

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
New York on September 27, 2001

COMMISSIONER PRESENT:

Thomas J. Dunleavy

CASE 94-C-0095 - Proceeding on Motion of the Commission to Examine Issues Related to the Continuing Provision of Universal Service and to Develop a Regulatory Framework for the Transition to Competition in the Local Exchange Market.

CASE 87-C-8425 - Proceeding on Motion of the Commission as to the Impact of the Modification of Final Judgment and the Federal Communications Commission's Docket 78-72 on Provision of Toll Service in New York State.

ORDER APPROVING OFFSETS TO EXTENDED
AREA SERVICE SETTLEMENT REDUCTIONS

(Issued and Effective September 27, 2001)

SUMMARY

The Order issued in these proceedings on December 4, 1998,¹ permits qualifying independent telephone companies to increase local service rates to recover the reductions in Extended Area Service (EAS) settlements received from Verizon New York Inc. (Verizon) as a result of a three year phase-down of such settlements. In the first of these phase-downs that occurred on October 1, 1999, twenty four companies lost approximately six million dollars in EAS payments from

¹ Cases 94-C-0095 and 28425, Order Resolving Issues Related to Independent Telephone Companies' Access Charges, the 1998 Ice Storm and Other Matters (issued December 4, 1998) (the December 4, 1998 Order).

Verizon, and fourteen companies filed proposals to recover the losses in settlement payments. In the second phase-down, twenty companies lost approximately \$3.9 million, and eight companies filed proposals to recover the losses in EAS settlements. In the third phase-down, twelve companies lost approximately \$1.5 million and five companies have filed proposals to recover the losses in settlement payments.² After analyzing the pro forma earnings of these companies, this order provides as follows:

- (1) Pattersonville Telephone will be permitted to recover the third year EAS reduction by ceasing deferral of Tax Reform Act of 1986 (TRA-86) and FASB 109 benefits and beginning amortization of the accrued benefits over a 10-year period;
- (2) Port Byron Telephone Company will be allowed to offset its third year EAS reduction with offsets in the local Access Line Credit allowed to customers;
- (3) Vernon Telephone Company will be permitted to recover the third year EAS reductions and to eliminate four-party service with an increase to local access line rates; and,
- (4) Ontario Telephone Company will be permitted to recover the third year EAS reductions through an increase to local access line rates.

Eight companies will continue to receive EAS payments totaling approximately \$1.2 million beginning October 1, 2001. No provision was made for EAS phase-downs or recovery beyond the three-year period set forth in the December 4, 1998 Order. Consistent with the purposes of that Order, we will consider extending the phase-down period to eliminate all EAS subsidies after noticing this issue for comment.

² Berkshire Telephone filed and later withdrew its petition.

BACKGROUND

As a long-standing practice, telephone companies in New York provide their customers the option of entering into EAS arrangements. Under an EAS arrangement, certain highly used toll routes are billed as local calls rather than toll. Because in many cases such a billing change results in a higher local rate, customer approval is obtained before any change is made. For certain EAS routes between Verizon and the independent companies³, Verizon makes annual payments or settlements to affected independent companies as a way to recompense those independent companies for the additional costs and/or lost revenue associated with the change from toll to local traffic. While this practice ceased for routes implemented after 1985, Verizon will pay various independent companies approximately \$2.7 million during the year ending September 30, 2001, for routes implemented prior to 1985.

The December 4, 1998 Order approved a three-year annual phase-down of EAS settlement payments from Verizon to the independents commencing on October 1, 1999, with the third reduction taking place on October 1, 2001. This reduction could equal as much as 2.5% of the recipient's regulated intrastate revenues during the previous calendar year, subject to certain constraints designed to mitigate the rate impact on customers. The order allowed the companies experiencing a reduced payment from Verizon to seek local service rate increases to offset those reductions, subject to an abbreviated earnings test. The order limited any rate increases to no more than \$1 per month, per line, per year.

³ The term "independent companies" is a commonly understood industry expression for the traditional, wireline incumbent telephone companies, other than New York Telephone Company, now Verizon New York Inc. The term "independent" refers to their independence from the now defunct Bell System.

The ultimate elimination of EAS payments by Verizon to the independent telephone companies may require, for some companies, small increases to basic service rates as discussed herein. Other rate structure changes also put pressure on basic rates. The Commission previously concluded that it is desirable to eliminate party-line service where feasible,⁴ and subsequently determined that basic service includes a single party access line⁵. Proposals for eliminating party-line services are considered on a case-by-case basis, and take into account such matters as the Commission's goal of eliminating touch-tone and locality charges.⁶ In order to accomplish these goals, the Commission has allowed monthly basic rate increases of up to \$1.50 for residential customers to recoup lost locality mileage charges.⁷

⁴ Cases 95-C-0983 and 95-C-1057, Ordinary Tariff Filings of Margaretville Telephone Company, Inc. and Frontier Communications of Seneca-Gorham, Inc., Order Allowing Elimination of Party-Line Service in Phases (issued January 29, 1996).

⁵ Case 94-C-0095, Opinion No. 96-13, Opinion and Order Adopting Regulatory Framework (issued May 22, 1996). Cases 94-C-0095 and 28425, Opinion No. 98-10, Opinion and Order Establishing Access Charges for New York Telephone Company and Instituting a Targeted Accessibility Fund (issued June 2, 1998).

⁶ Locality mileage charges must be eliminated before party-line service is withdrawn so that the same basic service rates are available throughout an exchange to all customers at the same rate, in accordance with the Commission's minimum grade of service guidelines.

⁷ The \$1.50 constraint (on increases to reduce touch-tone and locality charges) and \$1 constraint (on increases related to EAS phase-outs) are not additive. Under some conditions, a company may propose changes to rates of up to \$1.50 to address as many of these rate structure objectives as possible, thereby providing the company a fair opportunity for recovery. In other cases, sufficient earnings may exist to address the loss in EAS revenues, locality charge and touch-tone rate elimination without raising local rates, or by changes well

In a letter dated May 29, 2001, Department staff informed those companies receiving EAS payments of the procedure required to increase local service rates effective October 1, 2001, to recover the third reduction in EAS payments. The letter included:

- 1) guidelines and worksheets to assist the companies in determining whether they passed the abbreviated earnings test;
- 2) a chart to determine the allowed return on equity;⁸ and,
- 3) a partial listing of the types of services where rate increases could and could not be applied to the companies' tariffs.

The letter also invited any company that was continuing to defer tax savings attributable to the Tax Reform Act of 1986 (TRA-86)⁹ to reflect available TRA-86 benefits in the abbreviated earnings test. Specifically, a company could reflect one or both of the following adjustments:

- 1) stopping the ongoing deferral for the reduction in the tax rate from 46% to 34% (now 35% for some companies); and/or
- 2) amortizing TRA-86 benefits deferred over a period to be proposed by the company.

below the maximum. Each independent company is evaluated on a case-by-case basis.

⁸ The chart, attached to this order as Appendix A, provides the allowed return on common equity based on each company's equity ratio.

⁹ Case 29465, Statement of Policy on Accounting and Ratemaking Procedures to Implement the Tax Reform Act of 1986 (issued July 7, 1987).

In response, five independent companies submitted proposals.¹⁰ The filings and recommendations are discussed below. A summary of the proposed residential rates is provided in Appendix B, and the Administrative Details of such revisions are set forth in Appendix C.

DISCUSSION

Pattersonville Telephone Company (Pattersonville)

Pattersonville will be losing \$23,019 in EAS payments on October 1, 2001. In its filing, the Company states, "We are not seeking a rate increase at this time, rather Pattersonville would like to begin amortizing the TRA-86 deferral and the FASB 109 deferral over a 10 year period." The deferred TRA-86 benefits balance on September 30, 2001 will be \$31,365 and its FASB 109 balance on that date will be \$7,096. In addition, Pattersonville has not accrued annual carrying charges on its TRA-86 benefit balances during the eight-year period, 1986 to 1993, although required to do so. The carrying charges amount to \$7,360.¹¹ The addition of the carrying charge balance to the previously mentioned deferred TRA-86 benefit balance gives Pattersonville a total deferral of \$38,725 to be amortized. Pattersonville must recognize the accrual of its TRA-86 carrying charges for the eight-year period by debiting Account 4550.8 - Adjustments to Retained Earnings and crediting Account 4360 - Other Deferred Liabilities. The combined TRA-86 balance

¹⁰ Berkshire Telephone filed for EAS recovery but subsequently withdrew its petition. A review of Berkshire's earnings for the year 2000 disclosed a one-time merger related legal expense which, when normalized, increased the company's net earnings making it ineligible for EAS recovery.

¹¹ The applicable TRA-86 benefit balance carrying charges are calculated pursuant to instructions set forth in Case 29465, supra.

CASE 94-C-0095, et al.

including carrying charges and FASB 109 balance is \$45,821. Although only \$4,582 will be amortized annually, this partial offset of the \$23,019 loss of EAS payments is appropriate, inasmuch as Pattersonville's rates are higher than the national average, the fourth highest statewide. Pattersonville will be allowed to amortize the TRA-86 and FASB 109 deferred benefits over 10 years.

Port Byron Telephone Company (Port Byron)

Port Byron's EAS settlements will be reduced by \$55,029, but it does not seek a rate increase to recover the EAS loss. Instead, it proposes to reduce its Local Access Line Credit to customers from \$2.40 to \$1.20 for one party access lines and from \$1.20 to \$0.60 for two party access lines. The Local Access Line Credit, established to refund over-earnings to Port Byron customers, is not to exceed the amount of EAS settlement payments.¹². A pro forma return on equity analysis for Port Byron found that, primarily due to large Universal Service Fund (USF) losses, Port Byron is no longer in an over-earnings position. The rate design worksheet submitted with the tariff is acceptable, and its proposal will be approved.

Vernon Telephone Company, Inc. (Vernon)

Vernon filed tariff revisions to increase annual local service revenues by \$37,576, the approximate amount of its third scheduled EAS settlement reduction. Vernon qualifies for full recovery of the loss in EAS settlements through the abbreviated earnings test. The proposed tariff revisions include increases in flat rate basic service charges for residential and business customers, and trunk rate increases for business customers. Flat

¹² Case 99-C-0356, Tariff Filing by Port Byron Telephone Company to eliminate locality mileage charges, increase its vacation discount and provide a monthly local access line credit (Untitled order effective April 14, 1999).

CASE 94-C-0095, et al.

rate basic service will increase by \$0.86 per month and \$0.73 per month for residential and business customers, respectively. Four party flat rate service will be eliminated. Trunk rates for business customers will also increase by \$0.68 and \$0.71 per month in the Vernon and Knoxboro exchanges, respectively. Finally, the advanced calling services, Repeat Dial and Call Return, will increase by \$0.50 per month. These increases are within the guidelines set forth in the December 4, 1998 Order and will be approved.

Ontario Telephone Company, Inc. (Ontario)

Ontario filed tariff revisions to increase its annual revenues by \$49,158 or \$0.75 per access line, per month to recover its reduction in EAS settlement payments. The company qualifies for recovery of the loss in EAS settlements under the abbreviated earnings test. Ontario's request is less than the maximum increase of 2.5% of intrastate revenues. The tariff revisions are reasonable and will be approved.

CONCLUSION

Analyses of petitioners' financial reports and recovery proposals, together with the application of the terms of the December 4, 1998 Order, establish reasonable bases for the relief to be granted to the companies. All companies have requested waivers of the newspaper publication requirements of Section 92(2) of the Public Service Law, as all customers will be notified through the use of bill inserts. These requests are reasonable and will be granted. The tariff revisions listed in Appendix C will be effective on the dates shown.

CASE 94-C-0095, et al.

Finally it should be noted that, pursuant to the December 4, 1998 Order, Verizon's settlement reductions will be treated as exogenous cost savings and netted against other exogenous changes.

It is ordered:

1. The proposals of Pattersonville Telephone Company, Port Byron Telephone Company, Vernon Telephone Company, Inc., and Ontario Telephone Company, Inc. to offset their respective losses of EAS settlement payments from Verizon New York Inc. are approved as discussed herein.

2. The tariff revisions listed in Appendix C will be effective on the dates shown.

3. The Public Service Law §92(2) requirement for newspaper publication is waived.

4. This proceeding is continued.

(SIGNED)

Commissioner

ALLOWED RETURN ON COMMON EQUITY

The allowed return on equity (ROE) for the independent telephone companies will be determined based on each company's equity ratio. The maximum allowed ROE will be 11.35% for any company with an equity ratio that rounds to 50% or less. The allowed ROE at other equity ratios will be determined according the chart below:

| For An Equity Ratio That Rounds To: | The Equity Return Threshold Is: | For An Equity Ratio That Rounds To: | The Equity Return Threshold Is: |
|--|--|--|--|
| 100% | 8.30% | 75% | 9.35% |
| 99% | 8.30% | 74% | 9.43% |
| 98% | 8.35% | 73% | 9.51% |
| 97% | 8.35% | 72% | 9.59% |
| 96% | 8.40% | 71% | 9.67% |
| 95% | 8.40% | 70% | 9.75% |
| 94% | 8.45% | 69% | 9.83% |
| 93% | 8.50% | 68% | 9.91% |
| 92% | 8.50% | 67% | 9.99% |
| 91% | 8.55% | 66% | 10.07% |
| 90% | 8.55% | 65% | 10.15% |
| 89% | 8.60% | 64% | 10.23% |
| 88% | 8.65% | 63% | 10.31% |
| 87% | 8.70% | 62% | 10.39% |
| 86% | 8.75% | 61% | 10.47% |
| 85% | 8.80% | 60% | 10.55% |
| 84% | 8.85% | 59% | 10.63% |
| 83% | 8.90% | 58% | 10.71% |
| 82% | 8.95% | 57% | 10.79% |
| 81% | 9.00% | 56% | 10.87% |
| 80% | 9.05% | 55% | 10.95% |
| 79% | 9.10% | 54% | 11.03% |
| 78% | 9.15% | 53% | 11.11% |
| 77% | 9.21% | 52% | 11.19% |
| 76% | 9.28% | 51% | 11.27% |
| | | 50% or less | 11.35% |

PROPOSED TARIFF CHANGES
 (Summary of residence rates only)

Port Byron Telephone Company

| Service | Current Rate | Proposed Rate | \$ Inc. | % Inc. |
|--------------------------|--------------|---------------|----------|--------|
| Local Access Line Credit | | | | |
| One Party Access Line | \$ 2.40 | \$ 1.20 | (\$1.20) | (50.0) |
| Two Party Access Line | \$ 1.20 | \$ 0.60 | (\$0.60) | (50.0) |

Vernon Telephone Company, Inc.

| Service | Current Rate | Proposed Rate | \$ Inc. | % Inc. |
|-------------------------------|--------------|---------------|---------|--------|
| Residence-Flat Rate-1 party | | | | |
| Vernon,Vernon Ctr. & Knoxboro | \$12.44 | \$13.30 | \$0.86 | 6.9 |
| Residence-Flat Rate-4 party | | | | |
| Vernon,Vernon Ctr. & Knoxboro | \$10.89 | N/A | | |

Ontario Telephone Company, Inc.

| Service | Current Rate | Proposed Rate | \$ Inc. | % Inc. |
|-----------------------------|--------------|---------------|---------|--------|
| Residence-Flat Rate-1 party | | | | |
| Clifton Springs & Phelps | \$ 6.18 | \$ 6.93 | \$0.75 | 12.1 |
| Residence-Flat Rate-2 party | | | | |
| Clifton Springs & Phelps | \$ 5.56 | \$ 6.31 | \$0.75 | 13.5 |
| Residence-Flat Rate-4 party | | | | |
| Clifton Springs & Phelps | \$ 4.91 | \$ 5.66 | \$0.75 | 15.3 |

1) Filing by: Port Byron Telephone Company
Revisions to: P.S.C. No. 16 - Telephone
Section 3
Second Revised Page 14A

Issued: July 3, 2001 Effective: October 7, 2001

CASE: 01-C-0994

PUBLIC NOTICE: Newspaper publication waived;
customers notified via bill insert.

XX

2) Filing by: Vernon Telephone Company, Inc.
Revisions to: P.S.C. No. 18 - Telephone
Section 3
11TH Revised Page No.6
11TH Revised Page No.9

Issued: July 2, 2001 Effective: October 7, 2001

CASE: 01-C-0996

PUBLIC NOTICE: Newspaper publication waived;
customers notified via bill insert.

XX

3) Filing by: Berkshire Telephone Corporation
Revisions to: P.S.C. No. 7 - Telephone
Section 3
4TH Revised Page No.6

Issued: July 2, 2001 Effective: October 1, 2001

Revisions to: P.S.C. No. 7 - Telephone
Section 3
5TH Revised Page No.6

Issued: August 13, 2001 Effective: October 1, 2001

CASE: 01-C-0943

PUBLIC NOTICE: Newspaper publication waived;
customers notified via bill insert.

- 4) Filing by: Ontario Telephone Company, Inc.
Revisions to: P.S.C. No. 10 - Telephone

Section 3

7th Revised Page No. 6

4TH Revised Page No. 18

Issued: July 2, 2001 Effective: October 1, 2001

CASE: 01-C-0941

PUBLIC NOTICE: Newspaper publication waived;
customers notified via bill insert.