STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
New York on December 16, 1998

COMMISSIONERS PRESENT:

Maureen O. Helmer, Chairman
Thomas J. Dunleavy
James D. Bennett

CASE 98-C-1249 - Proceeding to Consider Petition of Warwick Valley Telephone Company for Mediation of an Interconnection Agreement with Citizens Telecommunications Company of New York, Inc. and any Resulting Interconnection Agreement.

ORDER REQUIRING INTERCONNECTION AND
ADOPTING AN IMPLEMENTATION PLAN

(Issued and Effective December 23, 1998)

BY THE COMMISSION:

INTRODUCTION

On July 2, 1998, Warwick Valley Telephone Company (Warwick) sent Citizens Telecommunications Company of New York, Inc. (Citizens) its bona fide interconnection request to operate as a competitive local exchange carrier in Middletown, New York.[1] Warwick is a state-certified common carrier. As such, it can provide various telecommunication services throughout the State, including local exchange service.

As an incumbent local exchange carrier, Citizens serves about 300,000 access lines in rural and suburban areas throughout the State. With about 24,000 inhabitants, Middletown is the largest community it serves.[2] Middletown is also the closest city to Warwick's established service area. Warwick has purchased a building and plans to install a central office switch

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[1] Tr. 33 and 406; Exhibit 19.

[2] Tr. 32.

EXHIBIT
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in Middletown. It currently provides cellular and paging services in Middletown, and access to the internet.[1]

In July and August 1998, Warwick and Citizens made substantial progress negotiating an interconnection agreement. According to Citizens, it will absorb the cost of transporting its originating traffic to Warwick's Middletown switch.[2] Citizens is also committed to a timetable for resolving the provision of unbundled network elements to Warwick.[3] For its part, Warwick says it has kept its interconnection proposal simple and has avoided making any unusual requests. Like Citizens, Warwick will be responsible for the costs of delivering its originating traffic to Citizens' central office.[4]

Despite their ability to agree on these matters, the companies could not agree to a compensation arrangement for completing each other's local calls.[5] Warwick has sought usage-based reciprocal compensation;[6] Citizens prefers a bill-and-keep arrangement.[7] Consequently, on August 28, 1998, Warwick asked the Commission to help resolve this matter by participating in the parties' negotiations pursuant to the Telecommunications Act of 1996 (the Act).

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[1] Tr. 405.

[2] Tr. 34.

[3] Id.

[4] Tr. 406.

[5] Tr. 33 and 413.

[6] Such an arrangement requires each company to pay the per minute costs of completing its calls on the other company's network. Citizens objects to this approach as long as the majority of calls from its customers to Warwick flow to Warwick's internet service provider.

[7] Under this approach the companies do not make any payments to each other; instead, each absorbs the costs of terminating the other carrier's traffic. Such arrangements are common between contiguous carriers with extended area service (EAS) agreements.

In accordance with the Act, Department of Public Service Staff (Staff) was assigned to the case and a mediator appointed to assist the parties.[1] But the mediation efforts conducted in September 1998 did not produce any further agreements. In fact, to avoid a reciprocal compensation arrangement with Warwick, Citizens claimed "rural telephone company" status under the Act.[2]

Specifically, Citizens says it cannot afford to pay usage-based compensation for the one-way traffic flowing to Warwick's internet service provider (ISP) without incurring adverse effects. Citizens says such payments would increase its operating costs and force it to charge residential customers higher rates for basic local service. Moreover, Citizens claims a reciprocal compensation arrangement would impair its ability to provide universal service.[3]

Consequently, this proceeding continued in accordance with 47 U.S.C. §251(f)(1). Under this section, a rural telephone company is initially exempt from having to provide interconnections, unbundled access, wholesale services, and other items to competitive telecommunications carriers, until it receives a bona fide request for interconnection, services, or network elements, and the state commission determines that the request is not unduly economically burdensome, is technically feasible, and is consistent with universal service requirements. When the state commission is notified that a bona fide interconnection request has been presented to a rural telephone company, it has 120 days in which to conduct an inquiry and determine whether the rural exemption should be terminated. If it decides to do so, the state commission must also establish an

[1] See, 47 U.S.C. §252(a)(2).

[2] Citizens' September 18, 1998 letter citing 47 U.S.C. §§153(37)(A) and 251(f)(1).

[3] Tr. 35.

implementation schedule for the incumbent local telephone company to comply with the competitive carrier's request.

On November 18 and 19, 1998, an evidentiary hearing was held in the Commission's New York City offices to consider Citizens' "rural telephone company" status and the terms of an implementation plan. Five witnesses testified for Citizens;[1] Warwick's President and a consultant testified on its behalf. Staff presented a panel of three witnesses. The record consists of 587 pages of transcript and 24 exhibits. The parties filed initial and reply briefs on November 30 and December 7, 1998, respectively.

THE CONTESTED ISSUE: RECIPROCAL COMPENSATION

Citizens' Case

Citizens estimated that it would pay Warwick about $6,000 a week, or $310,000 annually, were it to agree to usage-based compensation. This figure is based on the current amount of traffic to Warwick's ISP and assumes a theoretical compensation rate of $0.0025 per minute of use.[2] Citizens also observed that Warwick's ISP will save $300,000 a year when it stops purchasing connecting circuits from Citizens.[3] Further, Citizens claims it would be unfair for Warwick to obtain revenues

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[1] Citizens Utilities Company's Vice President for Regulatory and Government Affairs testified as Citizens' policy witness. Three managers for interconnections, revenue and earnings, and economic cost analyses also testified, as did an independent consultant who helped design and evaluate the company's total service long-run incremental cost (TSLRIC) study.

[2] Exhibit 16. In contrast, Staff estimated first-year payments from Citizens to Warwick between $240,000 and $452,000, growing to between $547,000 and $1 million in the following year. Tr. 539. Staff's estimate assumes that the traffic to Warwick's ISP would grow by 1.6% per week and the compensation rate could be as low as Citizen's $0.001326 per minute switching cost. During the hearing, Citizens attempted to update and increase its estimate but, on Staff's motion, the untimely new estimate was stricken from the record. Tr. 183-186.

[3] Tr. 302-303.

for providing internet access both from Citizens and from ISP charges to end users.[1] Citizens seeks to avoid usage-based compensation for ISP traffic, believing instead that all carriers should keep the revenues they collect from their respective customers.[2]

Citizens estimated that it receives $22.55 in average monthly revenues from residential customers who subscribe to basic, flat-rate local service. This figure includes not only the local exchange revenues and the federal subscriber line charges (SLCs) that residential customers pay, but also the federal presubscribed interexchange carrier charges (PICCs) and the carrier common line (CCL) access charges that interexchange carriers pay. It includes, as well, the federal universal service funds (USF) that Citizens receives, but it excludes revenues obtained from second, or non-primary, residential lines.[3]

According to Citizens, these revenues do not cover its cost to provide basic residential service. The company says its TSLRIC for basic local service is $26.43, excluding common costs. Assuming $5.46 for common costs, Citizens estimates a TSLRIC of $31.89.[4] Thus, Citizens concludes that basic residential service is subsidized by other service categories and, it says,

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[1] Tr. 43.

[2] Tr. 44. Staff estimated, were Citizens to pay usage-based reciprocal compensation to the other 21 ISPs operating in its service territory, payments to each such company would be between $40,000 and $76,000 in the first year, and between $92,000 and $173,000 in the second. Tr. 538. Citizens considers Staff's estimates conservative and expects greater growth to occur.

[3] Tr. 384-385, 389-390; Exhibit 18. Citizens objects to including CCL, PICC, and USF revenues in its residential service figure but has done so to conform its calculation with recent Commission precedent. See Cases 94-C-0095 and 28425, Access Charges and Targeted Accessibility Fund, Opinion No. 98-10 (issued June 2, 1998).

[4] Tr. 368; Exhibit 17.

any amount of reciprocal compensation for Warwick's ISP would increase costs and threaten universal service.[1] Until a method is established to provide explicit funding for universal service, Citizens urges that the implicit funding provided in its prevailing rate structure not be disturbed.[2]

In sum, Citizens says it should keep its rural telephone company exemption and not pay reciprocal compensation for traffic flowing to Warwick's ISP. Citizens emphasizes that it will interconnect with Warwick, provide it network elements, and negotiate in good faith. But, Citizens insists, it needs its current revenues to meet its service responsibilities.[3]

The Other Parties' Presentations

Staff supports competitive entry in Middletown and notes that Citizens disavows any technical difficulty for it to interconnect with Warwick.[4] Since Warwick plans to install a switch and operate as a full-service provider to business and residence customers, Staff says the company should receive incremental, cost-based rates for all local traffic terminating on its system, including calls to ISPs. Only if Warwick were to avoid its commitments as a provider of local exchange services would Staff recommend that the company be denied reciprocal compensation.[5]

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1 Tr. 387-388.

2 Tr. 387-388.

3 Tr. 45. Citizens sponsored Exhibit 15, a preliminary evaluation of the company's earned return on common equity for a recent period, as proof that it is not overearning in New York.

4 Tr. 524.

5 Staff notes that none of the other 21 ISPs operating in the 12 counties that Citizens serves qualify for reciprocal compensation. Unlike Warwick, they do not provide local telephone services.

Staff recommended that the reciprocal compensation rate be set temporarily at $0.001326 per minute, subject to refund, pending a thorough examination of Citizens' and Warwick's costs.[1] Staff believes that Citizens should not delay the physical interconnection Warwick has requested, and Warwick should be able to begin to provide service as soon as its tariff for competitive services is implemented.[2]

Warwick disputes Citizens' rural telephone company status by pointing to Citizens' parent company and claiming it is too large for any of the subsidiary companies to be considered rural.[3] Warwick observes that the holding company obtains $1.4 billion in annual revenues, its subsidiaries are dispersed throughout 14 states, and it has foreign interests in Hungary.[4] It also notes that the holding company enjoys the same federal, price-cap regulation that applies to the Regional Bell Operating Companies.[5]

Addressing the Act's definition of a "rural telephone company", Warwick doubts that the holding company satisfies the

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[1] In the time provided for this proceeding, Staff performed a limited review of Citizens' TSLRIC study. Staff says it has concerns about the company's use of economic depreciation lives rather than the regulatory depreciation rates the Commission has approved. Staff is also concerned about the company's use of its current maintenance costs when they could be lower in the future. In this regard, Staff points to our decision in the Unbundled Network Elements Proceeding which suggests that the company's forward-looking costs should be developed with reference to a newly-installed network using the most efficient technology available. Tr. 542-546. Citizens submitted surreply testimony in this proceeding defending its economic depreciation rates, its use of current maintenance costs, and stating its opposition to the "scorched node" method of developing forward-looking costs. See, Tr. 263-271 and 300-303.

[2] Tr. 542.

[3] Citizens Telecommunication Company of New York, Inc. is a wholly-owned subsidiary of Citizens Utility Company.

[4] Tr. 408 and 447.

[5] Tr. 448.

criteria of 47 U.S.C. §153(37)(B)or(D) and that the study area in which Middletown is located qualifies pursuant to 47 U.S.C. §153(37)(A)or(C). Even if Citizens were deemed to be a rural telephone company, Warwick insists that the Act requires it to pay reciprocal compensation. Warwick says 47 U.S.C. §251(b)(5) imposes a duty on all local exchange carriers to pay reciprocal compensation, irrespective of their rural status.[1]

Warwick also denies that its interconnection request, and its demand for reciprocal compensation, place an undue economic burden on Citizens. It says Citizens should not be heard to complain about the sales and revenues it loses to competitors. Warwick observes that both it and Citizens have ISPs that compete in Middletown, and Citizens is not precluded from entering and competing in Warwick's service area. In these circumstances, Warwick believes reciprocal compensation should be deemed the norm.

As noted above, Staff estimated that Citizens' reciprocal compensation payments to Warwick could be as high as $452,000 in their first year, and could grow to $1 million thereafter.[2] Staff also observed that Citizens could be subject to additional payments were other ISPs in its service area to become associated with competitive local exchange carriers. Staff has estimated Citizens' financial exposure to be 0.2% of annual total company revenues, growing to 0.5% in the second year of Warwick's Middletown operations.[3]

Finally, Warwick and Staff doubt that Citizens' ability to provide universal service would be adversely affected by paying reciprocal compensation. Warwick estimated that Citizens would only lose $0.08 per access line per month, an amount far

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[1] Tr. 455-457. In opposition to Warwick's position, Citizens points specifically to 47 U.S.C. §252(d)(2)(B)(i) which says that bill-and-keep arrangements are permissible.

[2] <u>Supra</u>, p. 5.

[3] Tr. 539-540.

less than the company's uncollectible revenues.[1] It also noted that Citizens will continue to receive federal support for rural areas. Warwick will not become an "eligible telecommunications carrier" in Citizens' areas.[2] Warwick claims that its competitive telecommunications services in Middletown will enhance universal service by lowering prices to consumers, thereby causing subscribership to rise.[3] Staff pointed out that 2.3% of Citizens' subscribers in New York are Lifeline customers.[4] Staff also observed that residence subscription to telephone service stands at about 95% statewide and six of the twelve counties Citizens serves exceed this level.[5]

DISCUSSION AND CONCLUSION

In this interconnection case, we must determine whether Citizens has provided a sufficient basis to excuse it from complying with one of the requirements that the Act imposes on local exchange carriers. Relief is available for certain local exchange carriers if they can show that the Act's requirements produce a significant adverse economic impact on users of telecommunications services, or that it would be unduly economically burdensome or technically infeasible, and such action is consistent with the public interest, convenience, and

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[1] Tr. 462-465.

[2] Tr. 464.

[3] Tr. 412. In comparison to Citizens' $13.98 per month charge in Middletown for flat-rate residential service, Staff notes that Warwick's comparable rate is $6.04 per month. Tr. 533.

[4] Tr. 528. The Lifeline program reduces end-user charges for network access and local calling for a single telephone line in the principal residence of a qualified customer. Support is provided in the form of a waiver of the federal subscriber line charge (SLC) and a comparable amount of local charges. More Citizens customers may qualify for this program than those who have enrolled to date.

[5] Tr. 532.

necessity.[1] However, on the record here, we find that Citizens has not presented an adequate basis to suspend or modify any of the Act's requirements.

In general, we have determined that local calls to ISPs may be included in local exchange carriers' reciprocal compensation payments.[2] The Act entitles local exchange carriers to receive such compensation in order for them to recover the costs they incur to transport and terminate telecommunications.[3] In this instance, Citizens claims that the Act's reciprocal compensation requirement should be modified to a "bill-and-keep" arrangement in order to avoid an undue economic burden for the company and its ratepayers, and to provide it funds for universal service requirements.[4]

Contrary to these claims, Staff has shown that Warwick's interconnection in Middletown need not precipitate a substantial economic burden for Citizens. Significantly, Staff

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[1] Warwick attempted to show that Citizens, as a rural telephone company, cannot be exempted from the Act's reciprocal compensation requirements. However, the legal issues Warwick has raised neither preclude nor bar Citizens from seeking a modification of the Act's requirements. As a local exchange carrier with fewer than two percent of the nation's subscriber lines in the aggregate nationwide, Citizens may petition a state commission to suspend or modify the requirements of 47 U.S.C. § 251(b) or (c). While the company has petitioned us pursuant to 47 U.S.C. §251(f)(1)(B), rather than §251(f)(2), it is nonetheless clear that Citizens can seek relief from the Act's reciprocal compensation requirement as it has done here. For this reason, we have examined the merits of Citizens' position and ruled on it accordingly.

[2] Case 97-C-1275, Reciprocal Compensation and Internet Traffic Proceeding, Order Closing Proceeding (issued March 19, 1998), p. 6. Carriers need not enter into reciprocal compensation arrangements in the interconnection agreements they negotiate if both parties agree.

[3] 47 U.S.C. §§ 251(b)(5) and 252(d)(2)(A).

[4] Since the Act explicitly refers to bill-and-keep arrangements and does not preclude their use, Citizens urges that such arrangements be deemed a permissible form of reciprocal compensation for its interconnection with Warwick.

has shown that less than one percent of Citizen's revenues (about 0.2% in the first year and 0.5% in the second year) are at risk due to Warwick's provision of local service in Middletown to an ISP. This exposure does not present an exceptional economic burden for Citizens to warrant a modification of the Act's requirements. For its part, Warwick has shown that Citizens' potential payments to it are not out of line with other costs the company incurs.

With respect to universal service, we cannot credit Citizen's TSLRIC study due to the limited opportunity Staff has had to review it. In the short time available here, Staff identified several concerns about the methods Citizens used to estimate its costs which require additional consideration. Nevertheless, were Citizens able to demonstrate ultimately that its basic residential service is being subsidized by other service offerings, this fact alone would not require a modification of the compensation arrangement and interconnection plan we are adopting for it and Warwick. Universal service is a valid concern in the areas Citizens serves; however, these requirements can be met without impeding Warwick's competitive entry in Middletown. Such competition can have a salutary effect by providing Middletown customers opportunities for lower prices and a greater choice of services. In turn, this can increase telephone subscription in the City without reducing or adversely affecting subscription levels elsewhere.

Inasmuch as Citizens disavows any technical difficulty providing a physical interconnection for Warwick, and we have found no undue economic burden nor any adverse effects for universal service, we are adopting Staff's proposed temporary, reciprocal compensation rate of $0.001326 per minute of use pending a full examination of Citizens' and Warwick's costs. This rate will remain subject to adjustment, and permanent rates will not be established, until we review the companies' respective costs of transporting and terminating telecommunications. Our final determination on the proper rates to apply here will also depend upon the results of our inquiry into the costs of and compensation arrangements for terminating large volumes of local traffic to single customers, such as occurs with ISPs.[1]

We are also adopting, on a temporary basis, staff's proposed $15.54 per month link rate which will remain subject to adjustment pending our review of Citizen's costs. We expect Citizens to use its best efforts to provide Warwick the unbundled network elements it requires by March 31, 1999, and in no event any later than June 30, 1999. The remainder of the implementation plan for these companies, with few exceptions, is covered by the terms of the interconnection agreement that the parties have been able to negotiate.[2]

This order is being adopted as an emergency measure pursuant to §202(6) of the State Administrative Procedure Act (SAPA). Immediate action is necessary for the preservation of the general welfare and compliance with the advance notice and comment requirements of SAPA §202(1) would be contrary to the public interest. Swift action will promote competition in the state's telecommunication markets and will permit compliance with federal statutory deadlines.

The Commission orders:

1. Citizens Telecommunications Company of New York, Inc. (Citizens) and Warwick Valley Telephone Company (Warwick) are directed to execute, by no later than January 15, 1999, an interconnection agreement consistent with the results of their

[1] Citizens may continue to present its opposition to usage-based reciprocal compensation arrangements for ISPs in that proceeding.

[2] With respect to service order and directory listing matters that the companies are still considering, Warwick should complete its review of Citizen's "Local Interconnection Guide" and determine whether it can accept the Guide. Should any dispute remain on these matters after Warwick reviews the Guide, it should be reported to the Director of the Communications Division who is authorized to resolve it.

negotiations and which incorporates the requirements of the implementation plan contained in this order.

2. Citizens shall, without delay, provide Warwick a physical interconnection to its local network in Middletown.

3. Citizens shall use its best efforts to provide Warwick, by March 31, 1999, the unbundled network elements it needs to serve end users. Any technical difficulty in meeting this date shall be reported in writing to the Director of the Communications Division by no later than February 1, 1999 who is authorized to extend the date for good cause.

4. The reciprocal compensation rate applicable to traffic between Citizens' and Warwick's respective networks shall be set at $0.001326 per minute of use on a temporary basis, and subject to adjustment, pending a further review of Citizens' and Warwick's costs to transport and terminate calls.

5. The rate for Citizens-provided unbundled loops shall be set at $15.54 per month on a temporary basis, and subject to adjustment, pending review of the unbundled network element cost study required by ordering clause 6, below.

6. Citizens shall file, by no later than March 31, 1999, a study detailing and supporting the company's costs to provide unbundled network elements.

7. Warwick may file, by no later than March 31, 1999, a study detailing its costs to transport and terminate local calls.

8. This order is adopted on an emergency basis pursuant to §202(6) of the State Administrative Procedure Act.

9. This proceeding is continued.

By the Commission,

(SIGNED) DEBRA RENNER
Acting Secretary