BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Ohio Bell Telephone Company for Approval of an Alternative Form of Regulation.	)	Case No. 93-487-TP-AIR
In the Matter of the Complaint of the Office of the Consumers' Counsel, Complainant.	)	Case No. 93-576-TP-CSS
v.	)	
Ohio Bell Telephone Company, Respondent.	)	

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PUBLIC UTILITIES COMMISSION OF OHIO

OBJECTIONS OF TIME WARNER AXS TO THE STAFF REPORT OF INVESTIGATION

INTRODUCTION

On March 25, 1994, the Staff of the Public Utilities Commission of Ohio ("PUCO" or "Commission") submitted the Staff's Report of Investigation ("Staff Report") concerning the application of Ohio Bell Telephone Company ("Ohio Bell", "OBT", or "Applicant"). The Staff Report examines the operating income and rate base, rate of return, rates and tariffs (including OBT's price cap framework and the classification and pricing of services), quality of service and commitments of the Applicant. The Staff Report also examines OBT's financial performance and financial condition under the proposed alternative form of regulation plan and with certain revisions recommended by the Staff. In preparing Objections to the Staff Report, Time Warner AxS ("TWAxS") has focused its review on those aspects of the Staff Report that pertain to the Applicant's request for:

(1) Authority to establish rates and charges by a method other than specified in Section 4905.15, Revised Code; and,

(2) Relief pursuant to Section 4927.03, Revised Code[1].

1. Ohio Bell's application filed on June 30, 1993 indicates that it is seeking relief under Sections 4927.03 and 4927.04, Revised Code. As discussed below, it is difficult to determine what aspects of the requested relief are based on Section 4927.03 and which are based on Section 4927.04, Revised Code.

These proceedings are important from a number of perspectives. Ohio Bell is Ohio's largest telephone company and provider of local services. Thus, the policy, legal and fact determinations made in these cases will determine much about the nature and direction of Ohio's communication policy both in principle and practice. As noted in the Staff Report (at page 1), Ohio Bell's most recent comprehensive review of its rates and revenue requirements occurred almost a decade ago. Much has happened since Ohio Bell's last rate case. The scope and significance of the relief requested by Ohio Bell require the Commission to exercise all of its powers to make sure the product of any alternative method of establishing rates neither equips Ohio Bell to insulate itself from market forces (applied both at the point of capital formation by investors and at the point of purchase by customers) nor permits Ohio Bell to bias the marketplace's decision through its extensive monopoly and monopsony power. Care and time must be taken now to establish a proper baseline to evaluate Ohio Bell's legitimate requirements. In this context, TWAxS offers some general and orienting comments that may help to communicate the more specific concerns it is raising through the objections which follow.

As proposed by Ohio Bell, alternative economic regulation is designed to provide Ohio's largest incumbent supplier of communication services with the certainty of traditional (rate base/rate of return) regulation and the flexibility to establish prices where and when Ohio Bell, in its sole discretion, determines that an alternative price is warranted. In addition, Ohio Bell proposes to maintain, in substantial measure, current rate revenues. By means of this construction, the competitive label is used to determine which customers and which services will inherit the residual revenue requirement defined by traditional regulation exercised almost a decade ago. The Staff Report proceeds in a more correct direction by updating to provide a more recent measurement of the traditional revenue requirement and by seeking safeguards that must be established to, in effect, correct for the problems created, in part, by adhering to a traditional definition of Ohio Bell's revenue requirement. However, economic regulation, either in its traditional form or in the alternative, is rooted in a public policy that is striving, as it must, to produce market-driven pricing results and economic discipline for a supplier which does not confront market forces.

Alternative regulation must not be designed or implemented for the purpose of redistributing revenue responsibility (defined in the traditional form) among services or customers depending on the degree to which they are subject to the exercise of monopoly power or the extent to which they enjoy an incremental or marginal status. Alternative economic regulation must share the objective of traditional economic regulation; both methods of establishing rates strive to simulate the economic effect of a competitive market. The emergence of limited competition in communication industries provides useful pricing information where functions are available in the marketplace and this information should be used for the benefit of all customers. It is probably too ambitious to expect that current capabilities can produce a revenue requirement calculated as if a fully competitive communications market existed. However, this constraining practicality should not mean that Ohio Bell should be set free to

selectively[2] combine those aspects of traditional regulation and alternative regulation which it finds beneficial.

In formulating its recommendations, the Staff has relied extensively on the comprehensive and insightful report prepared by the National Regulatory Research Institute ("NRRI"). There are numerous instances, however, in which the Staff Report either deviates from or overlooks key recommendations of the NRRI Report; recommendations which provide more comprehensive actions which must be taken to address Ohio Bell's selective applications of traditional and alternative regulation. While the spirit of the Staff Report recommendations seems to recognize problems identified in NRRI's report, the letter of the Staff Report seems to stop short (in some cases) of identifying a corrective recommendation. On the other hand, the Staff Report's appearance as a less robust evaluation and analysis of OBT's proposals may be due to the Staff Report's extensive amount of cross-referencing to the NRRI document.

TWAxS, as a certified provider of telecommunications services in Ohio, is directly affected by the outcome of the Commission's investigation of Ohio Bell's alternative regulation proposal and revenue requirement. The degree to which any new regulatory framework provides (or fails to provide) OBT with proper incentives to act in a way that benefits ratepayers (e.g., to invest ratepayer funds wisely, to set cost-based rates, to improve operational efficiencies, to encourage diversity and innovation in the development and supply of the Ohio's communications services, and to share earnings in excess of a reasonable level with its ratepayers) will affect the ability of TWAxS and others to contribute to the diversity, quality, and options for telecommunications services and telecommunications-based applications throughout Ohio.

SPECIFIC OBJECTIONS

I. LEGAL

1. TWAxS objects to the Staff Report's failure to recommend that Ohio Bell's application pursuant to Sections 4927.03 and 4927.04, Revised Code, be dismissed for lack of subject matter jurisdiction. Section 4927.04, Revised Code requires that a Section 4909.18 and Section 4909.19, Revised Code, application to increase rates be filed before the Commission can exercise its authority to establish rates and charges by a method other than the method specified in Section 4909.15, Revised Code. No such application has been filed by Ohio Bell. Section 4927.03, Revised Code is not applicable to basic local exchange service. Section 4927.03, Revised Code also requires an applicant to allege and demonstrate that service-specific competition exists or that service-specific alternatives exist for customers before the Commission may exercise its jurisdiction to establish alternative regulatory requirements.

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2. Ohio Bell's selective combination of theories and strategies can also be seen in its approach to certification cases. In its application in Case No. 93-487-TP-ALT (at pages 1-2), Ohio Bell observes that public policy has shifted from one that prohibited competition for telephone service to a pro-competitive policy. Yet its pleadings in certification cases claim exclusive service rights (unless it is providing service to a former customer of another local exchange company). *Compare In Re Application of Time Warner AxS,* Case No. 93-2069-TP-ACE (PUCO March 10, 1994) *with In Re Complaint of GTE North, Inc. v. The Ohio Bell Company,* Case No. 88-1739-TP-CSS (March 10, 1994).

2. TWAxS objects to the Staff Report's failure to recommend that Ohio Bell's application be dismissed on the basis that Ohio Bell has failed to identify the specific relief it is seeking under Section 4927.03, Revised Code, and the specific relief it is seeking under Section 4927.04, Revised Code. This identification is required by the Commission's alternative regulation rules (Rule III.B.3.).

3. TWAxS objects to the Staff Report's failure to find that Ohio Bell's current rates are excessive, unreasonable and unlawful and that authorized revenues and rates must be reduced to reflect the appropriate cost of service irrespective of the Commission's response to Ohio Bell's request for relief under Chapter 4927, Revised Code.

4. TWAxS objects to the Staff Report's failure to find that Ohio Bell has not met its burden of proof [3] with regard to pricing flexibility for bundled Cell 1 services. The Commission's alternative regulation rules impose a higher burden of proof upon applications for pricing flexibility for bundled Cell 1 services.

5. TWAxS objects to the Staff Report's failure to find that Ohio Bell has not met its burden of proving that its non-sharing, non-earnings based proposal will be as beneficial to customers as traditional regulation (Rule IV.E.).

6. TWAxS objects to the Staff Report's failure to recommend that Ohio Bell's proposal to enter into contracts on an "individual case basis" be rejected because it violates the Commission's alternative regulation rules (Rule XIII). Furthermore, if individual contracts are going to be authorized, TWAxS objects to the Staff' Report's failure to recommend that services provided by contract be subject to imputation, unbundling, resale and other requirements that apply to tariffed services.

7. TWAxS objects to the Staff Report's failure to address the procedural and substantive rights of parties that are required (pursuant to the Commission's alternative regulation rules) in the case of alternative regulation proposals that contain phased commitments or pricing proposals.

8. TWAxS objects to the Staff Report's failure to recommend a mechanism by which customers or potential competitors can obtain timely relief from unreasonable policies or practices that emerge from the implementation of any alternative regulation plan approved in these proceedings.

II. RATE OF RETURN

1. The Staff Report erred in failing to recommend that any authorized "benchmark" rate of return be evaluated periodically and subject to adjustment based upon: (a) cost changes;

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3. As used here, the term "burden of proof" refers to the burden of coming forward with sufficient evidence to permit the Commission to enter a determination on the merits of a proposal and the burden of persuading the Commission that Ohio Bell's position should be sustained. Ohio Bell should be held accountable to the same standard that it has wielded successfully as a respondent in complaint cases.

and, (b) OBT's implementation of an alternative regulation plan that promotes the public interest and the communications policy of Ohio.

2. While TWAxS supports the Staff Report recommendation for a downward adjustment in OBT's base period revenue requirements, TWAxS objects to the failure to clearly identify and discuss the effect of OBT's proposed alternative form of regulation on OBT's cost of capital.[4] Moreover, unless OBT is willing to make commitments that will result in the elimination of barriers to competition (including a commitment to not contest entry by other suppliers), the cost of equity capital should be established at the low end of the range.

III. PRICE CAP PLAN

1. TWAxS objects to the Staff Report's failure to require OBT to forecast changes in demand for individual services.[5] As the NRRI Report correctly explains, such information would provide the Commission (as well as OBT) the ability to adjust for significant revenue changes associated with increases or declines in the demand for new services.[6] *See*, NRRI Report at 28. Such updated information is necessary to avoid inequitable, and potentially anti-competitive, results. TWAxS also objects to the Staff Report's failure to recommend that the Commission explicitly require OBT to track and properly account for all new services that it offers, projected annual revenues associated with each of the new services, and the actual revenues achieved for each of the new services. This information will be required to make sure that OBT's claim that its plan will transfer risk to its owners can be evaluated if an alternative form of regulation is approved in these proceedings.

2. TWAxS objects to the Staff Report's failure to recommend a limitation on OBT's discretion to carry over unused upward pricing authority from one annual pricing period or year to another. A limit is consistent with NRRI Recommendation 2.17.

3. TWAxS objects to the Staff Report's failure to propose a limitation on OBT's discretion to carry over unused downward pricing authority from one annual pricing period or year to another, A limit is consistent with NRRI Recommendation 2.18.

4. TWAxS objects to Staff's failure to adopt a consumer productivity dividend or "stretch" factor, as a way of capturing for consumers a portion of the efficiency and productivity benefits of alternative regulation. OBT. *See*, NRRI Report at 138-141.

5. TWAxS objects to Staff Report's failure to recommend the adoption of an earnings sharing mechanism.

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4. See Staff Report at 24-28.

5. See Staff Report at 52. Under NRRI Recommendation 2.6, OBT would be required to share such information with the Commission .

6. OBT was unable to provide a list of the services that it has introduced since January 1985. *See* OBT Response to TWAxS Interrogatory 7.

6. While TWAxS agrees with the Staff Report's recommendation to adopt explicit criteria for the consideration of exogenous impacts in a price cap framework (or, alternatively, to reject OBT's proposed exogenous adjustment entirely), the criteria recommended in the Staff Report are too broad and indefinite to properly limit the types of cost changes allowed to be reflected as adjustments to the price cap formula.

7. While TWAxS is encouraged by the Staff Report's commitment to take the initiative for monitoring and evaluating exogenous changes (rather than accepting OBT's self-screening proposal), TWAxS objects to the Staff Report's failure to provide a procedure by which other parties, including OBT, may identify exogenous events for consideration by the Commission.

8. TWAxS also objects to the Staff Report's failure to adopt recommendations from the NRRI Report to explicitly exclude certain enumerated future events, summarized in NRRI Recommendation 5.18, from consideration as exogenous events. By giving official recognition to such a specific list of events, the Commission has a unique opportunity to eliminate potential areas of dispute.

IV. CLASSIFICATION AND PRICING OF SERVICES

A. Classification of Services

1. TWAxS shares the Staff Report's concern about the potential for competitive abuse associated with OBT's proposed inclusion of monopoly and competitive services within the same group, but objects to the Staff Report's failure to reject explicitly OBT's proposal for the creation of "group" price indices based on three customer service groups. The creation of customer-specific groups and the overlay of group price indices is contrary to the Commission's alternative regulation rules, unnecessary and offers no offsetting benefit. In addition, OBT's group pricing proposal will be almost impossible to audit as a result of the excessive discretion OBT will retain under the proposal.

2. TWAxS concurs fully with the Staff Report's recommendation that the following services should be reclassified as Cell 1 (basic monopoly) services: Flat Rate Usage, Directory Assistance (local and toll), Call Screening, Public and Semi-Public — Local Message[7]. However, TWAxS objects to Staff Report's failure to recommend that all bottleneck functions and features that OBT offers and upon which "competitors" and enhanced service providers rely in order to provide a service be classified as Cell 1 services. For example, Remote Call Forwarding should be classified as a Cell 1 service because it is required by enhanced service providers before they can provide voice mail service and OBT has absolute control over number assignment and routing functions.

3. TWAxS objects to Staff Report's failure to recommend that services which contain local network access components bundled with other capabilities must be classified as noncompetitive and Cell 1 services. This includes, for example, intrastate intraLATA MTS,

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7. *See* Staff Report at 56-58.

WATS and 800 services, each of which involves bundled access and transport.[8] Services containing monopoly access components cannot reasonably be deemed competitive.

4. TWAxS objects to the Staff Report's proposal to reclassify certain services as Cell 2 services which the Applicant proposes be classified as Cell 4. Although TWAxS concurs with the Staff Report's finding that all the services identified on page 57 of the Staff Report (e.g., Channels — Digital Private Lines) should not be classified as Cell 4 services, TWAxS objects to their classification as Cell 2 services. Contrary to the Staff Report's recommendation, these services should be classified as Cell 1 services until such time as effective competition has emerged for these services. The *potential* for competition should not be considered synonymous with the *existence* of effective competition.

5. TWAxS objects to the Staff Report's failure to reclassify services from Cell 2 (emergingly competitive) into either Cell 1, 3, or 4[9].

6. TWAxS objects to the Staff Report's failure to recommend that Cell classification should be guided by objective standards (such as the "stand alone test" or market share and market power analysis) and the Staff Report's failure to recommend criteria for Cell classification and particularly for Cell 4 services. This subject is discussed at pages 162-177 of the NRRI Report.

B. Pricing of Services

1. TWAxS objects to Staff Report's endorsement of the Applicant's proposed authority to increase Cell 1 rates by as much as 5% in addition to the price cap index.[10] The vast majority of Ohio Bell's revenue is generated from its Cell 1 services, and therefore, the ability to raise rates for noncompetitive services by as much as 5% ***in addition to*** the price cap index would harm Ohio Bell's captive customers and provide OBT with the ability to alter its revenue in a way which could discourage innovation and diversity of supply in Ohio.[11] TWAxS objects to the Staff Report's failure to recommend that rate changes for any of the individual services that are classified as Cell 1 should be increased by no more than the average increase permitted by the price index.

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8. OBT proposes to classify Message Toll — Two Point Service and Optional Off Peak Toll in Cell 2 and to classify 800 Services and Outward WATS in Cell 4. *See* Testimony of Daniel R. McKenzie, Attachment 24.1.

9. TWAxS's recommendation regarding the reclassification of services from Cell 2 to Cells 1, 3 or 4 is linked to TWAxS's overall support for a price index form of economic regulation. If the Commission approves an alternative regulation plan that does not include such a price index (which would be contrary to Ohio Bell's proposal and to TWAxS's recommendation), it may be necessary to retain Cell 2 as a service category in order to establish a pricing constraint on services which fall in this Cell. Assuming such a roundabout method of price protection is unnecessary - i.e., that an overall price index would exist and thus would serve to constrain average rates — Cell 2 is not necessary.

10. Staff Report at 45.

11. Although Ohio Bell's overall average price change would be constrained by the price cap index, by raising rates for inelastic services and lowering rates for services that exhibit elasticity of demand (thus stimulating new demand), Ohio Bell could comply with the overall price cap yet generate additional revenue.

V. SAFEGUARDS AGAINST CROSS-SUBSIDIZATION

1. TWAxS objects to Staff's omission of any discussion of the relationship of OBT's application for alternative regulation to OBT's various efforts at the federal level to seek relief from prohibitions on interLATA service, and OBT's applications with the Department of Justice or Federal Communications Commission ("FCC") to provide video dial tone service. Staff erred in not identifying and exploring the implications of the clear link between Ohio Bell's efforts at the state level to obtain substantial flexibility in the way that it sets prices for its noncompetitive services and establishes depreciation rates, and Ohio Bell's multifaceted attempts to enter new competitive markets.

2. TWAxS is encouraged by the Staff Report's careful review of OBT's LRSIC studies and methodology, but objects to the Staff Report's failure to identify and explore the relationship between Ohio Bell's LRSIC studies and Ohio Bell's construction planning and budgeting process. Ohio Bell indicated that the costs reflected in the LRSIC studies will "include all costs that are affected by the decision under consideration and will exclude costs that do not change as a result of the decision. Since relevant costs arise from a decision, the circumstances surrounding the decision provide the framework from which relevant costs are calculated."[12] TWAxS objects to the Staff Report's oversight of the essential matter of defining the "circumstances surrounding the [deployment] decision," and the Staff Report's related failure to require explicit cost-causation principles to be incorporated into the implementation of LRSIC studies. By way of illustration, if Ohio Bell decides to deploy video services, it is essential that the LRSIC that is conducted for video services reflect fully *all the costs that are associated with the decision to deploy such services,* including a reasonable share of common overhead costs.

3. TWAxS objects to Staff's failure to recommend that the Commission make clear in this proceeding that underlying "input" data, assumptions and complete cost modelling information should be made available to all parties so that parties have the opportunity to make an independent assessment of the validity of OBT's cost studies. Absent close scrutiny of OBT's assumptions and cost studies, ratepayers are at risk of OBT failing to allocate costs associated with its deployment decisions to those services that it is able to offer as a result of such deployment. The minimum LRSIC prices should be established at incremental costs inclusive of all expenditures without which the proposed services could not exist (which include all measurable direct costs) plus a reasonable share of common overhead costs. TWAxS objects to the Staff Report's failure to recommend with specific reference to OBT's deployment of fiber optic facilities or other plant capable of being used to provide video service that for all such plant (other than interoffice facilities), OBT should have the burden of proving that the plant was not installed for the benefit of and to facilitate OBT's provision of video services.

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12. OBT Ex. 28.0 at 12.

VI. COMMITMENTS OF OHIO BELL

A. Infrastructure Commitments

1. TWAxS is encouraged by the Staff Report's support for "the removal or elimination of monopolistic barriers to entry which may preclude effective competition,"[13] and by the Staff Report's specific recommendations regarding such barriers as number portability, uniform terminating compensation for local traffic, and 1+ intraLATA presubscription. TWAxS objects, however, to the Staff Report's failure to comment critically on OBT's omission of any explicit commitments to eliminating barriers to competition in OBT's service area. Other providers of telecommunications service are striving to contribute to the development of an innovative and diverse telecommunications market, but the degree to which such competition can efficiently and effectively develop depends greatly on the removal of barriers to new entrants. Also, TWAxS objects to Staff's failure to recommend the establishment of a process, overseen by a neutral, independent party, to ensure that OBT is not thwarting the development of a competitive and diverse telecommunications industry. Furthermore, TWAxS objects to the Staff Report's failure to identify other measures that should be taken by OBT to promote effective and efficient competition, such as access by competitors to service control points for queries to intelligent network databases; access for "competitors" to databases and OBT's commitment to unbundle the local network.

2. TWAxS objects to the Staff Report's failure to reject the unwarranted assumption that OBT is the most appropriate supplier of fiber optic facilities or other communication systems for schools and public institutions and of services and support personnel for education and distance learning in the State of Ohio. TWAxS also objects to the Staff Report's failure to recommend a process (such as a competitive bidding process) that would permit the innovation and efficiency of the market place to cost effectively address the communication needs of schools and other institutions.

3. TWAxS objects to the Staff Report's failure to require that OBT's captive customers not underwrite the Applicant's proposed universal deployment of a fiber optic based, two-way fully interactive, multi-channel distance learning network (i.e., to public high schools, colleges and universities). TWAxS objects to the Staff Report's apparent acquiescence in OBT's assumption that the most extensive **OBT** distance learning network is in the public interesty.

4. While TWAxS agrees with the Staff Report's conclusion that OBT should be required to file its proposed educational tariffs in this proceeding, TWAxS objects to the Staff Report's endorsement of "discounted" rates for such service. *See*, Staff Report, p. 109. OBT should be required to demonstrate that its education tariffs are cost justified. TWAxS objects to Staff Report's failure to identify and condemn the anticompetitive effects that would result from below-cost pricing of such services.

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13. Staff Report at 74.

B. Pricing Commitments

1. TWAxS objects to the Staff Report's failure to require clarification of OBT's commitment to "not increase" residential or business exchange access and local usage rates for the first three years of the plan. *See generally*, NRRI Report, Recommendation 7.5. Because of the importance of this commitment, it is not sufficient for the Staff Report to simply declare its belief as to the Applicant's intention. *See*, Staff Report at 106. As explained in the NRRI Report, Ohio Bell has not explained whether the cap is based on a revenue requirement, in which case rates for individual services could change up or down. Also, if the commitment is construed to freeze all rates at *exactly* current levels, it would prevent residential or business access rates from benefitting from a *decrease* that would otherwise be due under the price cap formula.[14] Ohio Bell's costs are declining, and, therefore, the alternative regulation plan should incorporate a clear mechanism for flowing through the benefits of reduced costs to customers of Cell 1 services during the term of the plan.

C. Public Input Commitments

1. While TWAxS concurs with Staff Report's recommendation to require OBT to propose and justify a specific program for public input and education, TWAxS objects to the Staff Report's implicit assumption that OBT is the appropriate entity to gather, analyze, and disseminate information pertaining to the development and supply of advanced telecommunications services. That role should be reserved for a neutral, independent and objective entity.

VII. CONCLUSION

OBT's proposal affords the Company excessive flexibility in rate-setting and the deployment of advanced services, and does not deliver to ratepayers a fair and adequate share of the productivity benefits that OBT would derive from alternative regulation. OBT's proposal also fails to eliminate barriers to competition in OBT's service area and would inhibit progress toward Ohio's goals of innovation and diversity in the supply of telecommunications services. TWAxS applauds the Staff Report for successfully identifying many of the most serious deficiencies in OBT's alternative regulation plan. More detailed and critical attention needs to be focused, however, on eliminating certain aspects of OBT's plan which, if approved, would

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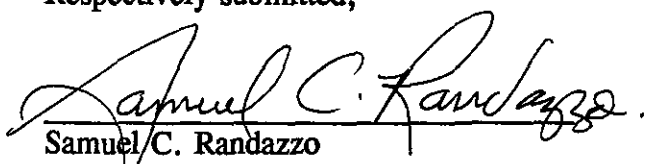
14. Ohio Bell "commits" to not raising the rates for any basic exchange services in the first twelve months of its plan and also commits to not raising rates for exchange access and local usage for an additional 24 months of its plan. Testimony of Daniel R. McKenzie at 20.

discourage competitive entry and investment in Ohio, thus denying Ohio's citizens the benefits of innovation, reasonable rates, and diversity in the supply of communication services.

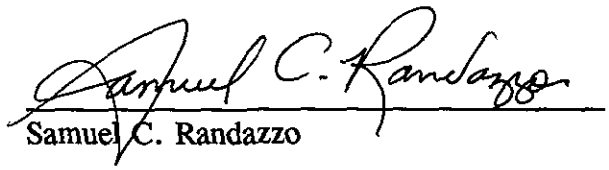
Respectively submitted,



Samuel C. Randazzo
Richard P. Rosenberry
J. Richard Emens
EMENS, KEGLER, BROWN, HILL & RITTER
65 E. State Street, Suite 1800
Columbus, OH 43215-4294
614-462-5400 (T)
614-464-2634 (F)

CERTIFICATE OF SERVICE

I, Samuel C. Randazzo hereby certify that a copy of the foregoing Objections to Staff Report, was served upon the following parties of record this 25th day of April, 1994, via electronic transmission, hand-delivery or ordinary U.S. mail, postage prepaid.



Samuel C. Randazzo

Via Facsimile/Federal Express

Michael Mulcahy, Esq.
William H. Hunt
Ohio Bell Telephone Company
45 Erieview Plaza, Suite 1400
Cleveland, OH 44114

Via U.S. Mail

Jon F. Kelley, Esq.
Senior Attorney
Ohio Bell Telephone Company
150 East Gay Street
Columbus, OH 43215

Bruce J. Weston, Esq.
American Association of Retired Persons ("AARP")
169 W. Hubbard Ave
Columbus, OH 43215-1439

Judith B. Sanders, Esq.
Allnet Communication Services, Inc.
IXC Coalition
LCI International Telecom, Inc.
c/o Bell, Royer & Sanders Co., L.P.A.
33 South Grant Avenue
Columbus, OH 43215-3927

Barth E. Royer, Esq.
IXC Coalition
LDDS Communications, Inc.
c/o Bell, Royer & Sanders Co., L.P.A.
33 South Grant Avenue
Columbus, OH 43215-3927

Robin P. Charleston, Esq.
Larry Salustro, Esq.
AT&T Communications of Ohio, Inc.
AT&T Legal Department
227 W. Monroe St., 6th Floor
Chicago, IL 60606

Judith M. Troup
AT&T Communications of Ohio, Inc.
65 E. State St., Suite 1500
Columbus, OH 43215

Sally W. Bloomfield, Esq.
Cablevision Lightpath, Inc.
New Par Companies
c/o Bricker & Eckler
100 South Third Street
Columbus, OH 43215

Mary W. Christensen, Esq.
New Par Companies
Northern Ohio Cellular Telephone
c/o Bricker & Eckler
100 South Third Street
Columbus, OH 43215

William M. Ondrey Gruber, Esq.
City of Cleveland
Room 106 City Hall
601 Lakeside Avenue
Cleveland, OH 44114

Kerry Bruce, Esq.
City of Toledo
Department of Public Utilities
One Government Center
Toledo, OH 43667-0001

William A. Adams, Esq.
Bell Communications Research, Inc.
c/o Arter & Hadden
One Columbus
10 West Broad Street
Columbus, OH 43215

CERTIFICATE OF SERVICE (Cont'd)

Gregory J. Dunn, Esq.
City of Columbus
c/o Crabbe, Brown, Jones, Potts & Schmidt
500 South Front Street, Suite 1200
Columbus, OH 43215

John W. Bentine, Esq.
City of Columbus
c/o Chester, Willcox & Saxbe
17 South High Street, Suite 900
Columbus, OH 43215

John C. Klein, Esq.
Assistant City Attorney
City of Columbus
90 West Broad Street
Columbus, OH 43215

Robert Ganton, Esq.
Department of the Army
901 North Stuart Street
Room 400
Arlington, VA 2203-1837

Ellis Jacobs, Esq.
William A. Thorman, III, Esq.
Edgemont Neighborhood Coalition
c/o Legal Aid Society of Dayton
333 West First Street, Suite 500
Dayton, OH 45402

Joseph P. Meissner, Esq.
Greater Cleveland Welfare Rights Organization, Inc.
1223 West Sixth Street
Cleveland, OH 44113

Douglas W. Trabaris, Esq.
MCI Telecommunications Corporation
205 N. Michigan Avenue, Suite 3200
Chicago, IL 60601

Joseph M. Patchen, Esq.
MCI Telecommunications Corporation
c/o Carlile, Patchen & Murphy
366 E. Broad Street
Columbus, OH 43215

Dennis K. Muncy, Esq.
METAS
c/o Meyer, Capel, Hirshfeld, Muncy, Jahn & Aldeen
Athenaeum Building
306 West Church Street
P. O. Box 6750
Champaign, IL 61826-6750

William S. Newcomb, Jr., Esq.
Ohio Cable Television Association
c/o Vorys, Sater, Seymour & Pease
52 East Gay Street
P. O. Box 1008
Columbus, OH 43216-1008

Daniel A. Malkoff, Esq.
Assistant Attorney General
Ohio Department of Administrative Services
30 East Broad Street
Columbus, OH 43215-3428

Sheldon A. Taft, Esq.
Ohio Library Council
Ohio Newspaper Association
c/o Vorys, Sater, Seymour & Pease
52 East Gay Street
P.O. Box 1008
Columbus, OH 43216-1008

Randy J. Hart, Esq.
Ohio Public Communication Association ("OPCA")
c/o Hahn, Loeser & Parks
3300 BP America Building
200 Public Square
Cleveland, OH 44114-2301

Maureen R. Grady, Esq.
Janine L. Migden, Esq.
Ohio Public Communication Association ("OPCA")
Hahn, Loeser, & Parks
Suite 200
431 East Broad Street
Columbus, OH 43215-3820

Mary A. Hull, Esq.
ATTN: Rhonda McClearen
Sprint Communications Company
8140 Ward Parkway
P. O. Box 8417
Kansas City, MO 64114-0417

CERTIFICATE OF SERVICE (Cont'd)

David C. Bergmann, Esq.
Barry Cohen, Esq.
Andrea Kelsey, Esq.
Office of Consumers' Counsel
77 S. High Street, 15th Floor
Columbus, OH 43215

Karin W. Rilley, Esq.
Assistant Attorney General
Office of the Attorney General
Education Section
30 East Broad Street, 15th Floor
Columbus, OH 43266-7250

Gena M. Doyscher
Enhanced Telemanagement, Inc.
730-2nd Ave. S. Suite 1200
Minneapolis, MN 55402

Jodie L. Donovan, Esq.
TCG America, Inc.
Teleport Communications Group, Inc.
One Teleport Drive
Staten Island, NY 10311

Robert Hegler
Swidler & Berlin
3000 K. Street, NW
Suite 300
Washington, DC 20007

Clyde Kurlander
Law Offices
TCG America, Inc.
Three First National Plaza
Suite 4000
Chicago, IL 60602

Calvin Manshio
TCG America, Inc.
4201 N. Sheridan Road
Chicago, IL 60613

Madelon Kuchera
TCG America, Inc.
c/o TC Systems - Illinois, Inc.
233 South Wacker, uite #2100
Chicago, IL 60606