STATE OF NEW YORK

PUBLIC SERVICE COMMISSION

Petition of Rochester Telephone Corporation for Approval of Proposed Restructuring Plan – Status of Frontier Telephone of Rochester, Inc.'s Open Market Plan	Case 93-C-0103
Petition of Rochester Telephone Corporation for Approval of a Multi-Year Rate Stability Agreement	Case 93-C-0033

COMMENTS OF THE
NEW YORK STATE CONSUMER PROTECTION BOARD

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Albany, New York

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On April 5, 2005, Frontier Telephone of Rochester, Inc. ("Frontier") filed a petition with the Public Service Commission ("PSC" or "Commission")[1] seeking termination of the remaining provisions of the Open Market Plan ("OMP" or "the Plan"), the regulatory plan applicable to the Company since 1995. The OMP and the vast majority of its provisions expired on December 31, 2004. However, certain provisions of that plan related to the creation and operation of a holding company structure are permanent unless modified by the Commission. Frontier requests that the Commission immediately terminate "all remaining restrictions under the OMP."[2] Subsequently, the Commission issued a notice inviting parties to comment on the Petition.[3] The Consumer Protection Board ("CPB") submits these comments in response to that Notice. We conclude that the Petition is premature and would provide no apparent

1 Cases 93-C-0103, 93-C-0033, Petition of Frontier Telephone of Rochester, Inc. For Termination of Remaining Open Market Plan Provisions, April 5, 2005 ("Petition").

2 Petition, p. 10.

3 Cases 93-C-0103, 93-C-0033, Notice Soliciting Comments, May 24, 2005.

benefit to consumers. Therefore, at this time, CPB recommends the Commission not approve Frontier's proposal.

The OMP was a comprehensive regulatory plan that addressed corporate restructuring, price regulation, and measures to foster competition in Frontier's local telephone markets. Since the Plan's inception, the telecommunications market has evolved considerably, with increased competition from competitive local exchange carriers as well as wireless, cable, and broadband providers. Frontier claims that the OMP significantly impaired its ability to meet increased competition from these and other telephone service providers. The Company contends that even after the OMP formally expired on December 31, 2004, the few permanent provisions of the OMP continued to harm the Company.[4]

A key element of the OMP was that it permitted Frontier to establish a new, unregulated holding company. The PSC had repeatedly concluded that stand-alone operation of a utility is superior to a holding company structure.[5] The Commission found that disadvantages of the holding company structure include potentially increased utility costs, potential diversion of utility capital resources to non-utility operations thereby degrading service quality, and diversion of managerial attention from utility operations.[6] To address these risks to consumers, the OMP contained safeguards to help protect the regulated utility's financial stability, preclude opportunities for financial manipulation, and provide incentives for the proper management of the utility. The

[4] Petition, pp. 1 – 2.

[5] E.g., Case 27015, Rochester Telephone Corporation – Corporate Restructuring, Opinion No. 78-5, May 27, 1978; Cases 93-C-0103, 93-C-0033, Opinion No. 94-25, Opinion and Order Approving Joint Petition and Agreement, November 10, 1994 ("Opinion No. 94-25"), p. 12.

[6] Opinion No. 94-25, p. 12.

measures include capital structure requirements, restrictions on dividend payments to the parent corporation if the utility's debt rating or service quality fell below specified levels, limitations on membership of the utility's Board of Directors, and restrictions on the transfer of utility services to affiliates. In approving the OMP, the Commission stated:

> Because these protections (including the service quality-related dividend restriction) are vital to our approval of the restructuring, we will condition our approval upon [the Company's] agreement that the protective provisions in the Joint Stipulation aimed at eliminating or minimizing potential improprieties under a holding company structure will remain permanent unless modified by us.[7]

The Company claims that subsequent mergers, acquisitions and corporate structure changes render these provisions "obsolete, discriminatory and unnecessarily burdensome."[8] In support of that contention, the Company cites a series of corporate transactions subsequent to approval of the OMP including the purchase of Frontier Corporation, the Frontier holding company in question, by Global Crossing Ltd., and the purchase of the Frontier telephone companies by Citizens Communications Company ("Citizens"). Frontier claims that these transactions render the holding company restrictions obsolete.

Frontier argues further that Citizens, already an approved holding company itself, was not held to any holding-company restrictions or OMP-like regulatory plan when it purchased other telephone companies. The Company contends that, as a result, the regulatory framework applicable to these acquisitions by Citizens, contrasts with the regulatory treatment applicable to Frontier's New York telephone companies, which were also purchased by Citizens.

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7 Id., p. 20.

8 Petition, p. 3.

Frontier also asserts that other holding companies in New York such as Alltel, TDS and Verizon are not subject to holding company restrictions such as those that survive the expiration of the OMP. Similarly, it argues that these measures do not apply to Frontier's other competitors, such as AT&T, MCI or cable television companies, each of which currently offers telephone services in Frontier's markets. As a result, the Company contends that the holding company provisions are discriminatory.

Frontier also argues that the holding company restrictions are burdensome, particularly the service quality-related provisions. Frontier asserts that the service quality standards the Commission put in place ten years ago do not accurately reflect the current marketplace and require Frontier to "expend scarce resources tracking and achieving obsolete service 'points' that are not relevant" in the marketplace today.[9]

In Point I, we explain that Frontier's request is premature. The PSC recently initiated a proceeding to examine whether current PSC rules, regulations and practices are obsolete and/or discriminatory,[10] as asserted in Frontier's Petition. Consideration of the Company's request should await the conclusion of that proceeding. We demonstrate in Point II that the Petition would modify the results of a negotiated and balanced agreement in a one-sided manner that does not provide any apparent consumer benefits. In Point III, we explain that provisions establishing an incentive for Frontier to provide high quality telephone service should not be eliminated at this time.

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9 Id., p. 9.

10 Case 05-C-0616, Proceeding on Motion of the Commission to Examine Issues Related to the Transition to Intermodal Competition in the Provision of Telecommunications Services, Order Initiating Proceeding and Inviting Comments, June 29, 2005 ("Intermodal Competition Order"), p. 4.

I. FRONTIER'S PETITION IS PREMATURE.

Frontier's request to terminate all remaining provisions of the OMP comes at a time when the Commission is reevaluating its regulation of telephone service in New York. The Commission has recognized that technological advances and increased competition may obviate the need for some regulations, and has initiated a proceeding to identify appropriate amendments to its rules and regulations.[11]

Frontier's Petition should not be addressed until the PSC has issued its determination in Case 05-C-0616. The Company has not demonstrated that there is any compelling public interest requirement to resolve its Petition before December 2005, when the issues in Case 05-C-0616 are expected to be resolved.[12]

II. FRONTIER'S REQUEST APPEARS TO PROVIDE NO COMMENSURATE BENEFIT TO CONSUMERS.

The OMP, including the permanent holding company restrictions, represents the product of contentious negotiations among many parties lasting more than one year.[13] It reflects the give and take of those parties on numerous issues. The Company benefited from, among other things, being permitted to establish a holding company. Ratepayers benefited from, among other things, the certainty that consumer safeguards relating to the holding company would be permanent.

Having received the benefits of the OMP, Frontier now proposes to terminate permanent consumer safeguards which it voluntarily agreed to provide in consideration of benefits it received. Any benefits to consumers from the Company's Petition are not

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[11] Id.

[12] Intermodal Competition Order, p. 20.

[13] Opinion No. 94-25, p. 2.

apparent. The proposed one-sided change to the negotiated and PSC-approved permanent consumer safeguards is not in the public interest, and should be rejected by the Commission.

III. FRONTIER'S PROPOSAL REGARDING SERVICE QUALITY IS WITHOUT MERIT.

Frontier's dividend to its corporate parent is currently restricted if its service quality falls below a certain level, as a result of the OMP which the Company negotiated and the PSC approved. Frontier argues that this requirement should be terminated, since it is burdensome and the Commission's service standards are outdated.[14] The CPB opposes that recommendation.

The Company's contention that this provision is burdensome, is without merit. The public interest requires that Frontier provide quality telephone services, and the dividend restriction is a key measure to ensure that Frontier has appropriate incentives to achieve that public policy goal, regardless of any inconvenience to Frontier or its non-regulated corporate parent. Regarding the Company's claim that the service standards are outdated, as explained in Point I, the PSC is currently conducting a proceeding to determine, among other things, how its "service quality regulation [should be adapted] to the marketplace realities."[15] The Company's concerns that the service standards may be outdated will therefore be addressed directly in that proceeding, and need not be addressed here. Moreover, if the Company's recommendation were adopted, a key incentive for Frontier to provide high quality service would be eliminated, despite the

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[14] Petition, pp. 8 – 9.

[15] Intermodal Competition Order, Appendix A, p. 2, "Service Quality" question 1.

fact that the Commission may conclude in Case 05-C-0616 that it is essential that Frontier provide high quality service.

In addition, assuming <u>arguendo</u> that the Company's assertion regarding the appropriateness of the service standards in today's environment is correct, the remedy is to update those service standards, not eliminate the primary incentive for the Company to provide quality service as Frontier recommends.

Service quality continues to be an important issue for consumers even with increased intermodal competition, and in our view, should continue to be an important focus of the PSC in the future. Regulations concerning the quality of landline telephone service will continue to be required in recognition of the importance of reliable telephone service for public health and safety, as well as the state's economic development. The CPB disagrees with any assertion by Frontier that service quality is less important to the public interest now, than when the OMP was approved. Accordingly, in the event that the Commission declines to adopt CPB recommendations identified in Point I and II herein, the PSC should reject Frontier's request to eliminate the service quality-related dividend restriction, which is arguably the most important incentive for the Company to provide high quality telephone service.

CONCLUSION

For the reasons stated herein, the Consumer Protection Board recommends that the Public Service Commission deny the Petition of Frontier Telephone of Rochester, Inc. For Termination of Remaining Open Market Plan Provisions, at this time.

Respectfully submitted,

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