Agenda Date: 08/15/12
Agenda Item: IVD

STATE OF NEW JERSEY

Board of Public Utilities
44 South Clinton Avenue, 9th Floor
Post Office Box 350
Trenton, New Jersey 08625-0350
www.nj.gov/bpu/

TELECOMMUNICATIONS

IN THE MATTER OF THE PETITION OF WARWICK VALLEY TELEPHONE COMPANY FOR APPROVAL OF A PROPOSED RESTRUCTURING PLAN))))	ORDER DOCKET NO. TO12010069

Parties of Record:

William K. Mosca, Jr., Esq., Bevan, Mosca, Giuditta & Zarillo, P.C., on behalf of Petitioners
Stefanie A. Brand, Esq., Director, New Jersey Division of Rate Counsel

BY THE BOARD:

This matter was brought before the Board of Public Utilities ("Board") pursuant to N.J.S.A. 48:2-51.1 and N.J.A.C. 14:1-5.14 through a Verified Petition ("Petition") filed by Warwick Valley Telephone Company ("WVTC" or "Petitioner") on January 17, 2012. WVTC is an incumbent local exchange carrier ("ILEC") serving approximately 5,000 access lines in Sussex and Passaic counties. WVTC also provides service to approximately 10,000 customers in Southeast Upstate New York. Since June 2010, WVTC has operated under a Board-approved Plan for an Alternative Form of Regulation ("PAR").[1] In addition to serving as an ILEC, WVTC also serves a small number of customers as a non-facilities based competitive local exchange carrier ("CLEC"), and it owns and operates several other subsidiaries, none of which provides traditional wireline local exchange or access services.

The Petitioner requests the Board approve a restructuring plan ("Plan")[2] that will enable WVTC to separate its local exchange operations from its non-regulated business units and transform WVTC into a holding company that will re-name itself WVT Communications Group, Inc. ("WVTCG"). WVTCG will become the holding company parent of (i) a new, regulated subsidiary (referred to for these purposes as "Newco") that will offer the ILEC and CLEC local

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[1] I/M/O Warwick Valley Telephone Company d/b/a WVT Communications for Approval of a Plan for an Alternative Form of Regulation, Docket No. TO09010084, Telecommunications Order, issued June 7, 2010 ("WVTC PAR Order").
[2] Petitioner has sought the New York Public Service Commission's approval of the Plan on a parallel track.

telephone services WVTC currently offers and (ii) WVTC's other non-ILEC subsidiaries, including Warwick Valley Long Distance, Hometown Online, Inc., Warwick Valley Mobile Telephone Company, Inc. (which will be renamed "USA Datanet") and Warwick Valley Networks, Inc. (which, pursuant to a 2011 acquisition, will be renamed Alteva).

Under the Plan, WVTCG will transfer to Newco the operating assets currently used to provide WVTC's ILEC services, including but not limited to retail local exchange service, intraLATA toll service, local directory service and wholesale access service.[3] The operating assets of WVTC's other subsidiaries will remain with those companies.

Petitioner states that after a careful review of the rapidly changing telecommunications industry, it believes that its shareholders, ratepayers, employees and the public interest will be best served by the proposed restructure, which it contends meets all of the requirements of N.J.S.A. 48:2-51.1. In particular, Petitioner states that the Plan will enable WVTCG and its non-regulated operating companies to compete more effectively and on an equal footing in the fast-moving world in which new non-regulated and converging telecommunications technologies have permanently changed the landscape for traditional telecommunications providers. Petitioner also states that the Plan will protect retail and wholesale customers of WVTC's currently regulated services, because those customers will continue to have access to high quality, reliable and generally available service at just and reasonable rates. Petitioner further notes that the Plan provides WVTC employees the greatest job opportunities, because the Plan is not expected to have any effect on WVTC's total employee headcount, even though it has lost a substantial proportion of its local service customers in recent years.

A few weeks before Petitioner filed the instant Petition with the Board, it filed a similar petition with the New York Public Service Commission ("PSC") seeking identical relief ("New York Restructure Petition").[4] On November 30, 2011, Petitioner filed a companion petition with the PSC requesting modification of a 1988 PSC Order ("the "1988 Order") that granted Petitioner the right to use funds generated from regulated revenues to invest in a partnership that provides cellular service ("New York Modification Petition").[5] The New York Modification Petition sought a change to the 1988 Order that would permit Petitioner to treat the funds generated by the partnership as non-regulated. Petitioner also filed a Supplement to both New York petitions on June 6, 2012 ("New York Supplement"). In the New York Supplement, Petitioner agreed that it would use sufficient revenues received from the partnership to guarantee that the new regulated subsidiary ("Newco") (i) will be established with an initial cash balance of $700,000 as defined in and recorded pursuant to account 1130 of the Uniform System of Accounts and (ii) will operate on a cash flow neutral basis through 2016.

In an Order issued and effective July 13, 2012 ("New York Order"),[6] the New York PSC granted both New York petitions, finding (i) that "[t]he modified corporate restructure serves the public

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[3] Because WVTC is a non-facilities based CLEC, no assets will be transferred to Newco in connection with WVTC's CLEC services, which are not subject to Board regulation and only serve about 200 New Jersey customers.

[4] Petition of Warwick Valley Telephone Company for Approval of a Proposed Restructuring Plan, Case 12-C-2003, filed December 16, 2011.

[5] Petition of Warwick Valley Telephone Company for Authority Pursuant to Section 107 of the Public Service Law to Use Revenues Received from the Rendition of Public Service as a Capital Contribution to Orange-Poughkeepsie Limited Partnership and to Provide Resale of Cellular Service, Case 12-C-0004, filed November 30, 2011.

[6] The New York Order is appended as Attachment A.

interest" and (ii) that Petitioner's "four year guarantee of financial viability for [Newco] is a reasonable compromise between the two objectives of growing the corporation through diversification into new enterprises and maintaining the financial viability of a declining business." (New York Order, pp. 14 & 15-16) Thus, the PSC approved the proposed restructuring and amended the terms of its 1988 Order to provide that Petitioner's "share of any revenues received or income earned or tax credits generated from its investment in the Partnership shall be used to maintain [Newco's] regulated cash balance at $700,000 through December 31, 2016, and otherwise be considered non-regulated revenues." (Id. at p. 17)

Upon review of the Petition and other information provided by Petitioner to Board Staff, we find that the Petition is consistent with the applicable statutory and regulatory requirements and will serve the public interest. The analysis supporting our conclusions is set forth below.

DISCUSSION

I. The Proposed Plan

Petitioner provided the following information and description in support of the Plan. WVTC is a New York transportation company duly authorized and existing under the laws of the State of New York, and its executive offices are located at 47 Main Street, Warwick, New York 10990. It has been authorized to provide service as an ILEC in the Vernon and West Milford areas of New Jersey for many decades and, as noted above, it now operates under a PAR. As required by N.J.A.C. 14:1.5.14(b), WVTC provided with its Petition (i) a recent balance sheet for itself; (ii) pro forma balance sheets for WVTCG and Newco; (iii) a recent income statement for WVTC; and (iv) pro forma income statements for WVTCG and Newco.

The Petition describes the proposed operation and implementation of the Plan as follows:

WVTCG - the Holding Company – Under the Plan, WVTC's corporate management functions and related administrative functions (e.g., legal, tax, corporate financing, accounting) will remain with WVTCG, which will continue as a publicly traded company and serve as the holding company for Newco and all of WVTC's other subsidiaries.[7] As a result, the Plan will not affect the equity ownership interests in WVTC. Moreover, WVTC reports that no franchise cost will be capitalized on either the holding company's or Newco's books. Because, as described below, Newco will assume all the obligations and privileges related to WVTC's regulated functions, Petitioner urges the Board to permit WVTCG to become an unregulated business that has the same freedom and flexibility to deploy capital and respond to strategic industry developments as other competitors that own regulated telephone businesses through parent holding companies. Petitioner notes that this is the same corporate structure that currently applies to CenturyLink and Verizon Corporation, which operate the largest New Jersey ILECs.

Newco – the new ILEC – To replace WVTC as the regulated local service supplier, Petitioner proposes to create Newco, which will be a limited liability company organized (as is Petitioner) under the laws of New York and in which WVTCG will own the entire membership interest. WVTCG will transfer to Newco all of the fixed assets WVTC currently uses to provide its ILEC services, including its central office and outside plant network, land, rights-of-way, buildings,

[7] Petitioner's other subsidiaries and investments will be retained by WVTCG and will be unaffected by the restructuring. In this regard, WVTCG will retain WVTC's ownership of 8.108% of the Orange Poughkeepsie Cellular Partnership, which operates as in Orange and Dutchess Counties in New York.

engineering and operations, customer and facility records, and billing and order processing. In addition, WVTCG will transfer to Newco sufficient personnel to operate the transferred assets and provide the current ILEC services.[8] Once established, Newco will obtain a certificate of public convenience and necessity ("CPCN") from the Board and operate as a local exchange company subject to the Board's jurisdiction.

Petitioner proposes to have Newco use the transferred assets and personnel to provide all the services WVTC currently provides at WVTC's current rates and subject to WVTC's PAR. In addition, Newco will agree to be subject to the same carrier of last resort ("COLR") obligations as WVTC and also subject to the same eligible telecommunications carrier ("ETC") obligations and rights that currently apply to WVTC. As a result, Newco will be obliged to offer services and facilities that provide access to every person and every location within the current certificated service territory on reasonable terms and without undue preference or discrimination, and it will be subject to the Board's authority if any questions were to arise over its performance of these obligations. The Board will also have full access to Newco's records.

To assure Newco's independence and structural separation from its WVTCG affiliates, Newco's sales of regulated services to those entities will be limited to sales (i) under Newco's tariffs, (ii) subject to any Board affiliate transaction pricing rules and related requirements and/or (iii) made at fair market value. Finally, Newco's management will operate Newco as an independent entity, maintain separate books and records using the same financial and accounting practices as WVTC, and issue separate financial statements that are subject to Board review.

The Division of Rate Counsel has reviewed this matter and, by letter dated July 31, 2012, states that it approves of the restructuring plan proposed by Petitioner.

II. Requested Board Actions

In order to implement the Plan, Petitioner seeks the Board's immediate approval of the following specific actions:

- The transformation of WVTC (to be re-named WVTCG) into an unregulated holding company by amendments to its New York certificate of incorporation
- The formation of Newco as a New York limited liability company and the issuance of 100% of its membership units to WVTCG

Once the above actions have been completed, Petitioner requests that the Board permit or grant the following upon further application:

- The transfer from WVTCG to Newco of the operating assets and supporting personnel currently used to provide WVTC's local services
- Issuance of a CPCN to Newco
- Surrender of WVTC's CPCN
- Assumption by Newco of WVTC's PAR

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[8] Because of WVTC's reduced service volumes, some current ILEC employees are expected to be transferred to WVTC's non-regulated entities. However, WVTC's net employee headcount is expected to remain stable under the Plan.

- Immediate effectiveness of Newco's tariffs after their filing, provided they are identical to the then-current WVTC tariffs
- Assumption by Newco of WVTC's obligations under WVTC's existing tariffs
- Assumption by Newco of WVTC's COLR duties and ETC status
- All other actions reasonably necessary to complete implementation of the proposed Plan

III. Petitioner's Rationales for the Plan

Petitioner states that the proposed restructuring is central to the company's plans to remain commercially viable and a source of employment in the New York/New Jersey area. As technological change and competition have caused significant contraction in its traditional ILEC service base in recent years, Petitioner states that it has expanded the scope of its operations to include other telecommunications businesses that are not subject to the Board's (or any other agency's) regulation. In order to compete effectively, especially in the markets for these unregulated services, Petitioner states that the proposed unregulated holding company parent needs the flexibility to access and deploy capital and related manpower in response to rapidly changing marketplace conditions. In particular, Petitioner states that it needs to be able to react quickly in the debt and equity markets to undertake business opportunities as it deems appropriate without the delay or cost associated with regulatory oversight. In this regard, Petitioner notes that losing a business opportunity because of these delays means the company cannot put people to work in support of that opportunity and that it is simply seeking parity with other publicly traded entities both within and outside of New Jersey, such as Vonage Holdings Corporation, j2 Global Communications Inc., and Premiere Global Services, Inc.

IV. The Public Interest

Ultimately, our review and approval of the Plan depends upon any effects it may have on the public interest in New Jersey. The Petition asserts that the Plan supports calls from the public and private sectors to expand the capabilities of the telecommunications infrastructure and foster future economic growth and development. It further notes that the competition generated by the introduction of new telecommunications technologies has caused WVTC's traditional ILEC business to decline significantly. Petitioner states that its ILEC business now faces competition from cable TV, wireless and "over the top" VOIP providers and the use of social media, which in turn led to a loss of 42% of its access lines between 2005 and 2010. As a result of these irreversible changes, Petitioner has moved into other telecommunications related businesses, none of which is regulated. Indeed, with its recently approved purchase of Alteva, a non-regulated provider of Unified Communications services, Petitioner expects that more than half of its 2012 earned revenues will be from non-regulated businesses. As a result, Petitioner contends that it no longer makes either business or public policy sense to have those non-regulated businesses controlled by a regulated entity.

Specifically, Petitioner argues that adoption of the Plan will enable it to compete on a level playing field with other companies in the telecommunications and unified communications industry, which typically operate under a holding company structure. Thus, it notes that after the Plan is approved, WVTCG will be able to issue stock and debt in the same manner as other non-regulated holding companies, i.e., without any need for regulatory oversight. This in turn will give WVTCG easier access to capital and increased ease in its ability to deploy that capital, all of which will support the continued development of the competitive communications marketplace in New Jersey and elsewhere.

Petitioner further states that the Plan is fully consistent with the Board's longstanding policy to encourage competition wherever practicable and Petitioner also asserts that the time has come to permit it to restructure its business so that it can operate in the same manner as its competitors.

Petitioner further argues that no public interest is served by requiring the company to continue to operate as though it were a traditional LEC that provides only monopoly services to captive customers. Petitioner posits that this is all the more true given its willingness to have its regulated business located entirely within Newco, which will be a structurally separate affiliate that is fully subject to the jurisdiction of the Board and other regulators. Combined with the Board's limited authority over holding companies (see N.J.S.A. 48:2-51.1), Petitioner believes that this is sufficient regulatory oversight to protect the public interest from any conceivable anticompetitive threats.

Finally, Petitioner states that the Plan permits a reasonable balance between competition and regulation and meets all the requirements of N.J.S.A. 48:2-51.1. Specifically, Petitioner notes that the Plan will (i) preserve affordable universal service; (ii) assure continuation of high quality service; (iii) provide an adequate forum for resolving consumer concerns; (iv) avoid rate shock; (v) maintain employment opportunities for WVTC's employees and (vi) retain the Board's authority under the WVTC PAR Order to re-regulate Newco, if necessary.

In support of these contentions, Petitioner notes that under the Plan Newco will assume and continue uninterrupted WVTC's COLR and universal service obligations to offer facilities that provide access to every person and every location in its ILEC service territory. As a result, this will fully protect the Commission's long-standing commitment to universal affordable telephone service, and ensure that all customers can obtain local exchange service from the carrier of their choice at just and reasonable prices.

Petitioner acknowledges that Newco will continue to be subject to the same installation interval and service quality standards that apply to WVTC. Newco also will remain subject to the full breadth of the Board's authority if any service questions arise.

Petitioner further notes that Newco will remain subject to the full range of Board's procedures for resolving consumer concerns, which assures consumers a forum for addressing any issues that may arise. Moreover, there will be no rate shock because Newco will adopt WVTC's current local service rates and agree to be governed by the WVTC PAR Order. In addition, Petitioner states that adoption of the Plan gives WVTC employees the greatest opportunities for continued employment, because it does not expect that implementing the Plan will require the elimination of any positions. Finally, Petitioner notes that under the WVTC PAR Order the Board retains the authority to monitor compliance and, if necessary, terminate the PAR and take other measures, if appropriate.

Analysis

We find that Petitioner's proposal to modify its current corporate structure may enable the company to more effectively and aggressively pursue plans for expansion into new services and deployment of its corporation.

Allowing WVTC to restructure as proposed will place it at parity with Verizon and CenturyLink, the other local exchange carriers subject to the Board's regulatory oversight. Thus, we find it in the public interest to allow WVTC to modify its corporate structure and segregate the regulated portion of its business into a separate entity. We see no reason to require Petitioner to maintain its non-wireline LEC businesses within the current regulated structure and do not believe that granting of the Petition will have any negative impacts upon competition.

With regard to the creation and operation of Newco as the regulated entity, we believe that Petitioner has taken reasonable care to ensure Newco will have what it needs to replace WVTC as the regulated service provider in the relevant areas. First, Petitioner has agreed to transfer to Newco all of the physical assets WVTC now uses to provide the services still subject to our oversight, together with the personnel needed to operate those assets and provide the full range of services WVTC currently provides. This should provide Newco with the tools it needs to continue to provide the services that WVTC's customers are entitled to receive.

Second, Petitioner has assured that WVTC's customers will not be subject to rate shock or to any changes in service quality. Petitioner proposes – and we concur – that Newco should be required to provide service at the rates now charged by WVTC and subject to the WVTC PAR Order. On the one hand, this will assure rate stability for the affected customers and will provide customers with access to Board remedies if Newco for example, abuses its position and seeks to raise rates above currently approved levels or if its service falls below acceptable quality standards. In addition, we note that, according to Petitioner, adoption of the Plan provides a reasonable likelihood that WVTC employees will not face job reductions even if the demand for wireline local services declines. We also believe that Petitioner's guarantees to support Newco's operations through 2016, as described in the New York Order, will provide Newco with substantial economic stability that will also inure to the benefit of Petitioner's New Jersey customers. Accordingly, the proposed restructure is expected to result in a competitive entity that will continue to provide proper service to consumers.

FINDINGS AND CONCLUSION

Based upon the above, and pursuant to N.J.S.A. 48:2-51.1, the Board hereby **FINDS** that approval of the Plan proposed by Petitioner:

- Will have no negative effects upon competition in the State of New Jersey and will in fact improve Petitioner's ability to be an effective competitor in the expanded market for telecommunications services and Unified Communications services, thereby conferring a net benefit upon New Jersey consumers and businesses.
- Will have no negative impact upon the rates paid by ratepayers because Newco's rates will continue to be governed by the terms of the WVTC PAR Order that was previously found to be in the public interest.
- Will have no negative effects upon Petitioner's employees and may in fact provide a greater likelihood of job security.
- Will have no negative effects upon the provision of safe and adequate utility service at just and reasonable rates, because the Board will retain continuing jurisdiction over Newco pursuant to the terms of the WVTC PAR Order and the Board's other applicable rules and regulations, and indeed should confer a net benefit upon New Jersey consumers and businesses by ensuring a more competitive WVTC that is better able to address competitive challenges going forward.

The Board further **ORDERS** as follows:

- WVTC is authorized to make appropriate amendments to its New York certificate of incorporation to re-name itself WVTC Communications Group and to permit it to act as a holding company for its existing subsidiaries and the to-be-formed Newco subsidiary.

- WVTC is authorized to take appropriate actions to establish a New York limited liability company that may, after appropriate authorization, seek authorization from the Board to operate as WVTC's successor in New Jersey.
- Upon the establishment of Newco as described above, WVTCG may request permission (i) to transfer to Newco the WVTC operating assets currently used to provide WVTC's local services in New Jersey and sufficient personnel to support Newco's offer of such services and (ii) to surrender WVTC's CPCN.
- In connection with the transfer of the assets and personnel described above, Newco shall file a petition with the Board seeking a CPCN in New Jersey. Newco's CPCN petition shall (i) request authorization from the Board to assume the rights and obligations of the WVTC PAR Order, (ii) request the immediate effectiveness of companion tariffs that shall be identical to WVTC's then-effective tariffs, (iii) request permission to assume WVTC's obligations under WVTC's tariffs as WVTC's successor; and (iv) request authorization to assume WVTC's COLR obligations and WVTC's designation, rights and obligations.
- This approval will expire if the transaction is not fully consummated on or before September 30, 2013.

DATED: 8/15/12

BOARD OF PUBLIC UTILITIES
BY:

ROBERT M. HANNA
PRESIDENT

JEANNE M. FOX
COMMISSIONER

JOSEPH L. FIORDALISO
COMMISSIONER

NICHOLAS ASSELTA
COMMISSIONER

MARY-ANNA HOLDEN
COMMISSIONER

ATTEST

KRISTI IZZO
SECRETARY

I HEREBY CERTIFY that the within document is a true copy of the original in the files of the Board of Public Utilities

IN THE MATTER OF THE PETITION OF WARWICK VALLEY TELEPHONE COMPANY FOR APPROVAL OF A PROPOSED RESTRUCTURING PLAN
DOCKET NO. TO12010069

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ATTACHMENT A

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service Commission held in the City of Albany on July 12, 2012

COMMISSIONERS PRESENT:

Garry A. Brown, Chairman
Patricia L. Acampora
Maureen F. Harris
James L. Larocca
Gregg C. Sayre

CASE 12-C-0003 - Petition of Warwick Valley Telephone Company for Approval of a Proposed Restructuring Plan.

CASE 12-C-0004 - Petition of Warwick Valley Telephone Company for Modification of Ordering Clause 5 of the Commission's June 6, 1988 Order.

ORDER AUTHORIZING RESTRUCTURING AND TRANSFER OF INVESTMENT REVENUES

(Issued and Effective July 13, 2012)

BY THE COMMISSION:

INTRODUCTION

By petitions dated November 30, 2011 and December 16, 2011 and a supplement dated June 6, 2012, Warwick Valley Telephone Company (Warwick or company) requests that the Commission approve a corporate restructuring, including establishment of a holding company (WVT Communications Group) (WVTCG), designate the revenues Warwick receives from its investment in the Orange County - Poughkeepsie Limited Partnership (O-P or Partnership) as non-jurisdictional and approve transfer of the O-P funds to WVTCG. Warwick uses a portion of O-P revenues to offset losses in Warwick's operations. The reorganization and designation of O-P revenues as non-jurisdictional would allow the corporate entity greater flexibility to invest the funds without obtaining Commission authorization pursuant to Public Service Law (PSL) §107. Under the restructuring, a new corporate entity would become the regulated incumbent local exchange company (ILEC) (Newco); and, the ILEC and other non-jurisdictional Warwick subsidiaries[1] would become separate subsidiaries of the holding company. In order to maintain the ILEC's financial viability, Warwick proposes that the holding company guarantee that the ILEC will operate on at least a free cash flow neutral basis through December 31, 2016, by agreeing to transfer sufficient funds to offset any cash shortfall that the ILEC experiences. The holding company would execute an agreement with the Newco to implement this guarantee.

In this Order, we authorize Warwick to reorganize its corporate structure as proposed, transfer the O-P investment to the WVTCG holding company and designate the O-P funds as non-jurisdictional. The corporate restructuring and ability to invest O-P funds without seeking regulatory approval for each investment will provide the corporation with the means to pursue business growth opportunities and improve its financial strength while the guarantee will maintain the ILEC's financial viability. For an additional four years, the guarantee will provide protection for the ILEC's customers against the potential for further decline in its financial viability to assure the continuation of the ILEC's provision of safe and adequate service.

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[1] Warwick's non-regulated subsidiaries are: Warwick Valley Long Distance Co. Inc., Hometown Online Inc., USA Datanet and Alteva, LLC.

PUBLIC COMMENT

In accordance with State Administrative Procedure Act §201(1)(a), notices of the petitions were published in the State Register on January 25, 2012. The comment periods expired on March 10, 2012. No comments were received.

BACKGROUND

In 1988, Warwick received authorization pursuant to PSL §107 to invest up to $300,000 ($150,000 for 1988 and $150,000 for 1989) of its revenues derived from the rendition of public service in the Partnership.[2] The Commission determined that the investment was not likely to affect adversely the company's utility operations. It authorized the use of public service funds for the investment because it complied with its criteria for approval of investments outside of a utility's core business: the venture is related to the core business; the utility can afford to lose the investment without affecting utility rates or service; and adequate accounting safeguards exist to assure proper cost allocations, including full access to books and records of subsidiaries. The Commission's 1988 Order, in Ordering Clause 5,[3] required that Warwick's share of any revenues received or income earned or tax credits generated by the transaction shall be used only to provide cellular service or transferred to Warwick. In 1988, NYNEX acted as O-P general partner with 45% interest; and Warwick, Taconic

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[2] Case 29724, Warwick Valley Telephone Company - Orange County - Poughkeepsie Limited Partnership (issued June 9, 1988) (1988 Warwick Order).

[3] A similar clause appears in the Commission's order approving Taconic Telephone Corporation's O-P investment (Case 29662, Taconic Telephone Corporation - Orange County - Poughkeepsie Limited Partnership (issued February 1, 1988) (Taconic 1988 Order)).

Telephone, Highland Telephone Company (Highland) and Sylvan Lake Telephone Company (Sylvan Lake) each invested $300,000 for a 7.5% interest.[4] Since that time, Warwick's interest increased to 8.108%.

In 2011, Warwick received authorization to issue common stock pursuant to PSL §101 and to use up to $13,000,000 in income derived from its interest in the Partnership for acquisition of the assets of Alteva. Alteva is a cloud based unified communications provider and North America's largest enterprise-hosted VoIP provider. The Commission determined that PSL §107 approval or a waiver of Ordering Clause 5 is required. The rationale for this decision is that Ordering Clause 5 effectively determines that the funds Warwick receives from O-P are jurisdictional revenues derived from rendition of public service for purposes of PSL §107. The Commission determined that, because Warwick did not seek rehearing or modification of Ordering Clause 5, it requires Commission PSL §107 approval for use of O-P funds.[5]

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[4] The Commission's orders authorizing Highland and Sylvan Lake to invest in O-P did not include Ordering Clause 5 (Case 29732, Highland Telephone Company - Orange County - Poughkeepsie Limited Partnership, Untitled Order (issued March 31, 1988) and Case 29733, Sylvan Lake Telephone Company - Orange County - Poughkeepsie Limited Partnership, Untitled Order (issued March 31 1988)).

[5] In a 2007 Declaratory Ruling relating to Taconic Telephone Corporation (Taconic), the Commission determined that its order approving MJD Ventures, Inc.'s acquisition of Taconic rendered Ordering Clause 5 in the 1988 Taconic Order moot because, to the extent the funds were transferred to Taconic, it was free to dividend them to its parent "as long as it was not in violation of any other Commission order." (Case 07-C-0032, Taconic Telephone Corporation and MJD Ventures, Inc., Declaratory Ruling on Transfer of Investment (issued March 2, 2007), p. 3-4)).

The Commission approved the use of O-P income for the Alteva purchase because the investment satisfied its three criteria for use of PSL §107 funds for investments: related to core business, no adverse affect on company operations and access to books and records. It stated that the presence of competitors for telecommunications services in its service territory largely insulates Warwick's customers from the potential risks of Warwick's non-jurisdictional investments; Warwick's pursuit of other business opportunities provides it with a reasonable means to preserve or improve its financial strength; and, the company deserves the flexibility to invest in Alteva without many of the conditions typically associated with approval of the use of jurisdictional funds by monopoly providers.

PETITIONS

Restructuring Details

Warwick proposes to transform into an unregulated holding company, renamed WVTCG, transfer its local exchange assets and customers to the newly established ILEC and leave Warwick's non-regulated businesses in place as direct WVTCG subsidiaries. Warwick requests that the Commission determine that the revenues received from its 8.108% O-P ownership are non-regulated funds and authorize transfer of the O-P interest and income to WVTCG. WVTCG would operate as an unregulated business corporation outside the Commission's jurisdiction, except to the extent provided by PSL §110.

The holding company would become a publicly traded, non-operating management company; and it would maintain the Newco's corporate management and service functions (e.g., legal, tax, corporate and administrative). Re-classification of Warwick's O-P income would allow use of the funds without the need to obtain Commission review and approval, as it pursues its opportunities for success as a New York provider of unified communications.

The petition proposes that the Newco would become established as a limited liability company organized and existing under the laws of New York, obtain a Certificate of Public Convenience and Necessity (CPCN) and operate as a local exchange company subject to the Commission's jurisdiction. WVTCG would transfer to the Newco the personnel and fixed assets used to provide ILEC services, including its central office and outside plant network, land, rights-of-way, buildings, engineering and operations, customer and facility records and billing and order processing. It would provide the regulated services that Warwick offers at its current rates under tariffs approved by the Commission and agree to become subject to the same Carrier of Last Resort and Eligible Telecommunications Carrier obligations and rights applicable to Warwick.

The petition recognizes that the Newco's non-tariff transactions with affiliated entities would become fully subject to the affiliate transaction pricing rules and other requirements established in the Commission's Cost Allocation Order and/or be made at fair market value to prevent the Newco from subsidizing WVTCG's other subsidiaries.[6] Warwick states that the Newco would operate as an independent entity, maintain separate books and records and issue separate financial statements subject to Commission review. In order to assure the ILEC's independence and structural separation from its affiliated entities, ILEC sales of regulated services to those

[6] Case 88-C-0136, Standards and Reporting Requirements - Assigning and Allocating Telephone Companies' Costs of Regulated and Non-Regulated Activities, Order Adopting Permanent Cost Allocation Standards (issued February 8, 1990).

entities would be limited to sales under the Newco's future tariff. Upon approval of the petitions, the ILEC would agree to refrain from filing a rate-of-return based rate case for two years,[7] subject to any local service rate changes required or permitted by the Federal Communications Commission in connection with its restructuring of Universal Service Fund support or by the Commission in relation to intrastate access charges. Warwick specifically requests that the Commission authorize the formation of Newco, amendments to its certificate of incorporation, issuance of a certificate of convenience and necessity, transfer of assets to WVTCG, approval of Newco's local service tariff and Newco's assumption of Warwick's obligations.[8]

Restructuring Objectives

Warwick states that the proposed restructuring is central to its plans to remain commercially viable and a source of substantial employment in the Warwick and Syracuse areas. Due to technological change, competition and significant contraction of the ILEC's traditional service base, the company expanded the scope of its operations to include other non-regulated telecommunications businesses. To compete in markets for unregulated services, flexibility is needed to access and

[7] Warwick is expected to balance its interest in the ILEC's financial viability, the O-P revenue stream used to support the ILEC and the constraints of competition in making decisions relating to the need to file a rate-of-return rate case. Under Commission Orders, Warwick, operating in a competitive service territory, is authorized to increase its rates for basic residential service by $2 annually without filing a rate-of-return rate case.

[8] This Order does not authorize the specific actions necessary to implement the corporate restructuring. Warwick would follow the procedures established for filing petitions for these authorizations, together with the information required for Commission determinations on the petitions.

deploy capital and related work force in response to rapidly changing marketplace conditions. The company maintains that it requires the ability to react quickly in the debt and equity markets to undertake business opportunities without the delay and cost associated with regulatory review. Warwick states that any delay for regulatory review puts the company at a competitive disadvantage because its competitors (cable, VoIP and wireless providers) are not subject to similar regulatory requirements for reviews of their security offerings. The company asserts that this added financial flexibility provided by the new corporate structure can be advantageous to the long-term financial health of the company as a whole and preservation and creation of jobs in New York.

Public Interest

Warwick states that its proposal responds to public and private initiatives to expand telecommunications infrastructure, foster future economic development, and diversify its telecommunications businesses in response to the ILEC's loss of access lines and declining revenues due to wireless, cable, over-the-top VoIP and social media competition. With its Alteva acquisition, Warwick estimates that its non-regulated businesses will produce more than half of its 2012 earned revenues. As a result, it states that it no longer makes business or public policy sense to continue the regulated entity's control of its non-regulated businesses.

The company maintains that the proposed restructuring would enable more effective competition with other unified communications companies, which typically operate under a holding company structure. Warwick asserts that its proposed restructuring is fully consistent with the Commission's longstanding policy to encourage competition, wherever practical, and permits a reasonable balance between competition and regulation.

O-P Transfer to WVTCG

Warwick explains that it owns an 8.102% limited partnership interest in O-P; Verizon Wireless of the East, L.P is the general partner and owns a 91.892% interest; Cellco is another limited partner. On May 26, 2011, the partners entered into an agreement (4G Agreement) that authorizes O-P to provide 4G cellular services and convert from a wholesale to a retail business. The 4G Agreement guarantees Warwick an annual cash distribution of $13,600,000 in 2011 and an annual cash distribution of $13,000,000 in 2012 and in 2013 and establishes the right (put) to require one of the O-P's limited partners to purchase all of its ownership interest during April 2013 or April 2014 at the greater of $50,000,000 or a product of five times 0.081081, O-P's EBITDA.

Warwick asserts that granting it the opportunity to use O-P funds without the need for PSL §107 approval would allow it to react to business opportunities in an effective manner. Warwick states that this flexibility may mean the difference between a successful acquisition and enhanced employment opportunities for New Yorkers and another acquirer locating a business outside New York State. The company notes that, because of its recent access line losses, it is required to continue to invest in non-jurisdictional business opportunities in order to mitigate the negative effects of commensurate line losses and decline in its revenues. The company states that non-jurisdictional treatment of O-P funds will materially assist Warwick's ability to expand rapidly into new business opportunities.

Warwick notes that its request is in the public interest because local service customers' rates and service quality will remain protected, buttressed by the continued imposition of the rate limits established in the Competition III Order.[9] It states that Warwick's shareholders and employees will benefit from the added flexibility to apply revenues from the Partnership in ways that support the growth opportunities needed to preserve their interests.

Supplemental Petition

Warwick submitted a plan, in response to a Department of Public Service Staff request, to recommend an efficient and effective means to accomplish Warwick's objective of designating the O-P funds as non-regulated and outside the Newco's control, while continuing to assure the Newco's financial viability and high quality service. Warwick states that the simplest and most straightforward way to implement its proposals is to retain the O-P interest in its holding company. Warwick asserts that this plan would avoid a number of legal and financial obstacles, additional implementation delays and significant costs.

According to Warwick's petition, from 2008 to 2011, it generated adjusted free cash flow between a positive $3,296,000 and a negative $2,378,000, excluding any effects of the Partnership revenues; and, on average, its operations experienced an average negative free cash flow of about $166,000 for that period.

The company proposes that it guarantee that the Newco will operate on at least a free cash flow neutral basis through

[9] Case 05-C-0616, Intermodal Competition in the Provision of telecommunications Services, Statement of Policy on Further Steps toward Competition in the Intermodal Telecommunications Market and Order Allowing Rate Filings (issued April 11, 2006) (Competition III Order).

2016. Specifically, it agrees to establish the Newco with an initial $700,000 cash balance, approximately equal to Warwick's 2011 year-end cash balance. If the Newco's cash balance at the end of any fiscal year through December 31, 2016 falls below $700,000, Warwick agrees to transfer sufficient funds to the Newco to offset the shortfall within three months of the closing of the Newco's financial books for the applicable year. It proposes to implement this plan through an agreement between the WVTCG holding company and the Newco ILEC (Attachment 5 to the Supplemental Petition).

Warwick notes that it is a publicly held corporation subject to the authority of the Securities and Exchange Commission (SEC). It states that a variety of factors compel the company to maintain its commitment to support the Newco, including SEC requirements for disclosure of the financial support, lack of trust and litigation risk for failing to carry out its publicly disclosed commitments, affect on its stock price if management is viewed as untrustworthy and liability risk for failure to honor its commitments.

Warwick states that it will agree to the adoption of incentives to support Newco's future service performance, specifically the liability for refunds of a specific percentage of subscription fees to affected customers if the Newco fails to meet the Commission's customer trouble report rate service quality standard.

DESCRIPTION OF WARWICK

Warwick Valley Telephone Company is both an incumbent local exchange company and the parent company of wholly-owned subsidiaries. It began a transition to a cloud-based communications company in 2009 with its acquisition of USA Datanet, which serves smaller businesses (under 35 employees), and is based in Syracuse. The transition accelerated with its August 2011 acquisition of Alteva, which serves larger businesses (over 35 employees), and is based in Philadelphia.

The ILEC operating company, founded in 1902, provides local and toll telephone service, Internet high speed broadband service, and satellite video service to residential and business customers in primarily rural areas of Orange County, New York and northern New Jersey. It operates in a highly competitive service territory, with Cablevision as its primary competitor. The ILEC provided service to 29,000 access lines in 2002; at the end of 2011, it maintained 14,000 access lines, due to subscriber losses from wireless and cable substitution, and customer attrition. In 2011, Warwick's operations lost 7% of its access lines and total overall company revenues declined by 9%. Staff determined that, over the last four years, Warwick experienced deficits of approximately $2.4 million in 2011 and $2.4 million in 2008, offset by O-P funds. Warwick earned $3.6 million in 2009 and $.5 million in 2010, with no need for use of O-P funds. During 2010, the company experienced a negative return on equity of 13.6% on its intrastate operations.

Warwick's ownership interest in the Partnership generated $36 million in pre-tax income over the last three years and the company is guaranteed income of approximately $39 million from the Partnership for the years 2011 through 2013. The receipt of the O-P funds resulted in a beneficial effect on

Warwick's finances and balance sheet, increasing the company's equity ratio to 92% in 2010.

Warwick complies with the Commission's general 69% standard[10] for designation as an ILEC providing service in a territory where significant competition for telecommunications services exists,[11] with few or no non-competitive service areas (white spots), and, as such, is afforded residential non-basic pricing flexibility. Warwick is, thus, allowed greater flexibility in setting its non-basic rates and allowed up to $2 annual rate increases for basic residential service, limited by their allowed return on equity plus 500 basis points.

However, as a result of competitive constraints, Warwick charges monthly rates for its local telephone service that range from $11.99 to $14.04. These rates are lower than the overall state $23 cap. Once Warwick's basic residential rates are authorized at $23, a potential exists for obtaining funds from the proposed State Universal Service Fund.

Warwick's service quality, as measured by its customer trouble report rate (CTRR), earned excellent ratings over the past several years. The company received commendations for excellent service quality from the Commission for 4 of the last 5 years and 17 out of the last 23 years. On a rolling 12 month average, its CTRR has ranged between 92% and 100% over the last year.

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[10] As defined in our orders, more than 69% of the company's residential customers have two competitive alternatives; and its adjusted earned return on equity is less than its allowed return on equity plus 500 basis points.

[11] Warwick is classified as a Group 1 Company under the Commission's Framework for Regulatory Relief (Case 07-C-0349, Framework for Regulatory Relief, Order Adopting Framework (issued March 4, 2008)).

DISCUSSION

As a result of major technological developments that transformed the telecommunications markets and the consequent emergence of significant competition for telecommunications customers, small ILECs operating in New York, including Warwick, are experiencing substantial and continuing loss of access lines and associated revenues, diminishing inter-carrier compensation and significant downward pressure on the pricing of telecommunications service. Competition transformed Warwick's pricing structure from one historically based on the recovery of costs to one based on market conditions. To its credit, Warwick reacted aggressively to changes in its operating environment by expanding the scope of its operations and implementing marketing programs based on service bundling and discounts. It changed its business model to offer new, unregulated services. Its petitions seek approval of a new corporate structure that will enable the company to more effectively and aggressively pursue these plans for expansion into new services and development of its corporation.

The modified corporate structure serves the public interest. Accordingly, we approve Warwick's request to reorganize its corporate structure as described in its petitions.

Warwick's ability to use its O-P revenues will significantly improve its prospects for investing in business opportunities in order to lessen the effects on the corporation of the ILEC's line losses and decline in revenues. The transfer of O-P funds to the holding company will free up funds and eliminate the delay, uncertainty and cost associated with regulatory approval. It will shift funds from the control of an entity that is suffering customer losses and revenue declines to an entity with growth opportunities through other ventures.

The public interest is supported by ensuring that an appropriate level of financial resources is used to support the ILEC's regulated operations for a reasonable time. Warwick's interest in the Partnership and resulting cash flows greatly enhances the ILEC's financial strength and maintains its financial viability. Its network provides the essential infrastructure for wireless, interconnected VoIP provided by cable television corporations and landline communications. In 2010, funds from the Partnership represented about 50% of the total revenues of the entire corporation. The Partnership is the only venture that earned a positive return in 2010. Under the current corporate structure, the cash flow generated by this investment is on the books of and controlled by the Warwick ILEC.

The company asserts that it is vitally interested in preserving the ILEC's financial viability and proposes that the holding company guarantee that Newco will operate on at least a free cash flow neutral basis through December 31, 2016, under the terms proposed in its Supplemental Petition and implement this plan through an agreement between the WVTCG holding company and the Newco, the Newco ILEC (Attachment 5 to the Supplemental Petition). This arrangement will assure the availability of sufficient funds at the Newco to support regulated operations for a reasonable amount of time, as the corporation develops its business opportunities and undergoes the transition required by a dynamic telecommunications market. The Warwick proposal ensures that the regulated company is not deprived of funding under the new corporate structure while affording some protection regarding the Newco's financial health and its ability to maintain its commitment to service quality and affordable universal service during a market transition.

Loss of O-P funds after 2016 may result in financial difficulties for the ILEC, if it is unable to increase its revenues, maintain its customer base and/or become more efficient. Several mitigating factors operate to provide protection for customers. These include: strong competitive telecommunications alternatives available in Warwick's service territory that provide replacement options, albeit at less constrained prices if the ILEC can no longer function as a competitor; possibility of continuing ILEC service to dedicated customers supported through a subsidy from the New York State Universal Service Fund; possible WVTCG decision to continue the support of its ILEC after 2016, given the on-going use and importance of its infrastructure; and unforeseen opportunities for improvements of the ILEC financial position. We would anticipate that the ILEC would use the four-year transition period to strengthen its financial viability.

It is difficult, if not impossible, to predict the future of the telecommunications market; and, we have no way of knowing what the future brings for the ILEC, or if customers will continue to remain interested in its services. It is good public policy to provide Warwick with an opportunity to maximize the use of its investment revenues, grow its business and provide associated benefits to New York State. Warwick's four year guarantee of financial viability for the ILEC is a reasonable compromise between the two objectives of growing the corporation through diversification into new enterprises and maintaining the financial viability of a declining business.[12]

This arrangement strikes a reasonable balance between the ILEC's need for support during the transition and the general public interest in allowing the corporation to maximize the revenues derived from the O-P investment to develop more business opportunities. Accordingly, we designate the O-P revenues as non-jurisdictional to the extent they are not used to offset the Newco's regulated losses through December 31, 2016, authorize transfer of the Partnership to the holding company and amend Ordering Clause 5 in our 1988 Warwick Order to provide: "That petitioner's share of any revenues received or income earned or tax credits generated from its investment in the Partnership shall be used to maintain its ILEC's regulated cash balance at $700,000 through December 31, 2016, and otherwise considered non-regulated revenues."

In some prior restructurings, we required refunds to customers, if a company was unable to maintain service quality at the commendation level, as proposed by Warwick. For several reasons, refunds are ineffective for Warwick in today's telecommunications market. Warwick committed to maintain the new ILEC's positive free cash flow which provides the revenues necessary to maintain service quality; the competitive market provides incentives to promote service quality; refunds do not assist in improving the infrastructure necessary to provide quality service; and intra-modal competitors are not subject to similar service quality standards. Accordingly, we will not

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[12] The Declaratory Ruling in Case 07-C-0032, supra, mentioned that the 1998 Order approving a corporate restructuring by Taconic imposed dividend restrictions, but that other restrictions on inter-corporate transfers were rendered moot. Here, the Commission will impose continued requirements for the use of the revenues from the O-P investment through December 31, 2016, as proposed by Warwick Valley.

require customer rebates for declining service quality performance herein.

CONCLUSION

We approve the proposed restructuring and authorize transfer of the Partnership and any income or cash contributions associated with the investment from Warwick to its newly established holding company. Warwick's petition for designation of its O-P revenues as non-regulated and amendment of Ordering Clause 5 is granted, provided that it implements its plan for providing financial support for its Newco ILEC, as described in its Supplemental Petition and this Order and executed through an agreement between its holding company and the Newco ILEC.

The Commission orders:

1. Warwick Valley Telephone Company is authorized to implement its corporate restructuring, in accordance with the discussion in the body of this Order.

2. The revenues that Warwick Valley Telephone Company derives from its investment in the Orange County - Poughkeepsie Limited Partnership are designated as non-jurisdictional to the extent they are not otherwise preserved for ratepayers through December 31, 2016 as provided below and Ordering Clause 5 of the Commission's Untitled Order in Case 29724 issued June 9, 1988 is modified to state: "That petitioner's share of any revenues received or income earned or tax credits generated from its investment in the Partnership shall be used to maintain its ILEC's regulated cash balance at $700,000 through December 31, 2016 and otherwise considered non-regulated revenues." Such designation and modification are subject to the proviso that the holding company established in its corporate restructuring enter into an agreement with the

newly established incumbent local exchange company to provide funds from the Partnership to offset regulated losses and other cash flow needs including capital investment, so that such local exchange company operates on at least a free cash flow neutral basis through December 31, 2016, as described in the body of this Order.

3. The newly established incumbent local exchange company's non-tariff transactions with affiliated entities is fully subject to the affiliate transaction pricing rules and other requirements specified in the Commission's Cost Allocation Order in Case 88-C-0136 issued on February 8, 1990 and/or made at fair market value.

4. All costs incurred by Warwick Valley Telephone Company in the implementation of this transaction are not recoverable in the rates of Warwick Valley Telephone Company or its newly established local exchange company.

5. Warwick Valley Telephone Company is prohibited from pledging assets for debt obligations other than its own.

6. The newly established incumbent local exchange company shall submit an updated cost allocation manual no later than three months prior to submission of a request for a rate of return based rate change.

7. This proceeding is closed, unless the Secretary to the Commission finds good cause to continue the proceeding.

By the Commission,

Jaclyn A. Brilling
Digitally Signed by Secretary
New York Public Service Commission

(SIGNED) JACYLN A. BRILLING
Secretary