



COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
P.O. BOX 3265, HARRISBURG, PA 17105-3265

IN REPLY PLEASE
REFER TO OUR FILE

JUN 23 2006

R-00061376
P-00981429F1000

CINDY BRYAN JEANNE PRICE JOHN RUTKOWSKI
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EPHRATA PA 17552-0458

DOCUMENT
FOLDER

Conestoga Telephone & Telegraph Company
Supplement No.206 to Tariff PA PUC No.10
Supplement No.7 to Tariff PA PUC No.11

2006 Annual Price Stability Index/Service Price Index
Filing of Conestoga Telephone & Telegraph Company

To Whom It May Concern:

This is to advise you that the Commission in Public Meeting on June 22, 2006 has adopted an Order in the above entitled proceeding.

An Order has been enclosed for your records.

Very truly yours,

James J. McNulty
Secretary

MMB
encls
cert. mail

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**PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17105-3265**

Public Meeting held June 22, 2006

Commissioners Present:

Wendell F. Holland, Chairman
James H. Cawley, Vice Chairman, Statement attached
Bill Shane
Kim Pizzingrilli
Terrance J. Fitzpatrick, Statement attached

Conestoga Telephone & Telegraph Company
Supplement No. 206 to Tariff PA PUC No. 10
Supplement No. 7 to Tariff PA PUC No. 11

R-00061376

2006 Annual Price Stability Index / Service Price Index
Filing of Conestoga Telephone & Telegraph Company

P-00981429F1000

ORDER

BY THE COMMISSION:

BACKGROUND

Before us for disposition are the Conestoga Telephone & Telegraph Company ("Conestoga" or "Company") annual 2006 Annual Price Stability Index / Service Price Index (PSI/SPI) Filing and the associated tariffs to effectuate increases to local and access service revenues. Conestoga is a rural telephone company and the filing was made under the provisions of the new Chapter 30 law, Act 183 of 2004, P.L. 1398 (66 Pa. C.S. §§ 3011-3019) ("Act 183") and pursuant to the Company's Alternative Regulation and Network Modernization Plan ("Chapter 30 Plan").

As a result of the passage of Act 183, companies with Chapter 30 Plans are entitled to significantly lower inflation offset values within their respective price cap

formulas in exchange for a commitment to accelerated broadband deployment. Inflation offsets previously ranging from 2% to 2.93% were reduced to either 0% or 0.5%, depending on each company's Chapter 30 Plan. In Conestoga's case, the inflation offset was reduced from 2% to 0%. Accordingly, annual Price Stability Plan ("Plan") filings have the potential for substantial revenue and rate impacts on end-user consumers.

Under the Company's Plan, the allowable change (increase or decrease) in rates for noncompetitive services is based on the annual change in the Gross Domestic Product Price Index ("GDP-PI"). The Plan also contains special provisions for protected services and addresses revenue-neutral adjustments to the rates of noncompetitive services. The Plan set forth in Conestoga's Chapter 30 Plan is a complete substitution of the rate base/rate of return regulation. Noncompetitive services are defined as regulated services or business activities that have not been determined or declared to be competitive. The following services are defined as protected services: Service provided to residential consumers or business consumers that is necessary to complete a local exchange call; Touch Tone; Switched Access service; Special Access service; and Ordering installation, restoration and disconnection of these services. 66 Pa. C.S. § 3012

COMPANY FILING

Pursuant to the Plan, Advance Notice was issued on March 14, 2006, informing the Commission of the forthcoming rate changes. On May 3, 2006, Conestoga filed its annual Plan filing using the change in 2004 and 2005 third quarter GDP-PI (Gross Domestic Product – Price Index) of 4.016% that produced an overall 3.70% increase allowable for noncompetitive revenues.

Conestoga proposes to implement its Plan by increasing rates mainly for Switched Access Services through rate changes in Tariff-Telephone Pa. PUC No. 11, and certain Non-Basic local services in Tariff-Telephone Pa. PUC No. 10. The overwhelming

majority of the rate increases are targeted towards switched access services amounting to 99%, compared to 1% for non-basic local services. The proposal to increase switched access service rates is accomplished by lowering of \$0.33 to the Carrier Common Line (CCL) charge, and an increase of \$0.000962 per Minutes of Use (MOU) for Tandem Switching and \$0.007644 MOU for Local Switching. The non-basic local services rate increases are proposed for Return Check Charge, Foreign Exchange Mileage charges, and charges for Business Private Line Services for non-mileage-related services. The proposed tariff revisions are filed to become effective July 1, 2006.

On June 1, 2006, and June 9, 2006, Conestoga submitted certain responses and additional information to Staff inquiries relating to the filing. The additional information includes actual annual intrastate revenue figures for the period ending December 2005, and the Company's composite and individual access service rates per MOU for interstate as well as intrastate traffic. Conestoga also responded to a staff inquiry regarding why an overwhelming majority of the rate increases are directed towards access service charges, despite the industry trend to move in the opposite direction by reducing access service charges so they are closer to their actual cost. According to the Company, it has aggressively implemented local service rate increases over the past five years through a combination of price cap filings and rate rebalancing filings and it believes that additional local service rate increases would accelerate access service line loss.

The Company states in its response that certain aspects of the *Global Order* addressed access service charge reductions, but the overriding theme was mirroring intrastate access service rates with interstate access service rates. The Company also states that it has previously reduced its CCL rates and has been aggressive in reducing access service rates. The Company believes that it is in its customers' best interest to have their rates in line with other ILECs, so that when intercarrier compensation and

access service reform is implemented it will be implemented in a similar fashion for all ILECs. In response to Staff request for a cost study for access service services, the Company responded that it is an average schedule company and does not have any cost studies available to prove that the proposed access service rates were equal to or less than the cost for the Company to provide them.

DISCUSSION

1. Plan Calculations and Rate Increases

The annual Conestoga Plan submissions under Chapter 30 law must conform to its Commission-approved Amended Chapter 30 Plan. Conestoga submitted calculations it used to arrive at the PSI and SPI for the year 2006 based on the third quarter Gross Domestic Product Price Index for the years 2004 and 2005. Section 3015 (a)(1)(iii) of the Public Utility Code (Code), 66 Pa. C.S. § 3015(a)(1)(iii), enabled Conestoga to remove the productivity offset, thus allowing the Company to increase rates for every positive change to the Company's PSI.

Our review of the calculations submitted by Conestoga indicates that the 2006 SPI is 1.0623, allowing for a 3.70% rate increase calculated on the prior year total intrastate revenue.

As an initial matter, we disagree with the 2005 annual revenues that Conestoga used in its PSI/SPI calculation. Rather than using actual 2005 year-end revenues, Conestoga calculated its eligible revenue increase amount using the revenue for the month of December 2005. Conestoga then annualized the eligible increase by 12 to arrive at the annual rate increase for which it is seeking approval. As such, Conestoga's

calculated annualized 2005 annual revenues are 5% higher than its actual 2005 annual revenues,¹ allowing the Company to increase rates more than it is actually entitled.

Accordingly, we find the Company's PSI/SPI calculations to be only partially consistent with the terms of the Company's Price Stability Plan formula approved in its Chapter 30 Plan at Docket No. P-00981429F1000. As such, we will require Conestoga to amend its calculations in Attachments 2 to 4 to its filing based on the actual intrastate revenue for the 12 month period ending December 2005, and adjust the eligible rate increases in Company's Exhibit 1.

2. Local Service Rate Increase

A review of the proposed rate changes to local services was found to be consistent with the Company's Plan. Accordingly, these rates will be allowed to go into effect as filed.

3. Access Services Rate Increase

Upon consideration, we believe that the proposed increase in access service charges as a vehicle to recover the Company's allowable PSI revenues should be resolved as set forth below. The proposal appears to contradict long-standing access service reform in Pennsylvania including Docket No. I-00040105, the Pennsylvania Universal Service Fund rules and policies, and the Company's current Amended Chapter 30 Plan. For these reasons and the reasons set forth in more detail below, we shall give the Company the alternative to either allocate the increase to local rates or bank the remaining amount until a further date.

¹ Upon request from Staff, Conestoga provided its annual revenue amounts for the year ending December 2005.

Switched access service charges are the rates charged by LECs to other companies seeking access to the LEC's facilities in order to provide toll services to the end-user. Inter exchange carriers (IXC) rely on the switched and special access facilities of the LECs to transmit calls between customers and IXC facilities. Accordingly, access services are "protected services" pursuant to the listing of "Switched Access Services" as a protected service under Chapter 30. 66 Pa. C.S. § 3012

Traditionally, in the ILEC monopoly environment, ILECs priced access service charges above cost as a means of generating additional revenues that were used to support local rates and thus keep basic local services affordable. The current laws require that the Commission promote and encourage the provisions of competitive services by a variety of service providers on equal terms and throughout the geographic areas of this Commonwealth without jeopardizing reasonableness of rates or the provision of universal telecommunications service at affordable rates. 66 Pa. C.S. §§ 3011(2), 3011(8).

Conestoga's proposed rate increases for switched access service charges may be contrary to these provisions. Switched access service rate increases contradict Pennsylvania's long-standing attempt to reduce local carriers' dependence on access service revenues and preserve the affordability of local rates. An increase in switched access service rates may avoid an increase in local rates that could attract more service providers. In addition, an increase in access service charges may also undermine the obligation to promote the competition that could occur if ILEC access service charges were priced closer to costs.

By the same token, however, 66 Pa. C.S. § 3011(2) and (8) empowers the Commission to maintain universal telecommunications service at affordable rates while encouraging the accelerated provision of advanced services deployment of broadband telecommunications network in rural, suburban and urban areas. Finally, the Commission

must also ensure that rates, terms and conditions for protected services are reasonable and do not impede development of competition. 66 Pa. C.S. § 3011.

In furtherance of these objectives, the Commission established a Pennsylvania Universal Services Fund (PaUSF). Conestoga's will collect approximately \$1,731,156 support for the year 2006 from the PaUSF to support its current access service charges. The current rate, reduced from the rates in effect prior to creation of the PaUSF, is consistent with the goals of access service reform, the promotion of competition, maintenance of universal service, and the obligation to ensure that rates, terms, and conditions are just and reasonable. Conestoga has already rebalanced rates by decreasing intrastate access service rates and toll rates and increasing local service rates in furtherance of access service reform and to reduce any possible subsidization from toll and access service charges which may have existed prior to toll competition. All jurisdictional Pennsylvania telecommunications service providers are contributing to the PaUSF based on their intrastate end-user revenues. The rural Companies, including Conestoga, were encouraged and permitted to restructure, their access, toll and local rates, accordingly.

The primary purpose of the PaUSF is to maintain the affordability of local service rates for end-user customers while allowing rural telephone companies to reduce their dependency on switched access service revenue and intraLATA toll rate revenues on a revenue-neutral basis. See: 52 Pa. Code § 63.161. The Commission is responsible for assuring the maintenance of universal telecommunications services at affordable rates in Pennsylvania. Universal services are those telecommunication services "essential for a resident of this Commonwealth to participate in modern society at any point in time." 52 Pa. Code § 63.162

Conestoga's proposed rate increases for switched access services appear to hinder this participation as well as contravene its earlier agreement to reduce access service charges as stipulated in a Joint Procedural Stipulation (Joint Stipulation) in response to the Commission's Access Charge Investigation – Phase II.² That Joint Stipulation calls for further switched access service charge reductions in a revenue-neutral method that are recovered not through an increase in the size of the PaUSF, but through gradual increases to local residential and business rates. The Joint Stipulation envisions a continuation of the current PaUSF support under the existing Regulations codified at 52 Pa. Code §§ 63.161-63.171 until a future rulemaking determines otherwise. This is evident in the fact that, although the fund was originally set to expire by December 31, 2003, the PaUSF was continued pursuant to a Joint Stipulation filed by the parties in the proceeding. Conestoga is a party to the Joint Stipulation.

The Joint Stipulation provides for each ILEC to do what is permitted under their respective Chapter 30 Plans. This includes a restructuring of rates on a revenue-neutral basis in a manner that does not increase local rates by more than \$3.50 per month. While the Joint Stipulation did not necessarily require the rural ILECs to mirror interstate access service charges, we note that mirroring interstate rates is a step towards attaining cost-based intrastate access service charges while avoiding arbitrage and promoting competition.

In the Joint Stipulation³, the ILECs reserve the right to change access service rates in order to ensure each access service rate element recovers its cost based upon development of a cost study when the ILECs service price index allows for an increase. In the instant filing, Conestoga failed to provide a cost study consistent with the

² Joint Procedural Stipulation regarding Access Charge Investigation per Global Order of September 30, 1999, order entered on July 15, 2003, Docket Nos. M-00021596 *et al.*

³ See part 2 paragraph 2 to Attachment A to RTCC/Sprint/OCA/OSBA Joint Access Proposal attached to Commission Order at Docket No. M-00021596 *et al.* entered on July 15, 2003.

Joint Proposal requirement to change access service rates that are below cost based on the cost study.

Moreover, Conestoga's proposal may also contravene the Commission's grant of a recent request of the ILECs, including Conestoga, to suspend the investigation of further reductions in switched access service rates. This request arose in the context of a Commission investigation and rulemaking proceeding at Docket No. I-00040105, by Order entered on December 20, 2004, which was further considering additional intrastate access service reform in the service territories of rural ILECs and to address possible modifications to the PaUSF regulations and resulting rate issues should disbursements from the PaUSF be reduced in the future. This investigation was instituted as a result of the Commission's prior Order entered July 15, 2003, at Docket No. M-00021596 which, *inter alia*, discussed implementing continuing access service charge reform in Pennsylvania.

The investigation is also looking into what possible regulatory changes are necessary to 52 Pa. Code §63.161-63.171 given the complex issues involved as well as any necessary changes occasioned by recent amendments to the Public Utility Code.

“Consideration should be given to applicable orders, regulations, policy statements and guidelines of this Commission, including any necessary changes occasioned by recent amendments to the Public Utility Code⁴ The General Assembly has repealed 66 Pa. C.S. § 1325 (limiting local exchange service increases) and added 66 Pa. C.S. §§ 3011-3019 (governing alternative form of regulation of telecommunications services). We would expect, for example, the parties to address the policy and legal ramifications of new sections 3011 (declaring the policy of the Commonwealth), 3015(B) (governing rate changes for rural telecommunications carriers) and 3017 (providing that Commission “may not require a local exchange

⁴ If applicable, federal reforms of the intercarrier compensation scheme should be addressed.

telecommunications company to reduce access service rates except on a revenue-neutral basis” and limiting a competitive local exchange carrier’s ability to charge access rates higher than the ILEC’s rate). Act No. 183, P.L. ____ (Nov. 30, 2004)”⁵.

As indicated above, however, the Commission, at the request of the Rural Telephone Company Coalition, including Conestoga and other ILECs, stayed the proceeding for a period of twelve months or until the FCC issues its ruling in its *Unified Intercarrier Compensation* proceeding, (FCC 01-92) whichever occurs earlier. (Docket No. I-00040105 Order entered on August 30, 2005). The Commission established this deadline when granting the request given the complexity of the federal proceeding, the probable impact in Pennsylvania, and the Commission’s involvement in that proceeding. The Commission granted the request with the expectation that this federal proceeding would be completed within a twelve-month period.

The Commission’s decision also reflected the ILEC’s request for a stay from any further access services rate reduction until the FCC acts on its Intercarrier Compensation proceeding at CC Docket No. 01-92. An important consideration for granting this request is the fact that carriers in states with extensive intrastate access service charge reforms in place prior a federal resolution could be at a disadvantage in securing federal support to lower their rates compared to states that did not engage in intrastate access services rate reform prior to federal action.

Moreover, when granting the stay we required parties to the investigation to submit appropriate status reports to the Commission and directed Commission Staff to monitor the developments in the FCC Intercarrier proceeding. Accordingly, we ordered:

⁵ Commission Order at Docket No. I-00040105, Page 6.

“10. That, upon the resumption of the investigation, the participating parties shall address and provide evidence on the legal, ratemaking, and regulatory accounting linkage between a) the Federal Communications Commission’s ruling in its Unified Intercarrier Compensation proceeding; (b) the intrastate access charge reform for rural ILECs in view of the new Chapter 30 law and its relevant provisions at 66 Pa. C.S. §3015 and 3017; (c) the Pennsylvania Universal Service Fund and d) the potential effect on rates for the basic local exchange services of the rural ILECs.”⁶

We believe that Conestoga’s proposed access service rate increases in the instant filing could undermine our decision to suspend this investigation of further access service reforms, particularly reductions in access service rates, because the proposal reverses the current reforms by increasing the existing access service rates. Such a result could undermine the progress already achieved in our efforts to reduce and reform access service charges and promote competition in the toll and local arenas. We believe that maintenance of the current regulatory status quo, pending federal action, necessitates preservation of Conestoga’s current access service rates:

In addition, the Commission has consistently promoted competition as required by Chapter 30. Consistent with this obligation, the Commission endorsed reform in ILEC access service rates in order to minimize any access service charge support for local rates. The transition to cost-based access service and local service rates is expected to be achieved using revenue-neutral means while also ensuring there is a provider of last resort available to all consumers within the rural ILECs territories. The Commission’s approach also sought to give the ILECs a reasonable time to modernize their networks and ready themselves for competition.

Given these important and sometimes competing regulatory and legal considerations, we believe that the proposed increase in access service rates as a vehicle

⁶ See Ordering paragraph 10, at 1-00040105, entered August 30, 2005.

to recover PSI revenues may contradict the policy of implementing switched access service reform. Access service rate increases at this time also seem to undermine the promotion of competitive markets by increasing the gap between access service charges and costs. The proposed access rate increases set forth in this filing appear to be inconsistent with the ILEC agreement to pursue continued access service reduction and the Commission's current policy of promoting competition.

In particular, the proposed Conestoga PSI/SPI submission does not simply implement a revenue and rate increase on services. The proposal unfairly targets access services by subjecting them to an overwhelming majority of the rate increases on IXC's (3.70% for local switching and 50% for Tandem Switching). As noted, access services are protected services, subject to proof that the rates are just and reasonable under 66 Pa. C.S. § 3109(h), Chapter 13 of the Code, as well as the Company's amended Chapter 30 Plan. The Company fails to provide adequate justification on whether the proposed rate increase for access services is in the public interest and whether or not it will negatively affect competition and, in addition, universal service in Pennsylvania. Furthermore, since the Company did not submit any cost studies with its filing establishing that the current rates are below cost, we cannot ascertain whether or not access services rate elements are priced below cost or unfairly above cost level.

Moreover, the Company's proposal represents a departure from the current practice of recovering PSI revenue increases from local rate increases or banking these revenues for future recovery. We recognize that two major sources for recovering PSI revenues are local rates or access service charges. The current practice of avoiding access service rate increases reflects the desire to promote competition by preserving Pennsylvania's progress on access service charge reform. An increase in access service rates is difficult to accept given that Conestoga is a recipient of PaUSF support and because increases could undermine that access service reform. By the same token,

however, increases in local rates that produce the kind of access service line losses the Company wants to avoid could contravene the Commission's legal obligation to preserve universal service in Pennsylvania and unnecessarily increase funding demands on PaUSF in advance of any national intercarrier compensation reform. The Commission's acceptance of these proposed access service rate increases could also trigger multiple requests for similar access service rate increases throughout Pennsylvania. A deluge of access service rate increases and local rate increases could erode the precarious gains made on access service reform and universal service.

The Commission recognizes that this proposal presents a very difficult issue and that it requires a careful balancing of multiple and sometimes conflicting considerations. The delicate balancing of these considerations is reflected by Commission decisions that promote competition through access service reform resulting in access service rate decreases supported by our PaUSF, as opposed to increases, while simultaneously avoiding adverse harm to universal service and triggering funding support demands from the PaUSF for local rates that exceed \$18.00.

The Company recognized as much in consultations with Staff and in their responses to information requests. Consequently, the Commission is extremely reluctant to disturb this very delicate balance absent truly compelling reasons to the contrary and in advance of national intercarrier compensation reform.

For these reasons, we find Conestoga's proposal to allocate and recover ninety-nine percent (99%) of their 2006 PSI revenue from access services rate increases in Tariff-Telephone Pa. PUC No. 11 as possibly contrary to the above-discussed considerations; **THEREFORE,**

IT IS ORDERED:

1. That the proposed revenue and rate increase proposed by Conestoga Telephone and Telegraph Company increases to Return Check Charge, Foreign Exchange Mileage charges, and Business Private Line Services for non-mileage-related services in its local Tariff-Pa. PUC No. 10 be permitted to go into effect as filed.

2. That the Company submit revised Attachments 2 to 4 (from its original filing) using actual 2005 annual year-end revenue for the calculation of revenue increase and adjust the eligible rate increases in Company's Exhibit 1 within five (5) days of the entry date of this Order.

3. That the Company's 2006 PSI/PSM filing is in partial compliance with its Commission-approved Amended Chapter 30 Plan.

4. That the Company be given the alternative to either "bank" the proposed revenue increase associated with the access service or, alternatively, allocate the proposed revenue increase amount associated with access service to the basic local exchange services in accordance with the applicable provisions of the Company's Amended Chapter 30 Plan.

5. That the Company shall provide the appropriate notification to the Commission's Bureau of Fixed Utility Services, within five (5) days of the date of entry of this Order, of which, if any, alternative they will exercise consistent with Ordering Paragraph No. 4 above.

6. That, in the event that the Company does not choose either of the alternatives set forth in Ordering Paragraph 4 above, the proposed access services rate increases be permitted to go into effect as filed subject to any final determinations on access reform, including the pending intrastate access reform proceeding in Docket No. I-0004015 as it now exists or changes made by the Commission or at the federal level.

7. That the access reform proceeding in Docket No. I-0004015 shall examine, but not be limited to, whether this proposal is consistent with the regulations and policies governing the Pennsylvania Universal Service Fund, the Company's previously granted request for suspension of further intrastate access reform in Docket No. I-00040105, the Company's previously approved Amended Chapter 30 Plan set forth in Docket P-00981430F1000, and the continuing statutory obligations set forth in Sections 3011(1)-(13), 3019(h) and Chapter 13 of the Public Utility Code.

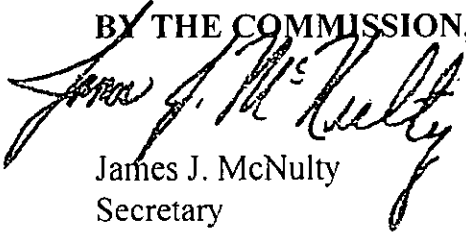
8. That the Company file the appropriate modified tariff supplements to become effective on one day's notice in accordance with the determinations made by the Company based on this Order.

9. That a copy of this Order be served upon Conestoga Telephone and Telegraph Company, the Office of Consumer Advocate, the Office of Small Business Advocate, and the Office of Administrative Law Judge.

10. That a copy of this Order be served on the Office of Trial Staff for such further action as it may deem appropriate.

11. That the Commission's Secretary shall publish this Order in the *Pennsylvania Bulletin*.

BY THE COMMISSION,

A handwritten signature in black ink, appearing to read "James J. McNulty", written over the printed name and title.

James J. McNulty
Secretary

(SEAL)

ORDER ADOPTED: June 22, 2006

ORDER ENTERED: JUN 23 2006

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105**

**Denver & Ephrata Telephone & Telegraph
Company Supplement No. 251 and 10 to
Tariff PA PUC No. 15 and Supplement No.
10 to Tariff PA PUC No. 16**

**PUBLIC MEETING: June 22, 2006
JUN-2006-FUS-0455*
Docket Nos. R-00061377**

**2006 Annual Price Stability Index / Service
Price Index Filing of Denver and Ephrata
Telephone and Telegraph Company**

P-00981430F1000

**Conestoga Telephone & Telegraph Company
Supplement No. 206 to Tariff PA PUC No. 10
Supplement No. 7 to Tariff PA PUC No. 11**

**JUN-2006-FUS-0456*
Docket Nos. R-00061376 ✓**

**2006 Annual Price Stability Index / Service
Price Index Filing of Conestoga Telephone &
Telegraph Company**

P-00981429F1000

**Buffalo Valley Telephone Company
Supplement No. 54 to Tariff PA PUC No. 7
Supplement No. 8 to Tariff PA PUC No. 8**

**JUN-2006-FUS-0457*
Docket Nos. R-00061375**

**2006 Annual Price Stability Index / Service
Price Index Filing of Buffalo Valley
Telephone Company**

P-00981428F1000

**STATEMENT OF VICE CHAIRMAN JAMES H. CAWLEY
CONCURRING IN PART AND DISSENTING IN PART**

Before us for disposition are the Staff recommendations regarding the 2006 annual price stability mechanism Price Stability Index / Price Service Index ("2006 PSI/SPI") filings of Denver and Ephrata Telephone and Telegraph Company ("D&E"), Conestoga Telephone and Telegraph Company ("Conestoga"), and Buffalo Valley Telephone Company ("Buffalo Valley" – collectively referred to as the "Companies"). These 2006 PSI/SPI filings have been submitted under the provisions of Section 3015 of the new Chapter 30 law, 66 Pa. C.S. § 3015, and under the provisions of the Companies' respective Amended Alternative Regulation and Network Modernization Plans ("Chapter 30 Plans") that have been previously approved by the Commission. These Companies are rural incumbent local exchange carriers ("ILECs").

Unlike previous Chapter 30 price stability mechanism PSI/SPI filings by various ILECs in the 2005-2006 time frame, these submissions present us with the more unique issue that the majority of the automatic revenue and rate increases to which the Companies are respectively entitled under the operation of the Chapter 30 law is channeled towards proposed increases in intrastate carrier access charges, and especially for switched access services. This proposed

allocation of the Chapter 30 2006 PSI/SPI revenue and rate increases presents the Commission with certain issues.

The Commission Staff has engaged in a comprehensive and in-depth examination of these issues. The Staff of the Bureau of Fixed Utility Services Telecommunications Industry Group and the Law Bureau should be commended for bringing to our attention these highly interrelated issues, and I sincerely thank them for their efforts in formulating proposed alternative resolutions. Essentially, in this proceeding the Commission is faced with the problem of how to reconcile the automatic annual revenue and rate increase entitlements for the ILECs with Chapter 30 Plans with past and ongoing Commission regulatory policies and goals that involve ILEC intrastate carrier access charge reform, competition, and the preservation of universal telephone service for end-user consumers within the Commonwealth.

Although I agree with most of the Staff analysis and certain recommendations, I believe that some of the resolution alternatives for the issues presented by the Companies' filings are not the most optimal.

A. Calculation of the Companies' 2006 PSI/SPI Revenue Amounts

I am in full agreement with the Staff analysis in this area. The Companies should recalculate their respective 2006 PSI/SPI revenue increases using the full 12-month period historical revenue data for their respective non-competitive revenues as ascertained and recommended by the Commission Staff. It is obvious that although these Companies are under Chapter 30 regulation, they should continue to implement well tried and true principles of conventional regulatory accounting.

B. Implementation of the Companies' 2006 PSI/SPI Non-Access Rate Increases

I am in full agreement with the Staff recommendation regarding the Companies' proposed increases to rate elements that do not involve the Companies' intrastate carrier access services. Naturally, these increases must follow the Companies' corrected 2006 PSI/SPI annual revenue increase figures.

C. Implementation of the Companies' 2006 PSI/SPI Access Rate Increases

The Companies' 2006 PSI/SPI filings and the incisive Staff analysis point out the divergence that exists between the revenue-driven implementation of the Chapter 30 law requirements, and the sound regulatory policies that this Commission has followed in reforming intrastate carrier access, enhancing telecommunications competition, protecting the principles of universal telephone service, and maintaining basic local exchange service rates for more price inelastic end-user consumers at reasonable and affordable levels. Indeed, we have to select the very "second best" choices in resolving the issues that the Companies' respective submissions have presented to the Commission. It suffices to point out that the Companies have selected to allocate the majority of their Chapter 30 automatic annual revenue increase entitlement to their respective intrastate carrier access services.

In its landmark *Global Order* this Commission instituted the Pennsylvania Universal Service Fund (Pa. USF) mechanism while implementing intrastate access reform for the rural ILECs. *Joint Petition of Nextlink Pennsylvania Inc., et al.*, Docket Nos. P-00991648,

P-00991649, Order entered September 30, 1999, 196 PUR4th 172, *aff'd*, *Bell Atlantic-Pennsylvania v. Pa. Public Util. Comm'n*, 763 A.2d 440 (Pa. Cmwlth. 2000), *vacated in part*, *MCI v. Pa. Public Util. Comm'n*, 844 A.2d 1239 (Pa. 2004). As the Staff analysis correctly points out, the Companies – and other rural ILECs – proceeded with access charge reform while receiving support payments from the Pa. USF. Under the regulatory principles that the Commission established in its various intrastate carrier access reform proceedings, the Pa. USF support levels to the Companies would automatically come into question since the Companies have chosen to reverse course and propose increases to their rates for intrastate carrier switched access services. However, the Companies' 2006 PSI/SPI filings are designed to capture their respective automatic annual revenue increase entitlements under the Chapter 30 law, and this proceeding does not readily lend itself to an easy and most optimal reconciliation between the mandates of the law and the existing regulatory priorities that this Commission has established. In summary, the Commission is faced with a range of very "second best" choices.

I believe that certain of the Staff recommended alternatives do not provide the optimal resolution of the interlinked issues that the Companies' 2006 PSI/SPI submissions have generated. The alternatives to either bank or reallocate the proposed revenue increases to the Companies' respective basic local exchange services, rather than channeling such increases to the Companies' intrastate carrier access services, generate other less than desirable implications. Banking the proposed revenue increases creates the usual problems of inter-generational equity. Eventually, the Companies' non-competitive services and the end-users of such services may have to absorb part or all of the banked revenue increases some time in the future on top of new automatic annual PSI/SPI revenue and rate increases.

Channeling the proposed revenue increases to basic local exchange service rates may go against the price elasticity of demand for basic local exchange services that the Companies have identified. Furthermore, it is unclear if such a resolution may violate the \$18.00 rate cap for residential basic local exchange service for certain of D&E's and Buffalo Valley's exchanges. *See generally Access Charge Investigation per Global Order of September 30, 1999, et al.*, Docket Nos. M-00021596 *et al.*, Order entered July 15, 2003.

I believe that in considering the most optimal among the "second best" choices, the Commission should be guided by principles that first safeguard the interests of the Companies' end-user customers that have a lesser number of competitive choices and traditionally exhibit a lesser price elasticity of demand. These are the end-user customers for basic local exchange services. The same customers are also the subjects of universal service goals and protections. These customer classes have been largely absorbing the automatic revenue increase entitlements for the Chapter 30 ILECs during the 2005-2006 time frame, where such entitlements have been generated by the ILECs' total non-competitive services revenues, including those from their respective intrastate carrier access services. This has already happened with the Companies' 2005 PSI/SPI submissions that were approved by the Commission.¹

I have stated this previously and I will state it again. The end-user customers of basic local exchange services do not have an infinite capacity to absorb the Chapter 30 ILEC automatic annual revenue increase entitlements. This is especially true for end-user consumers that are in lesser income brackets. The latest FCC statistics indicate that telephone penetration rates in Pennsylvania – where such statistics capture the availability of wireless telephone service

¹ Docket Nos. R-00050520, R-00050521, R-00050522, Secretarial Letters issued July 29, 2005.

– have declined from 98%-98.2% in 2002 to 95.7%-96.7% in November 2005. Nationally, telephone penetration for households with incomes in the \$20,000-\$24,999 bracket has declined from 93.7%-94.7% in 2000 to 92.8%-94% in 2005.² If the implementation of the Chapter 30 automatic revenue increase entitlements has become divorced from such parameters as reasonableness of rates with measures of cost of service being taken into consideration – and it should not in my opinion – then the protection of basic local exchange service ratepayers from continuous rate increases and preservation of universal service in Pennsylvania are of paramount importance.

I believe that the only feasible resolution is to permit the proposed intrastate carrier access charge increases to go into effect until and such a time that the pending *Intrastate Carrier Access Charge Investigation* for rural ILECs comes to a conclusion, and/or when the Commission implements access charge reforms because of federal changes in intercarrier compensation mechanisms and the federal USF. See generally *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers, and the Pennsylvania Universal Service Fund*, Docket No. I-00040105, Order entered August 30, 2005. Because the intrastate carrier access charges of rural ILECs are interlinked to the intercarrier compensation mechanism and the universal service fund in the federal jurisdiction, the annual Chapter 30 price stability mechanism revenue increases, the Chapter 30 “revenue neutrality” provision for adjusting intrastate carrier access charges under 66 Pa. C.S. § 3017(a), and the Pa. USF, it is better to re-examine this issue in a comprehensive fashion at a later time. I believe that in this manner the Commission can strike an appropriate balance between the new Chapter 30 implementation, the long-standing regulatory goals of intrastate carrier access charge reform, and preserving the principles of universal service in Pennsylvania.

Since the access charges of these Companies’ will be subject to the *Intrastate Carrier Access Charge Investigation* for rural ILECs, I do not see the need to refer the Companies’ 2006 PSI/SPI submissions to the Office of the Administrative Law Judge for a separate investigative proceeding. I believe that it is sufficient that the Companies are placed on notice that their respectively attained revenue increases for their intrastate carrier access services will be prospectively at risk.

For these reasons, I respectfully concur in part and dissent in part.

June 22, 2006



James H. Cawley
Vice Chairman

² Alexander Belifante, *Telephone Subscribership in the United States*, FCC, Industry Analysis and Technology Division, Wireline Competition Bureau, May 2006, Table 3, pp. 18 & 21, Table 4, pp. 27 & 32. Both the respective “unit” and “avail.” statistics are included.

**PENNSYLVANIA PUBLIC UTILITY COMMISSION
HARRISBURG, PENNSYLVANIA 17105**

**Denver & Ephrata, Conestoga
and Buffalo Valley Telephone
Companies 2006 Annual Price
Stability Index/Service Price
Index and Related Tariff Filings**

**PUBLIC MEETING June 22, 2006
JUN-2006-FUS-0455 R*
R-00061377
P-00981430F1000**

**JUN-2006-FUS-0456 R*
R-00061376 ✓
P-00981429F1000**

**JUN-2006-FUS-0457 R*
R-00061375
P-00981428F1000**

**STATEMENT OF
COMMISSIONER TERRANCE J. FITZPATRICK**

Before the Commission today are the 2006 annual price stability index/service price index reports and related tariff filings for Denver and Ephrata, Conestoga and Buffalo Valley telephone companies.¹ I am supporting the staff recommendation, but with some reservations.

The companies have proposed increasing rates for non-basic local services and for access services. However, in each case, an overwhelming majority of the rate increases are assigned towards access services. Staff notes that increasing access rates goes against the industry trend of reducing these charges and moving them closer to cost. Staff also notes that raising these rates contradicts this Commission's long-standing policy of access reform which is meant to reduce local phone companies' dependence on access revenue. I agree and support the staff recommendation of providing the companies with the alternatives of either allocating the increases to local exchange rates or banking the increases for future use. If the companies do not accept either alternative, the rates will be permitted to go into effect, subject to the outcome of an access reform proceeding currently before an administrative law judge (ALJ).

¹ Denver and Ephrata Telephone and Telegraphy Company, Supplement No. 251 and 10 to Tariff PA PUC Nos. 15 and Supplement No. 10 to Tariff PA PUC Nos. 16 (R-00061377), and 2006 Annual Price Stability Index/Service Price Index (P-00981430F1000); Conestoga Telephone and Telegraphy Company, Supplement No. 206 to Tariff PA PUC No. 10 and Supplement No. 7 to Tariff PA PUC No. 11 (R-00061376), and 2006 Annual Price Stability Index/Service Price Index (P-00981429F1000); Buffalo Valley Telephone Company Supplement No. 54 to Tariff PA PUC No. 7 and Supplement No 8 to PA PUC No. 8 (R-00061375), and 2006 Annual Price Stability Index/Service Price Index (P-00981428F1000).

I understand the companies' reluctance to assign the rate increases solely to local services or to bank the revenue increases for a future date. However, this Commission has steadily reduced access rates as a matter of policy over the last 10 years, since the passage of the federal Telecommunications Act of 1996. In order to support and promote a competitive market, the subsidies built into access rates must be eliminated so that rates are moved closer to their true cost.

I see no reason to change course now, but I recognize the constraints of Chapter 30 and of the companies' network modernization plans. We simply don't have many options today. Therefore I am supporting the staff recommendation, knowing full well that the companies might increase access rates, but also recognizing that if they do, this issue will be addressed in the ALJ proceeding.

I also note that while Chapter 30 allows companies to raise rates automatically, companies are not required to always raise rates. That is a decision companies must make based on current market conditions.

DATE: June 22, 2006


Terrance J. Fitzpatrick
Commissioner