,[118] and if after notice and hearing the Commission shall find any such contract, [or] arrangement,[119] to be unjust or unreasonable, it "may make such reasonable order relating thereto as the public good requires." According to the third sentence, if the public utility shall fail to satisfy the Commission of the reasonableness of any such contract, arrangement, purchase, or sale, the Commission is specifically authorized to disapprove the same and disallow payments thereunder or such part of any such payment as the Commission shall find to be unjust or unreasonable.[120] According to the last sentence, if in any

[117] In addition, the statute authorizes the Commission to require a public utility to file full information with respect to "*any purchase from or sale to an affiliate*" (emphasis added), whether or not made in pursuance of a continuing contract or arrangement. As discussed above, all the directory publishing agreements between NET and NIRC and their successors have been filed with the Commission as services contracts and not as purchases and sales.
[118] Purchases and sales are also included.
[119] Purchases and sales are also included.
[120] The fourth sentence specifically forbids any payment disallowed by the Commission from being capitalized or included as an operating cost of the utility in the fixing of rates or as an asset in fixing a rate base.

such investigation the public utility *or affiliate* shall unreasonably refuse to comply with any Commission request for information with respect to relevant accounts and records, whether of such public utility *or any affiliate*, any portion of which may be applicable to any transaction under investigation, so that such parts thereof as the Commission may deem material may be made part of the record, such refusal shall justify the Commission in disapproving the transaction under investigation and disallowing payments in pursuance thereof. In addition, RSA 366:7 provides that in any proceeding the Commission may disallow the inclusion in the accounts of a public utility of any payments or compensation to an affiliate for any services rendered, or property furnished, under existing contracts or arrangements with an affiliate unless such public utility shall establish the reasonableness of such payment or compensation. It is apparent that this statute applies to contracts or arrangements existing on the effective date of Laws of 1933, Ch. 182, namely, June 19, 1933.

The services contracts to which RSA 366 applies include both contracts in which services are provided by the utility to the affiliate and in which the services are provided by the affiliate to the utility.[121] Thus, depending on the contract, the payments or other compensation for the services under such contracts could flow to the utility or to the affiliate or both. RSA 366:5 provides that the Commission is authorized to disallow payments under the contracts without limiting its authority to disallowance of payments or compensation made by the utility to the affiliate. The authority of the Commission under RSA 366:7 is limited to payments or compensation made by the utility to an affiliate; however, that statute appears to apply only to contracts in existence in 1933. The Commission's authority under RSA 366:5 is the broad, enduring and presently applicable authority under which we act.

[121] Similarly, the purchases and sales to which RSA 366 applies include both sales by the utility to the affiliate and sales by the affiliate to the utility.

Upon careful consideration, we conclude that the application of the principles of statutory construction as urged by OCA and Staff is consistent with the statutory language and the purposes of RSA 366. We reject VNH's argument that our remedial authority under RSA 366 is limited to disallowing payments actually made by the utility to the affiliate or by the affiliate to the utility under an affiliate agreement. Such an interpretation would lead to absurd, illogical and unjust results and contravene the manifest intent of RSA 366. *See e.g., Appeal of Estate of Van Lunen*, 145 N.H. 82, 86, 750 A.2d 737 (2000) and *Appeal of Town of Newington*, 149 N.H. 347, 352, 821 A.2d 1100 (court construes all parts of a statute together to effectuate its overall purpose and to avoid an absurd or unjust result); *see also Appeal of Coastal Materials Corporation*, 130 N.H. 98, 105, 534 A.2d 398 (1987) (court will not interpret a statute to produce an unjust and seemingly illogical result) and *Appeal of Rowan*, 142 N.H. 67, 75, 694 A.2d 1002 (1997) (statute vesting administrative board with broad discretion in areas of licensing and discipline would not be interpreted to prohibit the board from taking action and thus produce an illogical result).

For example, assume that a utility provides a service to the affiliate and the affiliate pays the utility nothing for that service under an affiliate agreement. Clearly, that agreement must be filed with the Commission under RSA 366:3 and the Commission has the authority to investigate it under RSA 366:5. In addition, there can be no doubt that the Commission can and should find such an agreement to be unjust and unreasonable under RSA 366:5. If VNH's argument is correct, then the Commission has no authority under RSA 366 to do anything about that unjust and unreasonable agreement because no payments are being made. Such a result would be contrary to the overarching purpose of RSA 366[122] and would ignore the

[122] RSA 366 exists because collusion between a public utility and an affiliate in the absence of arm's length dealings can harm ratepayers' legitimate interests and unjustifiably benefit others such as shareholders. *See US West*

express language in RSA 366:5 granting the Commission the authority to make reasonable orders relating to unjust or unreasonable contracts as the public good requires.

We conclude we have broad authority and discretion under RSA 366:5 to investigate and fashion an appropriate remedy for affiliate contracts we find to be unjust or unreasonable, including the imputation of revenues from an affiliate. *See e.g., Granite State Electric Company*, 120 N.H. 536, 539, 421 A.2d 120 (1980) (Commission was established to provide comprehensive provisions for the establishment and control of public utilities in the State and it must not only perform duties statutorily created but also must exercise those powers inherent within its broad grant of power). In addition, we also agree with OCA and Staff that our authority to impute revenues is also within our broad ratemaking authority under RSA 378:8. *See e.g., Legislative Utility Consumers' Council v. Public Service Company*, 119, N.H. 332, 339-340, 402 A.2d 626 (1979) and *Public Service Company of New Hampshire*, Order No. 24,171 in DE 03-078 (May 12, 2003, slip op. at 16-17); *see also US West Communications, Inc. v. Washington Utilities & Transportation Commission*, *supra,* 949 P.2d at 1346.

VNH argues that our jurisdiction does not extend to imputing revenues from an unregulated affiliate and that imputation would represent an unauthorized expansion of our jurisdiction. In part, the argument is based on a remark made in *PK's Landscaping, Inc. v. New England Telephone and Telegraph Company*, 128 N.H. 753, 519 A.2d 285 (1986).

The decision facing the New Hampshire Supreme Court in that case was whether the Superior Court had correctly granted the defendant NET's motion for summary judgment. The plaintiff PK's Landscaping had sought damages in its suit from the defendant for failure to place an advertisement of PK's in the Yellow Pages of the Nashua area telephone directory for

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Communications, Inc. v. Washington Utilities & Transportation Commission, *supra,* 949 P.2d at 1348. In construing a statute, it is especially appropriate to consider the "evil or mischief" the statute was designed to remedy. *See e.g., Rix v. Kinderworks Corporation*, 136 N.4. 548, 550, 618 A.2d 833 (1992).

the 1980 edition. Two issues were presented for review: (i) whether the trial court erred in ruling that the contract clause which limited NET's liability was enforceable; and (ii) whether the trial court erred in ruling that NET had not breached a duty of care in failing to publish the plaintiff's advertisement. The Court found no error and affirmed.

Regarding the first issue, the Court held that the contract clause was not an unconscionable provision in a contract of adhesion. In so holding, the Court declined to follow the view, represented by *Rozeboom v. Northwestern Bell Telephone Co.*, 358 N.W.2d 241 (S.D. 1984), that such a limitation of liability clause was unenforceable. According to the New Hampshire Supreme Court, the court in *Rozeboom* stated that the telephone company, as a public utility and monopoly, "foisted" upon a business a contract form about which the business had little choice whether to accept or reject because the Yellow Pages advertising was available from only one source. *Id*. at 755-756. According to the New Hampshire Supreme Court, the court in *Rozeboom* emphasized the importance of the telephone company's status as a public utility. The Court noted that "[c]ontrary to the court in *Rozeboom,* we find the contract between PK's and NET was not undertaken as a part of NET's duties as a public utility." *Id*. at 756.

The Court supported its ruling with a Second Circuit decision, *McTighe v. New England Telephone and Telegraph Co.,* 216 F.2d 26 (2d Cir.1954). In that case, the plaintiff's name had been omitted from both the White Pages and the Yellow Pages and the issue involved whether the limitation of liability clauses in NET's White Pages tariff approved by the Vermont Public Service Commission and a similar limitation of liability clause in NET's Yellow Pages contract with the plaintiff were enforceable. The court distinguished the White Pages and Yellow Pages activities and the resulting implications as follows:

> The courts will scrutinize with care clauses exonerating public utility companies, such as railroads, telegraph and telephone companies and others, from liability for

> the consequences of their own negligence, with reference to the public services rendered by them. The fact that the member of the public patronizing such public utility companies must take the contract proffered by the company or forego using the service has enabled the courts to inquire into the reasonableness of the type of clause now under discussion and by this test the clause applicable to the alphabetical directory would as a matter of contract law be considered unreasonable and unenforceable. But the principle which enables courts to strike down and condemn clauses affecting the performance by the company of its functions as a public utility is limited to the area in which the public services are rendered and has no application whatever to the domain in which the public utility may freely contract in its private capacity. The obtaining of the services of the public utility by way of transportation or communications or providing gas or electricity is quite apart from the leases, advertising contracts and a host of other miscellaneous agreements commonly made by members of the public with public utility companies. *If there be some disparity in the bargaining power of the contracting parties[regarding the Yellow Pages contract] it is no more than may be found generally to exist; and the courts follow the general rule that the parties are free to contract according to their own judgment and the reasonableness of their engagements will not be entered into.* (emphasis added). *Id*. at 28.

Regarding the White Pages "contract" included in the tariff, the court said, "having been sanctioned as reasonable by the Public Service Commission in the exercise of its regulatory functions, [it] is no longer one in connection with which the courts have the power to examine into the question of reasonableness on a collateral attack." *Id*. The court stated that "[t]hus, for different reasons, each of the two clauses under attack here would, by the application of sound general principles, be considered valid and enforceable." *Id*. The court went on to consider the application of Vermont law in particular and found that it was consistent with its description of the general law, concluding, "[i]n entering into the [Yellow Pages] advertising contract, the telephone company in its private capacity contracted as to matters outside the scope of its public service functions, and was free to include in the contract a limitation of liability, as this would not operate to defeat its public purpose." *Id*. at 30.

We do not understand OCA or Staff to be arguing that VYPC is itself a public utility or that the advertising rates, terms, and conditions of Yellow Pages advertising service are,

or have been in the past, regulated by the Commission. There appears to be no dispute that VYPC itself is not a public utility and that its advertising rates, terms and conditions of Yellow Pages advertising service are not, and have not been in the past, regulated by the Commission. Thus, we assume that Verizon's Yellow Pages business is not being, and as far as we know has not been in the past, operated within the scope of VNH's duties as a public utility. However, this does not necessarily mean that there is no public interest in Yellow Pages assets and revenues, see *Mountain States Telephone And Telegraph Company v. Colorado Public Utilities Commission*, 763 P.2d 1020, 1028 (Co. 1988) (public interest in Yellow Pages assets was not in dispute), or that the Commission has no jurisdiction over Yellow Pages assets and revenues, *see In re New York Telephone v. Public Service Commission of New York, supra* at 423 and cases cited (although Yellow Pages advertising was not a regulated service, the public service commission exerted limited authority over it to insure, among other things, that maximum revenues were derived from the sale of advertisements) and *State Utilities Commission v. Southern Bell Telephone and Telegraph Company*, 299 S.E.2d 763, 766, *supra* (prior case holding that Yellow Pages advertising in a telephone directory is not part of a telephone company's public utility business is not inconsistent with including expenses, revenues and investments arising from Yellow Pages in ratemaking proceedings since Yellow Pages is an integral part of the public utility's function of providing adequate service). Similarly, in Order No. 17,744, the Commission referred to its finding in a separate ratemaking docket, DR 84-95 that the costs associated with the affiliate agreements during the 1983 test year had been found to be "appropriate" and "reasonable."

The Utah Supreme Court's decision in *US West Communications, Inc. v. Public Service Commission of Utah*, 998 P.2d 247, *supra* is particularly instructive because of the

similarities of the facts and the issues to this case. Among other things, the court held that the Utah Public Service Commission (Utah Commission) correctly concluded that the directory publishing operations conducted by the utility directory publishing affiliate was a proper basis for imputing revenues to the regulated entity.[123] *Id*. at 251.

The telephone company, US West, was a rate of return regulated telephone company. The case arose when US West sought a rate increase and in that connection requested the Utah Commission to discontinue its practice of imputing to US West profits from the directory publishing business of Dex, US West's directory publishing affiliate. Dex published telephone directories containing both White Pages and Yellow Pages. The Utah Commission rejected US West's arguments against directory imputation and calculated a rate increase on the basis of continued imputation of Dex's profits. In its order, the Utah Commission concluded that under *Wexpro I,* a 1979 Utah Supreme Court case,[124] Dex's directory publishing operations are "utility operations," the profits from which should be applied to offset US West's revenue requirement and lower its rates. *Id*. at 248.

According to the court, the Utah Commission reached this conclusion primarily on the basis that, historically in Utah, both the directory publishing services and telecommunications services were provided by the same utility, which monopolized the market before divestiture. *Id*. at 248. Further, the court said that the Utah Commission had never approved the transfer of directory publishing operations but neither had it sought to invalidate the transfer. *Id*. Instead, according to the court, the Utah Commission had treated the directory publishing business as part of US West's regulated operations for purposes of setting US West's

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[123] *See Re US West Communications, Inc.*, Docket No. 97-049-08, 183 P.U.R. 4th 382 (Utah Public Service Commission, December 4, 1987).
[124] The *Wexpro I* case is formally cited as *Committee of Consumer Services v. Public Service Commission*, 595 P.2d 871 (Utah 1979).

rates and through directory imputation the Utah Commission had essentially fixed US West's rates as though the transfer did not occur. *Id*. at 248, 250.

The court summarized the *Wexpro I* jurisdictional ruling as follows:

> [w]here a public utility has held or operated properties which in and of themselves would not constitute utility assets (such as directory publishing), they are nonetheless *deemed to be* public utility assets or operations subject to Commission regulation if certain criteria are met." (emphasis added). *US West Communications, Inc. v. Public Service Commission of Utah, supra* at 249 *and see Wexpro I* at 876-879.

The court summarized the *Wexpro I* criteria guiding its decision as follows:

> [u]nder *Wexpro I,* ratepayers have an investment or proprietary interest in assets held by a utility if those assets (i) were developed or augmented in some manner by ratepayer funds . . . or (ii) contributed to the production of utility property . . . ." *US West Communications, Inc. v. Public Service Commission of Utah, supra* at 250.

The court reviewed the history of the Yellow Pages business and commented:

> [o]ur determination of whether U.S. West ratepayers have an investment or proprietary interest in Dex's publishing operations turns in large measure on the historical union of telecommunications and directory publishing services. AT & T originally provided telephone directories in conjunction with its telecommunications services. AT & T was a monopoly. The record indicates that AT & T's Utah operating company, Mountain States Telephone & Telegraph Company ("Mountain Bell"), provided these services without competition from any other telecommunications or directory publishing company 'for many decades prior to AT & T's breakup and divestiture. . .
>
> Hence, at the time of the 1984 transfer, U.S. West ratepayers had an investment or proprietary interest in the directory publishing operations. Before the transfer, those operations were an integral part of telecommunications services. Telephone directories were necessary for customers to make use of the telecommunications network. As a result of AT & T's monopoly, however, customers had no other telephone directory available to them. Likewise, local businesses had no other directories in which to advertise. Directory publishing inevitably increased accessibility to, and the usefulness of, telecommunications services which, in turn, increased the usage and circulation of telephone directories, making advertising therein more marketable. Telecommunications services and directory publishing operations each helped expand and develop the other. Moreover, the record shows that prior to AT & T's breakup, Mountain Bell's directory publishing expenses were included with its other utility operation expenses. Ratepayer funds were applied without distinction to support and develop both telecommunications

> services and directory publishing operations. Directory publishing assets were part of Mountain Bell's rate base, and a return on investment was allowed on those assets. Thus, the Commission did not err in concluding that under the *Wexpro I* criteria, the directory publishing operations transferred to Dex were utility operations.
>
> This conclusion is consistent with that reached by other jurisdictions addressing similar arguments. Those jurisdictions have also determined that U.S. West ratepayers have a compensable interest in Dex's directory publishing operations." (citations omitted). *Id*. at 250-251.

The court held that "[u]nder the principles we announced in *Wexpro I*--as applied to the 'supra competitive' nature of phone directories originally established during monopolistic circumstances--Dex's directory operations are utility assets subject to the Commission's authority." *Id*. at 251.

We are persuaded that the rationale of the *US West* and *Wexpro I* cases is applicable to the specific issue in this docket regarding our jurisdiction to impute directory revenues. Furthermore, imputation is not inconsistent with the New Hampshire Supreme Court's remark in the *P.K.'s Landscaping* case about the scope of a utility's public duties made in the context of a different issue.

For these reasons, and because one of the Commission's most basic duties is to be the arbiter between the interests of the ratepayer and the interests of the regulated utilities, RSA 363:17-a, we conclude that under existing statutes we have the authority and the jurisdiction to impute revenues from the Yellow Pages business now being operated by VYPC. In addition, imputation would not involve an improper expansion of our authority or jurisdiction.

VNH refers to certain testimony of Mr. Antonuk as an example of the unauthorized expansion of the Commission's jurisdiction over the unregulated affiliate. VNH Post Hearing Brief at 16-17. According to VNH, Mr. Antonuk argued that consistent with his theory of revenue imputation, the Commission can and should ensure that VYPC maximizes

those revenues, citing his testimony at hearing, Day 4 Tr. at 27-28. VNH's statement is incorrect. We are not exercising jurisdiction over VYPC but merely ensuring that VNH ratepayers are fairly compensated for the value that emanates from the association between VNH and VYPC.

Regarding VNH's further argument that Commission jurisdiction would mean that the Commission would be able to audit the unregulated affiliate's books and records and conduct other discovery, VNH Post Hearing Brief at 17, we note that RSA 366:3 and 5 expressly grant us very broad authority to investigate matters related to affiliate agreements, including discovery from an affiliate relevant to an affiliate contract, arrangement, purchase and sale. To the extent we may resort to such authority, that cannot be considered to be an expansion of our authority.

E. Imputation Methodology and Accounting Treatment for Ratemaking and Assessment Purposes

We have determined that revenue sharing under the 1984 DPA and the 1991 DLA was not intended to constitute full and final consideration to VNH for the value VYPC derived from Yellow Pages. We have also determined that the 2000 DPA does not compensate VNH and its ratepayers for the value or enrichment VYPC derives from its association with VNH. In addition, we have determined that the proper remedy in this situation is through the mechanism of imputing revenues to VNH. The remaining step is to quantify the amount and duration of the revenues to impute.

Inasmuch as there is insufficient evidence in the existing record to definitively answer the quantification questions for prospective application, it will be necessary to establish a second phase to this proceeding to determine the appropriate level of imputation. Accordingly,

in a subsequent procedural order, we will set a date for a prehearing conference to, among other things, delineate the scope of that inquiry.

In the interim, we find for current application that a modification of Staff's recommended imputation methodology, which essentially continues the revenue sharing that should have occurred in 1999, constitutes a reasonable estimate of the value of the Yellow Pages enterprise that should be imputed to VNH for New Hampshire regulatory purposes.

The parties disagree as to the appropriate level or average ratio to be applied, due largely to changes in methods of revenue accounting. Staff contends that the averaged ratio of historical un-audited VYPC's gross revenues to VNH's directory revenues averaged over the years 1995-1998 should be applied to VYPC's year end gross revenues for years 1999 forward, to determine annual imputed revenues. In short, Staff's data showed that while revenue sharing under the 1991 DLA was in effect, the average ratio was approximately 41 percent of VYPC NH gross revenues.

On the other hand, VNH challenges the validity of Staff's recommended imputation methodology by pointing out that in 1996 NIRC changed its method of revenue and expense recognition to "point of publication," which resulted in abnormally high revenues recorded in PART Puc 406.03 account 5230 for the year 1996. VNH further states that correcting for this change results in an averaged ratio of 36 percent. We note also that on January 1, 2003, VNH changed its accounting method again, from "point of publication" to amortization, which was essentially the method in effect before 1996. VNH and Staff appear to agree that any accounting method for imputing revenues should be consistent.

Upon careful consideration, we will adopt a variation of Staff's recommended imputation methodology for New Hampshire's regulatory purposes, including ratemaking and

assessments, with the resulting amount to be applied commencing with the year 1999. We are persuaded that any imputation methodology should be accompanied by safeguards and should be consistent, including normalizing revenue flows for accounting changes. We will require VNH to file restated financial statements, beginning with 1999 and continue the imputation until further order of the Commission. Specifically, for purposes of imputation, we will modify Staff's imputation methodology, to simply average calendar year 1995 and calendar year 1998, which results in an averaged ratio of 38%. The resultant revenue imputation for 1999 is $23.3 million. Consequently, in order to calculate the annual assessment required by RSA 363-A and to determine whether VNH is over-earning or under-earning for ratemaking purposes, we will impute $23.3 million per year, pending the issuance of a further order in the second phase of this proceeding.

We now turn to the question of where to properly record the imputation amounts. The parties disagree as to whether imputed amounts should be recorded on VNH's books or as a separate, special adjustment reported to the Commission. Staff urges that imputation amounts be booked to PART Puc 406.03 account 5230 in accordance with Commission rules in Puc 406.03 which was established as a state specific system to preserve the Commission's independence in setting intrastate accounting and ratemaking policy. On the other hand, VNH contends that imputed amounts should not flow through Account 5230, which is part of the FCC Part 32 Uniform System of Accounts for Telecommunications Companies (USOA) and the N.H. Code of Administrative Rules, PART Puc 406.03, because the USOA generally incorporates Generally Accepted Accounting Principles (GAAP) and imputation is not an accounting principle nor is it allowed under GAAP.

A review of our decision in *Uniform System of Accounts for Telecommunications Companies*, 73 NH PUC 34, *supra* overcomes VNH's arguments that a strict GAAP approach is required for purposes of our state specific accounting system. It is clear that the intent of the PART Puc 406.03 Uniform System of Accounts was to develop a state specific system to preserve the Commission's independence in setting intrastate accounting and ratemaking policy. We are also persuaded by Staff's arguments that the application of these rules does not conflict with RSA 374 and does not prevent VNH from complying with any requirements of the FCC or the Security Exchange Commission in terms of reporting in accordance with GAAP.

The Commission seeks only to meet the most basic objective of utility ratemaking by accurately monitoring the total amount of revenues for the purposes of ratemaking and determining the appropriate level of assessments due from VNH. We are sensitive to the need that the accounting of imputation should be accompanied by safeguards that will ensure that revenues are appropriately captured for these purposes. Inasmuch as there is an ongoing dispute we find that that a line item adjustment on the reports filed with this Commission is sufficient at this time.

Thus, we direct VNH to file restated and future financial statements, beginning with 1999, reflecting a unique line item adjustment for the imputed revenues of $23.3 million on the New Hampshire Earnings Statements and associated reports until further Commission order.

F. Impact of the TAct and FCC Regulations Implementing the TAct on the Directory Publishing Business and the Relationship between the Regulated Telephone Company and its Directory Publishing Affiliate

1. Section 222(e) of the TAct

VNH argues that Section 222 (e) of the Tact prohibited NET's grant of "special rights" to NIRC such as the license and non-competition benefit provided in the 1991 DLA.

Section 222(e) of the TAct requires telecommunications carriers such as VNH to provide subscriber list information on non-discriminatory terms to directory publishers. By its terms, the law protects all persons requesting subscriber list information for the purposes of directory publishing although the purpose of the law was to enhance competition by protecting independent publishers from possible discrimination by carriers favoring in-house or affiliated publishers. On its face, section 222(e) does not apply to directory publishing arrangements between a carrier and its affiliated directory publisher and despite its assertion that section 222(e) does apply to such arrangements, VNH has provided no citations to authority, and we have found none, from the FCC or any other body in support of its position. In any event, the documentary evidence indicates that NET and its successors have followed such a non-discrimination policy since divestiture in its listings licensing agreements and NET said as much in its March 8, 2000 letter to the Commission. The Commission itself recognized this policy in *New England Telephone and Telegraph Company, Inc.*, Order No. 19,188 in DC 88-135, 73 NH PUC 390 (1988) (Commission stated that since before divestiture, NET has provided names, addresses and telephone numbers of listed subscribers to independent publishers for the purpose of producing printed and electronic directories or for some non-publishing purposes on a case-by-case basis). Contrary to VNH's claims, there is no indication that section 222(e) made NET's grant of special rights to NIRC, such as the license and the non-competition benefit provided in the 1991 DLA, illegal. Section 222(e) did not require or justify the elimination of those special rights and thus the elimination of VNH's right to compensation for such special rights. We conclude that section 222(e) did not require or justify the termination of the 1991 DLA or the elimination of revenue sharing in the 2000 DPA.

2. Section 254 of the TAct

VNH argues that section 254 of the TAct renders imputation of Yellow Pages revenues unlawful. The argument is based on the premise that imputation is a universal service support mechanism within the scope of section 254 of the TAct and the FCC's *Universal Service Order* that is subject to the mandated policy principles. The argument appears to equate Judge Greene's use of the word "subsidy" and his affordability-for-all-Americans rationale for allowing BOCs to keep the Yellow Pages business with the term "implicit subsidy" and the universal service mechanisms established pursuant to section 254 and the FCC's *Universal Service Order*. VNH has not persuaded us that such an equation should hold true nor has it provided any citations to authority demonstrating that it is true. Further, we are not convinced that imputation would subsidize basic exchange service. The Commission determined in the last litigated retail cost of service case that basic exchange rates not only recover their incremental costs but contribute to common overhead costs. *See New England Telephone & Telegraph Company*, Order No. 20,082 in DR 89-010 and DR 85-182, 76 NH PUC 150, 167 (1991). As such, it is premature to conclude that imputation would subsidize basic exchange service.

In any event, even assuming that the Federal universal service policy principles apply to the imputation of Yellow Pages revenues, VNH has not persuaded us that imputation of Yellow Pages revenues exceeds State authority preserved in section 254(f) or conflicts with Federal requirements described in section 254(f), nor has VNH provided any citations to authority demonstrating that imputation exceeds State authority or that there is a conflict.

VNH concedes that imputation as such is not a subsidy and that if a subsidy is created at all, it is created as an immediate consequence of rate design rather than of determining the revenues to be included in a revenue requirement. In addition, imputation would preserve for VNH and its ratepayers the benefit of revenues earned by VNH and thus no subsidy, as it is

generally defined,[125] would be involved. More specifically, VNH disavows any reliance on the specific definition of "implicit subsidy" in the *Universal Service Order* and VNH is therefore in no position to argue that imputation is a Federally prohibited "implicit subsidy."

VNH complains that imputation would be a discriminatory and unfair burden on VNH and VYPC in violation of the "competitive neutrality" principle. Based on the unique history of the Yellow Pages business being conducted by VYPC, we agree with Staff that VNH and VYPC are not similarly situated with any other directory publisher in New Hampshire. We conclude that imputation would not violate any non-discrimination requirements within the scope of section 254(f).

All the public service commission and court decisions we are aware of have uniformly rejected arguments based on section 254-related considerations. *See Re Cincinnati Bell Telephone Company*, 190 P.U.R.4th 585, *supra*; *Re U S WEST Communications, Inc.*, UT 125 and UT 80, Order No. 00-191**,** *supra*; *Re U S WEST Comm., Inc.*, Docket No. UT-980948**,** 14th Suppl. Order, *supra*; *Re U S West Comm.,* 165 P.U.R.4th 235, *supra*; *US West Communications, Inc. v. Washington Utilities & Transportation Commission*, *supra,* 949 P.2d at 1350. We likewise reject VNH's arguments with respect to section 254 of the TAct.

VNH has not demonstrated that imputation is a universal support mechanism within the scope of section 254 and the *Universal Service Order* that is subject to the mandated policy principles. In any event, VNH has not persuaded us that imputation and revenue sharing would violate those principles even if they were applicable. For all these reasons, we conclude that section 254 of the TAct does not prohibit us from imputing Yellow Pages revenues to VNH,

[125] For example, Webster's Third New International Dictionary defines "subsidy" as "a grant or gift of money or other property made by way of financial aid."

nor does it justify the termination of the 1991 DLA or VNH's acceptance of the elimination of revenue sharing in the 2000 DPA.

3. Section 274 of the TAct

VNH describes section 274 of the TAct as a motivating factor behind NIRC's attempts to terminate the 1991 DLA and eliminate revenue sharing. That may be true. However, the evidence also indicates that NET and its affiliates were in compliance with section 274 as a result of the rearrangement of the ownership of NIT and revenue sharing was eliminated so that the print and electronic publishing activities could be conducted on a fully integrated basis. Thus, elimination of revenue sharing was a business choice likely to benefit NIRC's shareholders. VNH has not produced any evidence to show that the choice was likely to benefit NET and its ratepayers. On the contrary, rights of NET were sacrificed and harm was potentially caused to ratepayers' interests when revenue sharing was eliminated. In any event, the restrictions imposed by section 274 expired on February 8, 2000, one month before the 2000 DPA was filed with the Commission. Thus, section 274 of the TAct does not justify the termination of the 1991 DLA (from NET's point of view) or VNH's acceptance of the elimination of revenue sharing in the 2000 DPA.

G. Economic Policy Considerations

In the initial stages of this proceeding, VNH asserted that there was strong and increasing competition in the advertising market in which VYPC participates. VNH argued that because VYPC's Yellow Pages directory services are provided in a competitive market, imputation would distort Verizon's incentives to compete in the directory advertising market and result in inefficient prices for Verizon's other services, such as local exchange services. VNH subsequently argued that imputation would be bad economic policy irrespective of the exact

degree of competition in the Yellow Pages business. VNH stresses that what is important is that the market be "open" to competition. The degree of competition now enters into VNH's economic policy arguments in only one way: VNH argues that imputation is "particularly" costly and inefficient because it distorts market outcomes in a much greater way compared to collecting revenues from a market that is "less competitive" and where demand is highly price inelastic.

OCA argues that because Verizon Yellow Pages enjoys market power in New Hampshire, VNH's claims that imputation would create market distortions in the Yellow Pages publishing market are baseless. OCA states that in a non-competitive Yellow Pages market, distortions in favor of the dominant provider are irrelevant. OCA maintains the same argument applies with respect to VNH's claims of distortions to the local exchange market, which is, according to OCA, still dominated by VNH; however, OCA states those matters are not within the scope of this docket.

Staff asserts that the Yellow Pages business in New Hampshire is not an economically competitive market and that Verizon has market power in the relevant market. However, Staff states that given the apparent agreement of Dr. Taylor and Mr. Schlegel that policy considerations do not depend on the level of competition in the Yellow Pages market, the Commission is not called on in this docket to make an in-depth analysis of the level of competition.

On the basis of the record in this case, we cannot conclude that the relevant product market in which VYPC participates is nearly as all-encompassing as that claimed by VNH. Likewise, we cannot conclude that VYPC is not the dominant provider of Yellow Pages directory advertising services or that it lacks market power. Thus, VNH has not made a factual case against imputation. Furthermore, we do not conclude that the entry by some new

competitors into the Yellow Pages market in New Hampshire in and of itself proves that there is economically significant competition. Accordingly, we find that VNH has not made its case on the facts or, for the reasons set forth below, on economic theory.

VNH argues that the economic costs and inefficiencies resulting from imputation are greater in a market that is more competitive than in some other "less competitive" hypothetical market and where the elasticity of demand is lower. However, it has not been demonstrated by any persuasive evidence that the market for Yellow Pages is competitive or that the demand for Yellow Pages is elastic; therefore, we are not persuaded by VNH's argument. In all other respects, VNH's economic policy arguments do not depend on the degree of competition. In light of the posture of this case, we are not required to make any detailed findings or reach any final conclusions regarding the issue of competition and we do not do so.

Neither VYPC nor Verizon Communications, Inc. has filed appearances in this docket to support VNH's economic policy arguments. More important, no competitors of VNH for local exchange service or competitors of VYPC for directory advertising services have appeared. No party other than VNH challenges imputation or contends that it improperly distorts markets or constitutes a barrier to entry. We also note that the pro-competitive policies of the TAct relevant to this docket were not intended to protect the BOCs and the BOCs' affiliated business interests in directory publishing or electronic publishing. Rather, they were intended to help protect independent directory publishers and electronic publishers from the competitive threat posed by the BOCs and their affiliates. *See Third Report* at paragraph 3 (in enacting section 222(e), Congress' goals included preventing unfair local exchange carrier practices and encouraging the development of competition in directory advertising); *Bellsouth Corporation v. Federal Communications Commission*, 144 F.3d 58, 66-67 (D.C Cir. 1998) (section 274 a

response to risks of anti-competitive behavior by BOCs); *SBC Communications v. Federal Communications Commission*, 154 F.3d 226, 243-244 (5th Cir. 1998) (same). The Commission has historically sanctioned revenue sharing in connection with Yellow Pages, with the full agreement and support of the regulated telephone company and its directory publishing affiliate.[126] We believe that continuation of the benefits of revenue sharing for ratepayers through the remedy of imputation is necessary in this case to reach a just and reasonable result. We find no basis to deny a remedy based on the economic policy concerns presented by VNH or to find that an otherwise unjust and unreasonable agreement is just and reasonable.

H. Civil Penalty

The Order of Notice in this docket provided in part that, if it is determined that VNH failed to comply with RSA 366, we would inquire as to whether VNH should be assessed a penalty under RSA 365:41. We have found that the 1999 Amendment was a modification of an affiliate contract described in RSA 366:3, which was required to be filed with the Commission and that NET's failure to timely file the 1999 Amendment was a violation of its statutory duty under RSA 366:3. We have also found that VNH's arguments[127] are not sufficient reasons for finding that the 1999 Amendment was legally effective. We further find that neither argument, nor the related arguments advanced by VNH, excuse NET's failure to file the 1999 Amendment.

RSA 365:41 authorizes civil penalties up to $25,000 against public utilities for a violation of any provision of Title 34. Staff argues that NET's failure to file the 1999 Amendment is a clear violation of RSA 366:3 for which imposition of a civil penalty is justified.

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[126] *See* Order No. 17,744 and Order No. 20, 074. *See also New England Telephone and Telegraph Company,* Inc., Order No. 19,188 in DC 88-135, 73 NH PUC 390 (1988) (revenues from proactively marketing subscriber listing information to independent publishers and others will contribute toward the public good by diminishing the revenue burden on basic local rates).

[127] VNH argues that the amendment of the 1991 DLA is irrelevant to this docket and the failure to file the 1999 Amendment was unintentional and resulted from personnel changes and processes for which VNH has taken corrective action.

We agree under the particular facts and circumstances of this case. The 1999 Amendment accomplished a major change in the above-the-line revenues flowing from NIRC to NET, and contravened the Commission's long-standing policy in favor of revenue sharing. Accordingly, the failure to file does not concern some merely perfunctory affiliate arrangement. For the regulatory process to function as intended, strict compliance with the RSA 366 filing requirements is important. We also consider, however, that no evidence was introduced in this docket that the violation was willful or motivated by bad faith on the part of NET. In addition, the violation in and of itself did not harm ratepayers' interests. Upon careful consideration, we assess a civil penalty upon VNH in the amount of $1,000 pursuant to RSA 365:41.

With respect to the late filing of the 2000 DPA, we find that the delay was unintentional, that the period of delay, *i.e.*, 54 days, was *de minimis* under the circumstance and that no financial harm was suffered by ratepayers. Accordingly, no civil penalty will be assessed in relation to the 2000 DPA.

Based upon the foregoing, it is hereby

ORDERED, that, pursuant to RSA 366:5, the 2000 DPA is unjust and unreasonable as it pertains to VNH and its customers; and it is

FURTHER ORDERED, that to remedy the unjust and unreasonable effects of the 2000 DPA it is appropriate to impute revenues to VNH; and it is

FURTHER ORDERED, that a second phase to this proceeding will be conducted to quantify prospectively the level of imputation; and it is

FURTHER ORDERED, that, pending the conclusion of this proceeding, $23.3 million in revenues will be imputed annually to VNH for regulatory purposes in order to determine the annual assessment pursuant to RSA 363-A and to evaluate earnings; and it is

FURTHER ORDERED, that VNH shall file, within 45 days, restated financial statements beginning with 1999 to reflect imputed annual revenues in the amount of $23.3 million.

FURTHER ORDERED, that VNH shall for the duration of this docket include a unique line item adjustment on its financial statements, including its NH Earnings Statements and associated reports, reflecting the imputed annual revenue of $23.3 million.

By order of the Public Utilities Commission of New Hampshire this ninth day of July, 2004.

Thomas B. Getz Chairman	Susan S. Geiger Commissioner	Graham J. Morrison Commissioner

Attested by:

Debra A. Howland
Executive Director & Secretary