STATE OF NEW HAMPSHIRE
PUBLIC UTILITIES COMMISSION

DT 06-171

UNION TELEPHONE COMPANY

Tariff Filing to Modify Intrastate Charges and Basic Monthly Service Charges

Order Approving Settlement Agreement

O R D E R N O. 24,753

May 25, 2007

APPEARANCES: Orr & Reno, P.A. by Susan S. Geiger, Esq. on behalf of Union Telephone Company; Office of Consumer Advocate by Rory Hollenberg, Esq. on behalf of residential ratepayers; and Lynn Fabrizio, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On December 15, 2006, Union Telephone Company filed certain proposed changes to its local exchange and access tariffs, NHPUC No. 7 and NHPUC No. 10, respectively. The changes, filed pursuant to RSA 378:6, IV, would reduce the terminating rate for intrastate access and increase rates for basic residential service. Union asserted in its filing that the proposed plan is revenue-neutral. Additionally, Union relied on RSA 378:17-a, III, which permits the Commission to consider reducing intrastate access charges and increasing basic monthly service charges for local exchange carriers whose intrastate access charges exceed the state median for such charges and whose basic monthly service charge falls below the state median.

In a memorandum dated January 5, 2007, Staff advised the Commission that Union's request was reasonable and for the public good, recommending approval after allowing the public an opportunity to review the proposal and request a hearing. The Commission issued an order of notice on January 11, 2007, extending the review period by 30 days pursuant to RSA

378:6, IV, and scheduling a hearing for February 5, 2007. The Office of Consumer Advocate (OCA) entered an appearance on behalf of residential utility consumers pursuant to RSA 363:28, II on January 16, 2007. Union filed the testimony of its controller, Darren Winslow, on February 1, 2007. A hearing took place as scheduled on February 5, 2007.

At its public meeting on February 9, 2007, the Commission voted to reject the filing, in light of the impending statutory deadline, absent an express waiver by Union of the deadline imposed under RSA 378:6, IV. The Commission stated that if a waiver were filed, Union, the OCA and Staff should undertake additional review of the filing, seek agreement on the process, and file a recommendation for resolution. The Commission further noted that a full rate case and cost of service study were not necessary, as it believed there were other industry benchmarks and standards that could be used to round out the record.

On February 12, 2007, Union filed a letter "constitut[ing] an express waiver of the deadline imposed under RSA 378:6, IV." By secretarial letter dated February 13, 2007, the Commission accepted Union's waiver and scheduled a technical session for February 20, 2007.

Union, the OCA and Staff met for the technical session as scheduled and proposed a procedural schedule, which the Commission approved by secretarial letter on February 27, 2007. The OCA subsequently propounded data requests upon Union and Staff, and worked with Staff to assess statewide benchmarks for certain expenses. Technical sessions were held on March 12 and April 10, 2007. On May 4, 2007, Staff filed a settlement agreement signed by Union, the OCA, and Staff, and requested the Commission's approval of the agreement. On May 15, 2007, the Commission issued a secretarial letter scheduling a hearing on the merits of the agreement. The hearing was held as scheduled.

II. PRELIMINARY POSITIONS OF THE PARTIES AND STAFF

A. Union Telephone Company

Union Telephone Company's controller, Darren Winslow, testified at the February 5, 2007 hearing that Union has operated as an ILEC (incumbent local exchange carrier) for over 100 years and provides local calling, intrastate toll, and custom calling features as well as wholesale-related services. The company also provides interstate toll, DSL broadband and other services in conjunction with its affiliates. Union operates in five exchanges, including Alton, New Durham, Barnstead, Center Barnstead, and Gilmanton Iron Works, and has approximately 6,800 residential lines and approximately 850 business access lines. (Tr. at 11-12)

Union testified that the proposed tariff changes are revenue-neutral and would decrease terminating access rates from 4.75 cents per minute to 3.18 cents per minute. The company sought to offset the revenue loss by increasing basic monthly service charges to residential customers. *Id*. at 15. The company witness testified that median end-to-end intrastate access charges for the state, primarily set by Verizon, are 5.8 cents per minute, whereas Union's are 7.9 cents per minute. *Id*. at 17. Union compared four of its exchanges with Verizon's rate group D. Union's monthly service charge for the four exchanges is $9.59 - $10.67, and Verizon's is $14.41 for the same rate group. Union charges a monthly service charge of $9.79 to its Barnstead customers, which is equivalent to Verizon's rate group C. Verizon charges $13.25 for its rate group C customers. *Id*. at 18. Mr. Winslow stated that 49 percent of the company's revenues is derived from local service, while approximately 24 percent is derived from intrastate toll calling and 25 percent from access. Revenues from toll and access, however, are decreasing at a higher rate than basic service revenues, and, according to Mr. Winslow, the company cannot sustain a reasonable revenue requirement based on the current rate design. *Id*. at 31-32.

The company maintained that the proposed rate adjustments are calculated to be revenue-neutral based on 2005 revenues. *Id*. at 22. Union believes that its request is reasonable and that the transition to rates closer to state medians is in the best interest of the company and its customers. *Id*. at 20. Union further asserted that the basic service rates it proposes are just and reasonable and suggested that Verizon has maintained those same rate levels for some time. Mr. Winslow also testified that average local exchange rates throughout the country are approximately $25, whereas Union's rates are approximately $18, which includes a $6.50 Subscriber Line Charge and applicable state and federal taxes. *Id*. at 19-20.

B. Office of Consumer Advocate

Assistant Consumer Advocate Kenneth Traum, testifying on behalf of the OCA, noted that his testimony regarding Union's filing was based on his review of the record, as well as Union's annual reports for 2004 and 2005, Staff's final audit report dated October 10, 2005, Order No. 23,791 in Docket No. DT 01-149 concerning an investigation into Union's overearnings, spreadsheets prepared by Staff and marked as Exhibit 3, a document prepared by Staff entitled "Union Telephone Company Cost of Capital – 2005 Final," "Form I Input Master 2005" relating to separations, and Union's responses to data requests in this proceeding. *Id*. at 60-61.

The OCA stated that Union's filing is a request for a general rate increase for residential customers and, accordingly, should meet the requirements of and be treated as a rate case. The OCA noted that Union's capital structure is comprised of 100 percent common equity, but a more customer-friendly structure of 50 percent debt and 50 percent equity could very well lower the revenue requirement for New Hampshire customers. (Tr. pp. 61-63)

The OCA contended that in 2005 Union paid its affiliate UNEX for engineering, construction, maintenance, and internet services and it raised the question of whether those services had been competitively bid, whether payments reflected reasonable costs for labor, and whether the services had been provided at the lower of cost or market. The OCA also questioned pole expenses, which it claimed were up 135 percent. Another subject the OCA raised was accounting and finance costs, which increased between 2004 and 2005 by approximately 25 percent. The OCA stated that marketing expenses similarly increased 65 percent and switched access revenues increased over 11 percent. Id. at 63-64.

The OCA pointed out that Union stock is closely held by the Thayer family, members of which comprise the entire board of directors, questioning whether the $290,000 paid as compensation to two family members in 2005 was reasonable. The OCA expressed its concern that the Company's telecommunications plant-in-service had decreased 9 percent between 2004 and 2005, and another 6 percent between 2005 and 2006, totaling 15 percent in just two years. An investigation into these issues and potentially other issues with full discovery, the OCA maintained, could result in a finding that Union is overearning. *Id*. at 65.

Finally, the OCA questioned whether Union's access rates should be reduced, suggesting that any benefits would be outweighed by the substantial increase in rates for basic service paid by residential customers. *Id*. at 67-68.

Mr. Traum concluded that a general rate case investigation is necessary because it was the OCA's position that a decrease in access charges and an increase in basic service rates, resulting in revenue-neutral rates, is inappropriate because of the overearnings issue it would likely present.

C. Staff

Although Staff presented no witnesses at the February 5, 2007 hearing, it noted in its closing statement that it had reviewed Union's proposal for rebalancing access and local rates and analyzed in detail the supporting documentation filed by the company. Based on its review and analysis, Staff confirmed that the company's plan was revenue-neutral. Staff also reviewed Union's annual financial statements to conclude that the rate of return achieved by Union in 2005 was reasonable. Finally, Staff verified that Union's basic local exchange rates fall below the relevant median, and its access rates are above the median, for the state of New Hampshire. *Id*. at 105-106.

III. TERMS OF SETTLEMENT AGREEMENT

The parties and Staff recommended that the Commission approve the terms of the May 4, 2007 agreement, as summarized below. According to the signatories, the agreement achieves a revenue neutral rebalancing of Union's intrastate access and local exchange rates consistent with the requirements of RSA 378:17-a. The parties and Staff further agree that the issues raised at the February 5, 2007 hearing were reviewed through discovery and a series of technical sessions, and that the resulting agreement would yield just and reasonable rates.

a. Rate Design

Union agreed to decrease its terminating intrastate access rates from 4.75 cents per minute to 3.54 cents per minute. Union would increase its local exchange rates for both residential and business customers. The resulting revenue decrease due to the change in access rates and corresponding increase in revenue due to changes in local exchange rates would be equivalent, for a revenue neutral effect, according to the parties and Staff.

For residential rates, Union would distribute the increase such that one rate is charged in all five exchanges -- Center Barnstead, Barnstead, Gilmanton Iron Works, New Durham and Alton. For business rates, Union would apply an increase in an amount equal to the weighted average of the increase to residential rates.

b. Effective Dates

The settlement provides for the rate increases to take effect in two steps. The first increase would take effect on June 1, 2007, the second on December 1, 2007. Both increases would be implemented on a service rendered basis.

c. Customer Outreach

Union agreed to conduct aggressive outreach to low income customers to promote the Lifeline and Link-Up programs. Outreach efforts would include information in disconnect notices about the Lifeline and Link-Up programs, biannual messages in a newsletter explaining the programs,and a brochure with a federal poverty guidelines table and an explanation of acceptable documentation for determining if income meets guideline requirements or, alternatively, a toll free number from which a consumer could obtain such an explanation. Union agreed to include a contact number on its website for requesting application forms or further information.

Union would also participate in outreach to social service agencies, including mailing brochures to agencies in Union’s service territory at least twice in twelve months. Finally, Union agreed to update and maintain information about the company and its services on the Universal Service Administration Company’s web site.

IV. POSITIONS OF THE PARTIES AT THE MAY 15, 2007 HEARING

Union, the OCA and Staff all confirmed at hearing that the agreement as filed is revenue neutral and results in just and reasonable rates. All signatories confirmed, as well, that the increase in local exchange service rates would be borne by business as well as residential customers, should the terms of the settlement be adopted.

A. Union Telephone

Union pointed out that the proposed agreement would result in uniform rates applicable to all five exchanges in Union's service territory. The increase would take place in two steps, the first occurring on June 1, 2007, and the second on December 1, 2007. Union added that the terminating access rate would not decrease as much as in the company's initial December 15, 2006 filing, and that the local exchange rates would not increase as much. Finally, Union noted that the settlement agreement includes an aggressive outreach program to low income customers to promote Lifeline and Link-Up programs. Union concluded that the proposed agreement is consistent with the original filing under RSA 378:17-a, III, and that it would put Union and all its customers in a better long-term position to adapt to the future competitive and regulatory environments.

B. Office of Consumer Advocate

The OCA characterized the settlement agreement as a true compromise among the parties and Staff that is responsive to the Commission's deliberations following the February 5, 2007 hearing. While commenting that the data requests OCA propounded to both Staff and Union were more limited and expedited than what it would have done in a full rate case, the OCA stated that Staff and the OCA together had benchmarked Union's overhead and management costs against other independent telephone companies in New Hampshire. The OCA further noted that the basic service rate increase would be spread among all customers, not just residential customers, and that the proposed rate increase would occur on a slightly delayed schedule compared to Union's original proposal. Finally, the OCA suggested that the settlement terms, if adopted, would likely delay the need for a more costly and time consuming full rate case.

C. Commission Staff

Staff noted that the April 26, 2007 agreement differs from Union's initial December 15, 2006 tariff filing in the magnitude of the changes proposed, pointing out that the terminating access rates would not go down quite as much as originally proposed, and, correspondingly, the increase in basic local exchange rates would not go up as much. Staff confirmed that it had verified the revenue neutrality of the agreement, and that the rate rebalancing proposal is consistent with RSA 378:17-a, III(b), as both intrastate terminating access rates and basic service rates will be closer to the relevant state medians.

V. COMMISSION ANALYSIS

Pursuant to Puc 203.20, the Commission approves settlement agreements when it determines them to be just and reasonable and in the public interest. In the case of an agreement that affects the basic local exchange rates charged by an independent telephone company, we review the agreement's consistency with sound regulatory policies and ensure that the result is within the range of reasonable results that would be expected had the case been resolved through litigation. Our review will assess the agreement's success in achieving a balance between several interests, including the protection of consumers, fairness to investors, and the long-term economic viability of the utility. We recognize, as well, that settlement agreements by their very nature reflect agreement among normally adversarial parties, an element that warrants a certain weight in our final review.

The proposal before us involves a decrease in access rates and a corresponding increase in basic local exchange rates charged by Union Telephone. Residential and business rates would be increased to uniform rates of $13.15 and $33.27, respectively. It is our mandate to ensure just and reasonable rates for the consumer, while taking into account fairness to the investors in the utility concerned. All signatories to the agreement have verified that the proposed adjustment in rates is revenue neutral. Although we determined upon our initial review, as noted in our deliberations of February 9, 2007, that neither a full rate case nor a cost of service study were necessary to justify approval of the proposed rate design, we recognized that a more limited review of the potential impact on both company revenue and customers would be reasonable. Staff, the OCA and Union undertook such a review, including a benchmarking of overhead and management costs, and reached an agreement that, in their collective view, achieves a revenue-neutral result leading to just and reasonable rates. The company also has agreed to an aggressive outreach plan concerning the LifeLine and Link-Up programs, to ensure that low income customers are not disadvantaged as a result of the rate increase.

As Union testified, the impetus behind the proposed rate changes is a decline in minutes of use and corresponding revenue for Union. Given the continuing downward trend in minutes of use and access revenue demonstrated on the record, we agree that an adjustment is reasonable to ensure Union’s long-term economic viability. By decreasing the access rates and increasing basic service rates, the company is more likely to earn a reasonable rate of return in light of declining minutes of use. The signatories have indicated, as well, that, although the OCA would prefer a full rate case, the data reviewed do not indicate that unreasonable rates of return or over-earnings will result from the proposed agreement. A revenue neutral adjustment of access rates and basic service rates to bring them closer to the relevant state medians is both consistent with

RSA 378:17-a, III and in the public interest. We are persuaded that the proposed agreement will achieve a result that falls within the reasonable expectations of a fully litigated case.

We therefore find the agreement to be reasonable and in the public interest, and we approve the agreement as submitted.

Based upon the foregoing, it is hereby

ORDERED, that the settlement agreement is APPROVED, as filed; and

FURTHER ORDERED, that Union shall implement the change in rates on a service rendered basis and shall file, no later than June 15, 2007, tariff pages with an effective date of June 1, 2007; and it is

FURTHER ORDERED, that, as Union distributes materials regarding the LifeLine program to its customers, it shall file copies of those materials with the Commission's Director of Consumer Affairs.

By order of the Public Utilities Commission of New Hampshire this twenty-fifth day of May, 2007.

Thomas B. Getz Chairman	Graham J. Morrison Commissioner	Clifton C. Below Commissioner

Attested by:

Debra A. Howland
Executive Director