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BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission)	
Investigation of the Intrastate Universal)	Case No. 97-632-TP-COI
Service Discounts)	
)	
In the Matter of the Applications to)	
Suspend Mirroring of Interstate)	
Switched Access Rates)	
)	
Little Miami Communications Corporation)	Case Nos. 97-1307-TP-ATA, et al.

SEPARATE REPLY COMMENTS OF THE APPLICANT SMALL TELEPHONE COMPANIES:

ARCADIA TELEPHONE COMPANY, ARTHUR MUTUAL TELEPHONE COMPANY,
AYERSVILLE TELEPHONE COMPANY, BENTON RIDGE TELEPHONE COMPANY,
BUCKLAND TELEPHONE COMPANY, CHAMPAIGN TELEPHONE COMPANY,
COLUMBUS GROVE TELEPHONE COMPANY,
CONTINENTAL TELEPHONE COMPANY, CONNEAUT TELEPHONE COMPANY,
DOYLESTOWN TELEPHONE COMPANY, FARMERS MUTUAL TELEPHONE COMPANY,
FORT JENNINGS TELEPHONE COMPANY, FRONTIER COMMUNICATIONS OF MI,
GERMANTOWN INDEPENDENT TELEPHONE COMPANY, GLANDORF TELEPHONE
COMPANY, KALIDA TELEPHONE COMPANY, LITTLE MIAMI COMMUNICATIONS
CORPORATION, MCCLURE TELEPHONE COMPANY, MIDDLE POINT HOME
TELEPHONE COMPANY, MINFORD TELEPHONE COMPANY, NEW KNOXVILLE
TELEPHONE COMPANY, NOVA TELEPHONE COMPANY, OAKWOOD TELEPHONE
COMPANY, ORWELL TELEPHONE COMPANY, OTTOVILLE MUTUAL TELEPHONE
COMPANY, PATTERSONVILLE TELEPHONE COMPANY, RIDGEVILLE TELEPHONE
COMPANY, SHERWOOD MUTUAL TELEPHONE ASSOCIATION, SYCAMORE
TELEPHONE COMPANY, TELEPHONE SERVICE COMPANY, VANLUE TELEPHONE
COMPANY, VAUGHNSVILLE TELEPHONE COMPANY, AND WABASH MUTUAL
TELEPHONE COMPANY

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I. Introduction

In its Entry of July 7, 1999,¹ the Public Utilities Commission of Ohio ("Commission" or "PUCO") requested comments on a number of issues pertaining to establishing an intrastate Universal Service Fund ("USF"). A consortium of thirty-three Ohio rural independent telephone companies ("the Companies")² appreciates the opportunity to reply to the comments that have been filed in this proceeding.

In their Initial Comments, the Companies proposed a comprehensive solution to the Dial Equipment Minute ("DEM") weighting and Transport Interconnection Charge ("TIC") shortfalls, as well as to future revenue reductions that will likely result due to mirroring. That solution was via a small-company plan which would allow optional local rate rebalancing toward a statewide target rate, interstate mirroring of access rates and transitioning of the DEM and TIC shortfalls into a new, targeted USF.³ Having reviewed all parties' Comments, the Companies maintain that their plan is the most comprehensive and achievable solution to assure preservation of universal service in high-cost areas served by rural Ohio local exchange carriers ("LECs").

¹ See *Commission Investigation of the Intrastate Universal Service Discounts*, Case No. 97-632-TP-COI and *Applications to Suspend Mirroring of Interstate Switched Access Rates*, Case Nos. 97-1307-TP-ATA, et al., Entry, July 7, 1999 ("OUSF Entry"). Filing deadlines in this proceeding were modified by an Entry issued on July 27, 1999.

² Companies submitting these comments include: Arcadia Telephone Company, Arthur Mutual Telephone Company, Ayersville Telephone Company, Benton Ridge Telephone Company, Buckland Telephone Company, Champaign Telephone Company, Columbus Grove Telephone Company, Continental Telephone Company, Conneaut Telephone Company, Doylestown Telephone Company, Farmers Mutual Telephone Company, Fort Jennings Telephone Company, Frontier Communications of Michigan, Inc., Germantown Independent Telephone Company, Glandorf Telephone Company, Inc., Kalida Telephone Company, Inc., Little Miami Communications Corporation, McClure Telephone Company, Middle Point Home Telephone Company, Minford Telephone Company, New Knoxville Telephone Company, Nova Telephone Company, Oakwood Telephone Company, Orwell Telephone Company, The Ottoville Mutual Telephone Company, Pattersonville Telephone Company, Ridgeville Telephone Company, Sherwood Mutual Telephone Association, Inc., Sycamore Telephone Company, Telephone Service Company, Vanlue Telephone Company, Vaughnsville Telephone Company and Wabash Mutual Telephone Company.

³ See A Plan for an Ohio Universal Service Fund, filed October 25, 1999.

II. While the Companies Recognize the Positions of those Parties That Recommend Maintaining the *Status Quo*, This is Not a Satisfactory Long-Term Solution for Rural Ohio LECs and their Customers

Some commenting parties recommend that the Commission should not make decisions on DEM/TIC shortfalls that would result from mirroring interstate access rates or on a permanent USF for rural LECs, but rather permit the status quo to remain in effect. The Companies urge the Commission to resist taking what may be perceived to be an "easier" route – that being the status quo – when a long-term solution exists. By taking no action, as the Companies' argue in their Initial Comments, the Commission may head down a path that could harm customers in Ohio's most-rural telephone exchanges.

The Ohio Telecommunications Industry Association ("OTIA") states that the unknown status of the FCC's decisions in its universal service⁴ and access charge reform⁵ dockets cause it to believe a permanent USF/access mechanism for rural LECs should not be pursued at this time.⁶ Ameritech Ohio ("Ameritech") recommends a similar approach, observing that new universal service mechanisms for small companies will not likely be implemented until 2001 at the earliest.⁷

The Companies note that the main difference between their positions and the positions presented by these parties may be one of timing and methodology, not principles. The OTIA supports the need for maintaining adequate support for rural, high-

⁴See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45.

⁵See *Access Charge Reform*, CC Docket No. 96-262 and *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77.

⁶See OTIA Comments at 2.

⁷See Ameritech Comments at 13.

cost networks such as those provided by Ohio's rural companies.⁸ Ameritech concurs with the Companies that a long-term solution to high-cost support for rural LECs should include the rebalancing of local service rates.⁹ Thus, there appears to be widespread industry support for the principles of the Companies' plan. The Companies contend that their plan will accommodate future FCC decisions, and thus, the Commission can begin to implement the plan now.

Nevertheless, if the Commission were to determine that it is unable to implement the Companies' plan at this time, maintaining the status quo would be an acceptable alternative in the interim. The Companies believe the status quo should only be maintained until the Commission issues its directives on a permanent high cost support structure for rural LECs.

The OUSF plan as proposed by the Companies gives the Commission the tools to establish a flexible, reliable apparatus with the correct mix of local rate rebalancing, access restructuring via mirroring and targeted, limited USF support, regardless of what measures the FCC ultimately takes. Were the Commission to decide to maintain the status quo, it would unfortunately waste this unprecedented opportunity and cause rural companies and their customers additional years of uncertainty. With all the protections that are built into the Companies' plan, the Commission should not be lured by the security of maintaining the status quo.

⁸ See OTIA Comments at 3.

⁹ See Ameritech Comments at 14.

III. The Companies Suggest if Earnings Tests are Adopted, the Earnings Standard Should be Reasonable, Flexible, and Used as a Mechanism to Adjust Support.

Some comments¹⁰ suggest that no support funds are necessary to replace revenues lost due to the mirroring of federal access rates. These comments are prefaced on the belief that many of the companies are earning in excess of what the commenters believe to be an appropriate return on investment. These commenters suggest that a rate-of-return standard should be adopted, and that any company with returns in excess of the standard should not be eligible for support. This notion is at odds with the way that universal service support (both implicit and explicit) has historically been provided. Compounding the problem of an earnings cap as a test for support funding is the fact that some parties are suggesting unreasonably low returns on investment as a standard.

A. Current earnings data for small companies do not suggest that earnings tests are necessary to determine eligibility for support.

The Companies note that the average rates-of-return used by some commenters to suggest that support funds are not necessary to replace funds lost due to access mirroring do not take account of individual company situations, but only address the Companies as a group.¹¹ While the Companies as a group may be achieving returns on investment beyond what the commenters may consider to be necessary, an assertion that is open to debate, the same certainly may not be true of individual companies within the group.

The Companies also note that, as a group, their returns on investment are substantially less than larger companies in Ohio. The OCC presents an analysis of

¹⁰ See MCI Worldcom ("MWCOM") Comments at 3, AT&T Corporation ("AT&T") Comments at 6, Ohio Consumers' Counsel ("OCC") Comments at 15.

¹¹ See AT&T Comments at 6, MWCOM Comments at 3.

company returns on equity in Attachment 3 of its comments. This data shows that small LECs earned about one-third less on a return on equity basis than did large companies from 1994 through 1998.¹² In fact, the small companies' average return is likely well within the bounds of capital cost benchmarks suggested by some parties in the FCC's CC Docket No. 98-166, which prescribes an authorized rate-of-return for interstate services.¹³

B. To the extent that small companies' rate-of-return is considered, the Commission should only use it to adjust the amount of support and not to determine whether a company is eligible to receive support.

The Companies suggest that to take into account the volatility they experience in earnings and the effect that could have on support funding, if the Commission adopts a rate-of-return benchmark, it should use that threshold to adjust the amount of support a company receives, not to determine whether a company is eligible for support. By using the rate-of-return threshold in this manner, the Commission would not be providing universal service support beyond an earnings level it deems inappropriate.

C. If the Commission implements a rate-of-return benchmark to determine companies' OUSF support, that benchmark should be higher, not lower, than the current FCC authorized rate of 11.25 percent.

Some commenters suggested that the Commission adopt a rate-of-return benchmark substantially lower than the FCC's currently authorized rate of 11.25 percent.¹⁴ MWCOM does not specify a benchmark level, but concludes that the FCC will

¹² The Companies also note that they do not necessarily agree with the OCC's classification of companies into the groups shown in Attachment A of the OCC's Comments. A different grouping of the companies could result in a different estimate of funding need.

¹³ See *Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 98-166, Joint Responsive Case and Reply Comments of Local Exchange Carrier Associations, March 16, 1999, at 6. The parties conclude that the cost of capital for ILECs is at least 13.95 percent.

¹⁴ See AT&T Comments at 4.

adopt a benchmark return lower than the current rate.¹⁵ AT&T's and MWCOT's characterization of the FCC's possible actions are, at best, premature. However, small companies face significant risks which would warrant the setting of any benchmark rate-of-return above, not below, the current FCC authorized rate of 11.25 percent. Two major sources of risk are regulatory risks and competitive risks.

1. Regulatory Risks Facing Rural Companies

As noted in their initial comments, the Companies' derive the majority of their regulated revenues (62 percent) from access services. The FCC has initiated a rulemaking in which it is considering access charge reforms for rate-of-return companies similar to the changes it has implemented for price cap LECs.¹⁶ No decision has been reached in this docket; thus, the effect on access revenues is unknown.

A new federal mechanism for rural universal service will not be considered until January 1, 2001 at the earliest. Thus, it will be at least another year before the outcome of any changes to federal rural universal service funding will be known.

Small companies also face risks from increased costs due to additional regulatory requirements placed on them through the FCC's implementation of the Telecommunications Act of 1996 ("the Act").¹⁷ Requirements such as local number portability ("LNP"), customer proprietary network information ("CPNI") protection requirements which require audit trails regarding the accessing of customer records by

¹⁵ See MWCOT Comments at 3.

¹⁶ See *Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of-Return Regulation*, CC Docket No. 98-77, FCC 98-101 (rel. June 4, 1998).

¹⁷ Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56, codified at 47 U.S.C. §§ 151 et. seq.

employees, and new law enforcement requirements imposed under the Communications Assistance for Law Enforcement Act impose substantial new compliance costs, often without assurance that such costs will be recovered.

2. Competitive Risks Facing Rural Companies

OCC has suggested that rural companies are not subject to competition because they are subject to Sec. 251(f)(1) of the Act,¹⁸ often referred to as the “rural exemption”. However, this exemption is not guaranteed. In fact, the PUCO currently has a proceeding open in which it has said that competition has been slow to develop in rural markets and announced that it wishes “. . . to explore ways to incent providers to enter the rural and residential markets. . . .”¹⁹ It is apparent from these statements that the Commission may not intend the “rural exemption” to insulate small companies from competition.

The potential opening of small company markets to competition introduces uncertainty with regard to regulatory compliance costs, the costly process of defending exemptions if challenged, and operational changes in order to comply with interconnection and other requirements from which they would no longer be exempt. The risk of competition is compounded for small companies by the size and composition of the markets they serve, such as not experiencing substantial business and residential growth.

In addition to potential competition through the use of small companies’ facilities by a competitor, small companies also face potential competition from other facilities-

¹⁸ See OCC Comments at 19.

¹⁹ See *Commission Ordered Investigation of the Existing Local Exchange Competition Guidelines*, Case No. 99-998-TP-COI, Entry, August 26, 1999, at ¶4.

based providers. Wireless technology is probably the most ideally suited to serve customers that are not densely concentrated enough to warrant the cost of laying physical lines between customers. Wireless providers are already widely deployed in rural areas. While wireless providers may not be offering services that are viewed as perfect substitutes for local service today, wireless providers are establishing customer relationships through the services that they are currently offering. These customer relationships will provide easier entry into the market when wireless technologies and services that are clear substitutes for local service are introduced.

D. If the Commission decides to adopt some measure of earnings in determining eligibility for support, it should allow companies the option of electing either a rate-of-return on net plant or a return on equity.

The OCC suggests that return on equity is the only appropriate standard for an earnings benchmark.²⁰ The Companies agree that return on equity may be an appropriate standard, but think that this standard alone is too limiting.

The OCC notes that small LECs have vastly different capital structures.²¹ Some small LECs have a 100 percent equity capital structure, while other small LECs rely primarily on debt financing. These significant differences are precisely the reason why the Commission should allow companies to elect a measurement based either on return on net plant or a return on equity. Adopting one standard will unfairly treat companies that have not managed their capital structures to take advantage of the standard. Allowing companies the option to choose either standard will allow them to manage their

²⁰ See OCC Comments at 20.

²¹ Ibid.

capital structures as they see fit, without trying to align their capital structures to a particular regulatory construct.

IV. Local Rate Cases and Local Cost Studies Would be a Time-Consuming, Inefficient, and Costly Manner of Dealing with Access Reform and Universal Service Issues.

Some commenters have suggested that cost studies should be performed by small rural companies to determine the current relationship between costs and local rates.²²

These commenters believe that cost studies are necessary to determine if rates are exceeding the cost of providing service. Another issue discussed by many commenters is whether variances in calling scope between rural and non-rural customers should be accounted for in the Commission's determination of a "reasonable" rate. Finally, some comments have suggested that the pressure to raise local rates should be addressed through individual rate cases. The Companies believe each of these issues raise significant problems, which can be adequately remedied with the proposed OUSF plan.

A. It is not necessary to construct cost studies to determine whether rural LECs' rates are currently below cost.

Some commenters have suggested that cost studies should be conducted to determine whether small companies are charging local rates that are above the cost of providing service.²³ There are several reasons why such cost studies are not necessary.

1. Cost studies developed for rural exchanges of non-rural companies such as Ameritech should not be used as a proxy for the costs of rural companies.

²² See OCC Comments at 27, Ameritech Comments at 6, MWCOM Comments at 7.

²³ See OCC Comments at 27, MWCOM comments at 7. MWCOM does not directly say that cost studies should be constructed for small companies, however, it discusses the determination of reasonable rates based on economic cost, inferring that cost studies would be necessary to make such a determination.

The OCC suggests that if it is not possible at this time for small LECs to construct cost studies, that the costs of the least-dense exchanges for non-rural LECs such as Ameritech may be used to approximate the costs for small rural LECs.²⁴ This suggestion is inappropriate for several reasons.

As OCC notes in its comments, Ameritech Ohio's forward-looking economic cost ("FLEC") studies have never been subject to public examination.²⁵ It would not be appropriate to use the results of any model without appropriate regulatory scrutiny. Secondly, FLEC models are based on the premise that the cost of providing service is based on the most efficient currently available technology at current prices. This means that for a company like Ameritech, the cost of providing service is estimated by developing a model network and pricing that network at current prices for all the components necessary to build a network (switches, cable, etc.). These current prices are commonly referred to as "input costs".

It is obvious that if Ameritech were to rebuild its entire network, it would receive large volume discounts for the number of switches, feet of cable, etc. that it would take to rebuild a network of that size relative to a network the size of that served by small companies. Thus, input costs for large companies such as Ameritech would understate the costs for small companies. Since this cost differential applies to the whole network, it would carry through that the cost of providing service to rural exchanges in Ameritech Ohio's operating area would be understated relative to the costs for small rural LECs.

²⁴ See OCC Comments at 27.

²⁵ Ibid.

OCC indeed observes that Ameritech would have “efficiencies of scale” small LECs would not have.²⁶

Finally, because small LECs have a much smaller base of subscribers than large companies such as Ameritech, they tend to have higher overhead costs on a per-line basis, because they have fewer subscribers over which to spread relatively fixed expenses. OCC notes this discrepancy in its comments, mentioning that small LECs have a smaller base over which to spread joint and common costs.²⁷ Because of such vast discrepancies, non-rural cost studies are obviously not appropriate for use in determining rural LEC costs.

2. Publicly available cost study data for small companies indicates that current local rates are well below the cost of providing service.

To date, publicly available cost study models have been focused on providing costs for large, non-rural companies. This is largely because there was a current need to determine cost-based rates for unbundled network elements, and to develop the cost of providing local service for the federal proceeding that was establishing a new mechanism for universal service funding. However, there are currently no publicly available cost study data that have been widely reviewed and substantiated to estimate the cost of providing local service for small rural companies. The only major sources of publicly available cost data at this time are the Hatfield and BCPM models, although these models have not been verified to be accurate for rural companies.

²⁶ Ibid.

²⁷ Ibid.

Nevertheless, the results generated by the Hatfield and BCPM models indicate that local rates are currently far below the costs of providing local service for small companies. The Hatfield model produces an average monthly cost for local service of \$43.62 for the thirty-four small companies in Ohio, while the BCPM produces an average monthly cost for local service of \$50.20 per month for these companies.²⁸ While the Companies do not endorse the absolute costs generated by these models as being correct, the numbers clearly indicate that current local service rates in Ohio appear to be far below the costs of providing local service for small companies.

Given the large difference between the cost of providing local service for small companies indicated by publicly available models and the rates charged for such service, it would be a waste of time and money to develop cost studies so early in the process of access reform and universal service restructuring. If local service rates are dramatically increased over time, the PUCO may wish to reexamine the issue at a later date. In the meantime, the statewide affordable rate target proposed in the Companies' OUSF plan – or a rate close to it – is reasonable.

3. Company-specific cost studies for small companies would be difficult to maintain, and monitoring such studies would be an inefficient use of Commission resources.

Some parties²⁹ have proposed that FLEC studies be performed to determine the cost of providing local service for small companies.³⁰ The construction of company-

²⁸ These estimates were developed from independent runs of the model using default inputs contained in the Hatfield and BCPM Models.

²⁹ See OCC Comments at 27, Ameritech Comments at 6.

³⁰ The Companies would note that FLEC may not be an appropriate standard for cost for rural companies, as it may not allow them to recover embedded costs for which investments have already been made.

specific cost studies would be a very resource-intensive task, both for the Companies and the Commission. As mentioned previously, FLEC models rely heavily on current input costs. Publicly available models such as Hatfield and BCPM have input tables with thousands of items for which prices must be gathered. One of the more reliable methods for gathering such data is for companies to refer to recent purchases for given items. Obviously this is a very time-consuming process. However, even this method of gathering data is not adequate for all purposes.

FLEC models assume that the entire network is built at once, instead of being gradually built as new areas are served – as is the case in practice. Thus, prices paid for some components of the network such as cable will not reflect volume discounts that could perhaps be obtained if cable were purchased to construct the entire network at once instead of in increments. To adequately assess the possible effect that volume purchasing might have, it is best to obtain quotes from vendors for the volumes of inputs in question. Requesting and receiving quotes from vendors can also be a time-consuming process.

In order for the Commission to fairly assess the validity of any FLEC model for small companies, a review of the inputs would be just one of the components of the model it would need to examine. And this review would not just occur on a one-time basis, as models will need to be periodically updated to reflect the most current technologies and input costs.

Publicly available FLEC models also contain complicated computer code and mathematical code which must be verified to assure that the models are working correctly. Since there is no comprehensive data available on the location of customers (public or private), the existing models have extensive algorithms that attempt to model

where customers are located. These are also components that would need to be thoroughly reviewed before a model could be considered to produce valid results and used for any regulatory purposes.

The foregoing discussion illustrates that the construction and validation of a FLEC model would likely be a timely and costly process – especially if it were to be used by all applicant companies. Given the large difference between costs estimated by publicly available models and the current rates for local service cited previously, the expenditure of resources is certainly not warranted at this time.

B. The Companies agree that ideally differences in calling scope between rural and non-rural customers would be considered in the determination of a “reasonable” rate.

Some commenters have suggested that variance in calling scope between rural and non-rural customers may be a significant factor that should be accounted for in some manner in the Commission’s determination of a “reasonable” rate.³¹ The OCC recommends that the Commission account for the difference by adopting a local rate cap of \$18.00, or 25 percent above Ameritech Ohio’s local rate of \$14.40.³²

1. While the concept of accounting for differences in calling scope is reasonable, it would be almost impossible to implement in practice on a company-specific basis.

The Companies understand that the number of customers that one can call within a local service area oftentimes has a bearing on the perceived value of local service to the customer. However, it would be impossible to quantify this difference in value caused by

³¹ See OCC Comments at 38-40.

³² See OCC Comments, Attachment A at 2.

variances in calling scope between Ohio's rural and non-rural companies, especially on a company-specific basis.

The OCC's proposal, that small company local service rates should not be more than 25 percent higher than Ameritech Ohio's basic local service rate of \$14.40, appears to be an arbitrary solution to account for differences in local calling scope. OCC offers no explanation as to the development of the 25 percent higher criterion.

Data gathered by the OCC illustrate the difficulty in trying to place a dollar value on the difference between rates and calling scopes for the small and large companies in Ohio.³³ There is a patchwork of different local rates, varying numbers of access lines which can be reached within the local calling areas, some exchanges which can reach county seats at flat rates while others cannot, and some exchanges which can call contiguous exchanges at flat rates while others cannot. Clearly, there is no reasonable, specific, fair-across-the-board way to account for these differences.

2. Artificially low basic residential rates contained in large LECs' alternative regulation plans should not be used as a starting point from which to structure basic local rates for other companies based on differences in calling scope.

The OCC suggests³⁴ that Ameritech Ohio's basic local service rate of \$14.40 per month should be used as a starting point from which to measure the affordability of local rates of small companies based on differences in calling scope. This suggestion is not appropriate, as this rate was agreed to in an alternative regulation process in exchange for price-cap flexibility in setting other rates. Since the small companies are not operating

³³ See OCC Comments at Attachment B.

³⁴ See OCC Comments at 39.

with similar pricing flexibility, the use of this rate would constrain the small companies to a low local service rate without offsetting benefits in terms of pricing flexibility which were gained by Ameritech Ohio and other large companies.

C. Using individual rate cases to provide adequate revenue streams to support universal service would be inefficient and costly for the Commission, the Companies, and the Companies' customers.

MWCOM and the OCC have suggested that individual rate cases are the solution to providing adequate revenue streams to support universal service.³⁵ This process would be inefficient and costly for the Commission, the Companies, and the Companies' customers. Instead of addressing the situation comprehensively, the Commission would be faced with developing a piecemeal solution through rate cases. The workload for the both the Commission and the Companies would likely be far greater from a number of individual cases filed at different times with somewhat differing issues than from a comprehensive proceeding. The processing of individual rate cases would be expensive for the Companies, and the cost of these rate cases would ultimately be borne by the Companies' customers. As the Companies respond to a series of decisions yet to be made by the FCC regarding access reform and universal service implementation for rural companies, there might be a need to file new rate cases even before prior cases had been decided.

D. The Companies' plan establishes a reasonable benchmark for local rates, and would not require local cost studies and local rate cases in order to be implemented.

As proposed in the Companies' initial comments, the Companies' plan suggests a maximum reasonable rate of \$23.92 per line per month (including touch-tone service, the

³⁵ See MWCOM Comments at 4, OCC Comments at 24.

interstate subscriber line charge, and the E911 surcharge) for both residential and non-residential subscribers. That rate would be one percent of the statewide median household income from the 1990 Census.³⁶

The Companies believe that this is both a “reasonable” and an “affordable” rate. Because the Companies suggest that the rate be one percent of median household income, the target rate would move up and down with changes in state household income, making it “affordable” in response to economic changes. It is also well below the cost of providing local service, as discussed previously in this section.

Finally, since the Companies’ plan would establish an explicit universal service mechanism, local rate cases would not be necessary, because explicit funding would replace revenues that are currently coming from other sources but would be in jeopardy due to policies such as mirroring.

V. Costs Associated with DEM and TIC are Legitimate Costs which Should be Recovered, and the Companies’ Plan Provides an Explicit Mechanism for Recovery.

There are several issues regarding access costs and the policies and mechanisms for recovering those costs contained in the comments, all requiring replies. The Companies recommend that their plan is the only reasonable means to assure the recovery of DEM/TIC costs through explicit mechanisms, and would allow the Commission’s successful policy of mirroring access rates to continue.

A. The Commission’s policy of mirroring has been an efficient method of dealing with access cost recovery.

³⁶ See A Plan for an Ohio Universal Service Fund at 21.

AT&T suggests that mirroring should be discontinued at an unspecified future date.³⁷ This suggestion does not recognize the historical context of the Commission's policy of mirroring. This policy has been an efficient means to set state access rates and assure sufficient access cost recovery. Company resources have not been devoted to the task of developing state access rates and tariffs, and Commission resources have not been devoted to review of individual tariffs. The aforementioned comments suggest that mirroring be discontinued, without suggesting any means to replace sufficient cost recovery which mirroring has provided.

Adoption of the Companies' plan would allow for the successful policy of mirroring to continue, by providing an explicit universal service support mechanism to assure sufficient access cost recovery. This plan would allow mirroring to be reestablished to reflect current interstate access rates, and would allow for mirroring to continue into the future as changes are made to access structures and universal service mechanisms.

B. DEM weighting accounts for real differences in costs of processing local minutes versus toll minutes.

The Companies agree with the views of the OCC and ICORE³⁸ that DEM weighting is a procedure that is used to account for real differences in the cost of processing local minutes versus toll minutes. The views discussed in greater detail to follow indicate that the arguments made by parties such as MWCOM, which suggest that

³⁷ See AT&T Comments at 9.

³⁸ See OCC Comments at 29-30, ICORE Comments at 5-7.

DEM weighting is purely a subsidy element not related to the cost of providing the service,³⁹ are without merit.

DEM weighting is an appropriate allocation of cost because it recognizes differences in switch utilization time. The OCC and ICORE comments note that each minute of toll use causes higher local switching costs than a minute of local use. This is because a toll call that lasts one minute will use the switch at the originating end and terminating end of the call for one minute each, resulting in total use of local switching equipment of two minutes. Conversely, a local intraoffice call lasting one minute will only use local switching equipment for a total of one minute, because the call is originating and terminating in the same switch. Thus, DEM weighting results in a cost-based allocation of switching costs, because toll and switched access services utilize more than one minute of local switching resources to complete a one-minute call.

ICORE also defends DEM weighting as a proper method to allocate costs because it recognizes that a disproportionately large share of the costs of a small company's switching plant are attributable to toll network functions. Most of the expensive features contained in digital switches are for toll processing functions such as SS7, equal access, translation and recording. Since the processing of local and EAS traffic does not require the use of these expensive features, a methodology that assigns the costs to the traffic with which they are associated is appropriate.

³⁹ See MWCOM Comments at 4.

C. While the source of funding for DEM weighting has shifted, the FCC continues to recognize that the costs associated with DEM weighting are legitimate costs that must be recovered.

Some parties argue that DEM weighting is a subsidy and should be eliminated.⁴⁰

However, this suggestion runs counter to the treatment of DEM weighting by the FCC and the reasoning it used to develop its current position. In its Report and Order on universal service,⁴¹ the FCC adopted the Joint Board's recommendation that the amount formerly generated by DEM weighting be recovered by new universal service mechanisms. The FCC ordered that local switching access rates be calculated with DEM weighting at 1.0 (instead of 2.5 or 3.0) beginning on January 1, 1998. However, at the same time the FCC established a new universal service mechanism to ensure that the revenues that would have been recovered through DEM weighting were recovered through a new means.

As a matter of fact, the FCC rejected a fixed per-line recovery mechanism suggested by the Joint Board because the FCC thought that it would not provide adequate support for providing universal service.⁴² The FCC believed that the per-line mechanism might not provide rural carriers with sufficient resources to enable them to make necessary upgrades to their switching facilities so that they could continue to offer quality services to their customers. Thus, the record is very clear that while the recovery

⁴⁰ See MWCOC Comments at 4, AT&T Comments at 6. AT&T says the Commission must determine whether there is a need for intrastate DEM support in Ohio, but tentatively concludes that the information available indicates that small LECs do not need a universal service fund.

⁴¹ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45, Report and Order, FCC 97-157, (rel. May 8, 1997) at ¶303.

⁴² Ibid.

mechanism for costs associated with DEM weighting has been changed, the FCC felt strongly that these costs needed to be recovered in order to support universal service.

D. The FCC reassigned costs associated with tandem-switching functions from the TIC to tandem switching access rates, but continued to recognize these costs as valid costs that must be recovered.

MWCOM suggests that the TIC portion of access charges is a subsidy and should be eliminated.⁴³ However, while the FCC reassigned certain costs associated with tandem-switching functions in its First Report and Order on access charge reform⁴⁴ in response to a court remand, the FCC continued to recognize that all costs that were recovered through the TIC were legitimate costs that must be recovered.

The reassignment of TIC costs related to tandem switching caused some cost-recovery problems in the intrastate jurisdiction for small companies that do not own tandem switches due to mirroring. Costs for host/remote trunking and tandem port and multiplexer costs were reassigned from the TIC to the tandem-switched transport access element. In the interstate jurisdiction, the costs reassigned from the TIC were recovered from the National Exchange Carrier Association ("NECA") pool. Thus, the reassignment of costs was revenue neutral for companies participating in the NECA pool for the interstate jurisdiction.

However, since none of the small companies in Ohio own tandem switches and there is not a similar pooling mechanism in the intrastate jurisdiction, the Companies could no longer recover costs associated with these parts of the network that had been recovered through the TIC. This input led the PUCO, under Case Nos. 97-1307-TP-ATA

⁴³ See MWCOM Comments at 4.

⁴⁴ See *Access Charge Reform*, CC Docket No. 96-262, First Report and Order, 12 FCC Rcd 15982 (1997).

et al., to allow small companies to break the mirroring of interstate access charges for the TIC.

E. The Companies' plan is the only proposal to ensure that DEM/TIC costs are recovered through explicit mechanisms, consistent with actions by the FCC.

The plan proposed by the Companies recognizes the same facts and principles used by the FCC in dealing with issues surrounding DEM and TIC. As previously discussed, the FCC modified the mechanisms for recovering costs associated with DEM and TIC, but found that the costs being recovered through these mechanisms were legitimate. To the extent possible, the Companies' plan recommends the same recovery mechanisms instituted by the FCC.

The Companies' suggestion that costs associated with DEM weighting be recovered through an explicit universal service mechanism mirrors the method being used to recover these costs by the FCC. Meanwhile, the FCC reassigned costs associated with tandem switching which were in the TIC to tandem-switched access elements. As mentioned previously, the Companies cannot recover these reassigned costs because they do not own tandem switches. The Companies have proposed that the tandem switching costs that were reassigned out of the TIC be recovered in the same method as costs associated with DEM weighting; that is, through an explicit universal service mechanism. This suggestion is administratively efficient, since it can be effectuated as part of the mechanism set up to recover DEM weighting costs.

F. It is premature to consider moving access rates to TSLRIC at this time.

AT&T recommends that certain interstate switched access service rates be mirrored for rural LECs until TSLRIC studies are available for these LECs.⁴⁵ While not mentioning a specific timeframe, the implication is that access rates for rural LECs should be moved to TSLRIC. This suggestion is premature at this stage of the process in universal service and access reform.

There are many issues to be addressed regarding access charge reform for non-price cap LECs and universal service implementation for rural LECs. The FCC has initiated a rulemaking proposing access charge reforms for rate-of-return companies similar to those instituted for price cap LECs, but no decisions have been made. The FCC has announced it will attempt to identify implicit subsidies in non-rural LECs' rates as part of its implementation of a new universal service mechanism for non-rural LECs.⁴⁶ The FCC has stated that it will not consider changes to the current universal service system for rural LECs until January 1, 2001 at the earliest. With all the issues yet to be decided at the federal level regarding access rates and universal service support for small companies, it would be unwise for the Commission to move access rates to TSLRIC at this time. Forthcoming federal decisions on these issues could cause the Commission to revisit several times a decision to move access rates to TSLRIC.

VI. The Companies Support the Commission's Authority to Implement an Intrastate Universal Service Fund.

Finally, Ameritech raises a question as to the Commission's authority to implement a universal service fund under Ohio law. Ameritech argues that the

⁴⁵ See AT&T Comments at 9.

⁴⁶ See *Federal-State Joint Board on Universal Service*, CC Docket No. 96-45 and *Access Charge Reform*, CC Docket No. 96-262, FCC 99-119, (rel. May 28, 1999) at ¶43.

Commission does not have requisite authority “to create and administer a state USF, to levy assessments to support it, or to take other action in furtherance of such a fund.”⁴⁷

Ameritech differentiates between the specific authority granted to *states* and *state commissions* in the Act, and further states that the Commission would need to be granted additional authority by the General Assembly in order to implement a USF.⁴⁸

The Companies believe the Commission has already closely examined whether it has such jurisdiction, and agree with the Commission’s assessment that it indeed does. In its Entry initiating this investigation, the Commission observed that Substitute Senate Bill 306 enacted by the General Assembly afforded the Commission, “. . . the power and jurisdiction as is reasonably necessary for the Commission to perform the acts of a state commission pursuant to the Telecommunications Act of 1996.”⁴⁹ The Commission also cites Section 254(f) of the Act, which gives the states specific authority to adopt measures, including contributions from carriers, to preserve and advance universal service.⁵⁰

A reasonable interpretation of Ohio statute and the powers granted state commissions under the Act makes it clear that the Commission has such authority to move forward with a state USF in order to carry out its obligations of meeting Ohio’s universal service goals.

⁴⁷ See Ameritech Comments at 11.

⁴⁸ Ibid.

⁴⁹ See OUSF Entry at ¶10.

⁵⁰ Ibid.

VII. Conclusion

After reviewing all the comments, the Companies still believe that the Commission should not delay implementing the Companies' plan to address the important issues of revenue reductions caused by the mirroring of interstate access rates and other universal service issues. Parties suggesting that the status quo be maintained differ with the Companies on the timing of a solution and not on the actions that need to be taken.

If the Commission adopts an earnings test as a mechanism for receiving support, such a test should only be used to adjust support, not to determine eligibility. If the Commission chooses to adopt an earnings standard, it should be a reasonable standard that recognizes the risks small LECs face.

Local cost studies for small companies are not necessary, as local rates are likely well below cost. Individual rate cases are not an efficient solution to the revenue shortfalls caused by mirroring interstate access rates, and would be costly and time consuming for the Commission, the Companies, and the Companies' customers.

Costs associated with DEM and TIC are legitimate costs which should be recovered. The Companies' plan provides an explicit mechanism for doing so.

The Companies support the Commission's authority to implement an intrastate universal service fund. The Companies believe that their plan offers a flexible solution which should be adopted now, as it can easily be adapted as further federal decisions regarding access reform and universal service for small companies are issued.

Respectfully submitted,

THE APPLICANT SMALL TELEPHONE COMPANIES

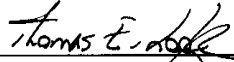
By: Thomas E. Lodge
Thomas E. Lodge (0015741)

Thompson Hine & Flory LLP
One Columbus
10 West Broad Street, Suite 700
Columbus, Ohio 43215-3435
(614) 469-3200

Their Attorney

CERTIFICATE OF SERVICE

The undersigned hereby certifies that the Separate Reply Comments of The Applicant Small Telephone Companies were served on November 23, 1999, by ordinary U.S. mail, upon the parties identified on the attached Service List.



Thomas E. Lodge (0015741)

Service List

Case Nos. In the Matter of the Commission Investigation of the Intrastate Universal Service Discounts, PUCO Case No. 97-632-TP-COI

In the Matter of the Application To Suspend Mirroring Of Interstate Local Switched Access Rates, Public Utilities Commission of Ohio,
Case Nos. 97-1307-TP-ATA -- 98-76-TP-ATA

Larry Whipkey
Alltel Telephone Services Corp.
P.O. Box 2177
Little Rock, AR 72203-2177

Dennis Depinet
Bascom Mutual Telephone Company
P.O. Box 316
Bascom, OH 44809

Kathy E. Hobbs
Alltel Ohio, Inc.
Fifth Third Center
21 East State Street
Columbus, OH 43215

Todd J. Stein
Brooks Fiber Communications of Ohio, Inc.
2855 Oak Industrial Drive
Grand Rapids, MI 49506-1277

Jon F. Kelly
Ameritech Ohio
150 East Gay Street, Room 4-C
Columbus, OH 43215

Paula K. Venema, Regulatory Affairs
Brooks Fiber Communications of Ohio, Inc.
2855 Oak Industrial Drive
Grand Rapids, MI 49506-1277

Michael T. Mulcahy
Attorney at Law
Ohio Bell Telephone Company
45 Erieview Plaza, Suite 1400
Cleveland, OH 44114

Boyd B. Ferris
Ferris & Ferris
2733 West Dublin-Granville Road
Columbus, OH 43235-4268

Lori Watiker
Ameritech Ohio
150 East Gay Street, Room 4-C
Columbus, OH 43215-3111

Vicki M. Norris
Century Telephone Company of Ohio
17 South High Street, Suite 1250
Columbus, OH 43215

David Chorzempa
AT&T Corporation of Ohio, Inc.
222 West Adams Street, Suite 1500
Chicago, IL 60606

Sandra M. Wolfe
Chillicothe Telephone Company
P.O. Box 480
Chillicothe, OH 45601-0480

William H. Keating, Esq.
GTE
5994 Whitecraigs Court
Dublin, Ohio 43017

Linda Claytor, Tariff/Billing Manager
Chillicothe Telephone Company
P.O. Box 480
Chillicothe, OH 45601-0480

Mr. Mark Romito
Donald I. Marshall
Assistant Vice President
Cincinnati Bell Telephone Company
201 East Fourth Street
Cincinnati, OH 45201

Tom McCould, Regulatory Specialist
Cincinnati Bell Telephone Company
P.O. Box 2301
Cincinnati, OH 45201

Jane E. Gettman
Columbus Grove Telephone Company
112 West Sycamore Street
Columbus Grove, OH 45830

Edgemont Neighborhood Coalition, Inc.
c/o Ellis Jacobs, Attorney at Law
Legal Aid Society of Dayton
333 West First Street, Suite 500
Dayton, OH 45402

Empowerment Center of Greater Cleveland
c/o Joseph P. Meissner, Attorney at Law
Director of Urban Development
1223 West Sixth Street
Cleveland, OH 44113

Eric Damman, Manager
Farmers Mutual Telephone Company
P.O. Box 118
Okolona, OH 43550

Shirley A. Berelsman, Office Manager
Fort Jennings Telephone Company
P.O. Box 146
Fort Jennings, OH 45844

Jeffrey P. Stommen
Frontier Communications of Michigan, Inc.
109 Randolph Street
Brooklyn, MI 49230-9370

Jack D. Phillips, Regulatory Staff Manager
Frontier Telephone Group
14450 Burnhaven Drive
Burnsville, MN 55306

Linda Heckman
Glandorf Telephone Company, Inc.
P.O. Box 31
Glandorf, OH 45848-0031

Jack W. Kennedy
GTE North, Inc.
100 Executive Drive
Marion, OH 43302

Christopher J. Marsh
Competitive Strategies
70 East Lake Street, 7th Floor
Chicago, IL 60601

Chris J. Phillips
Kalida Telephone Company, Inc.
P.O. Box 267
Kalida, OH 45853

Judith B. Sanders
Bell, Royer & Sanders Co., LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Matthew H. Berns
MCI Telecommunications Corporation
205 North Michigan Avenue, Suite 3700
Chicago, IL 60601

Ronald D. Long, General Manager
Middle Point Home Telephone Company
P.O. Box 41
Middle Point, OH 45863

Douglas W. Kinkoph
Nextlink Ohio, Inc.
Two Easton Oval, Suite 300
Columbus, OH 43219

Daniel Waggoner
2600 Century Square
1501 Fourth Avenue
Seattle, WA 98101-1688

Orwell Telephone Company
P.O. Box 337
Orwell, OH 44076-0337

Donald J. Hoerstein
Ottoville Mutual Telephone Company
P.O. Box 427
Ottoville, OH 45876

Joseph R. Stewart
Sprint
50 West Broad Street, Suite 3600
Columbus, OH 43215

Lee T. Lauridsen, Senior Attorney
Sprint Communications Company LP
8140 Ward Parkway
Kansas City, MO 64114

Madelon Kuchera
TCG Ohio
233 South Wacker Drive, Suite 2100
Chicago, IL 60606

Marsha Schermer, Vice President
Time Warner Telecom of Ohio, LP
65 East State Street, Suite 1800
Columbus, OH 43215

Ruby A. Rimer, Secretary-Treasurer
Vaughnsville Telephone Company
P.O. Box 67
Vaughnsville, OH 45893

Michael S. Lucas
The State Library of Ohio
65 South Front Street
Columbus, OH 43215-4163

Barry Cohen, Attorney at Law
Office of Consumers' Counsel
77 South High Street, 15th Floor
Columbus, OH 43266-0550

David C. Bergmann, Attorney at Law
Office of Consumers' Counsel
77 South High Street, 15th Floor
Columbus, OH 43215-0550

Roger Eversman
The New Knoxville Telephone Company
301 West Street
New Knoxville, OH 45871

William H. Hunt, Attorney at Law
Bank One Center, Suite 1300
600 Superior Avenue East
Cleveland, OH 44114-2650

Charles S. Rawlings, Esq.
2639 Wooster Road
Cleveland, OH 44116-2911

Benita A. Kahn, Attorney at Law
Vorys, Sater, Seymour and Pease
P.O. Box 1008
Columbus, OH 43216

Louise L.M. Tucker
Bell Communications Research, Inc.
2010 L Street, NW, Suite 600
Washington, DC 20037

William A. Adams, Attorney at Law
Arter & Hadden
One Columbus Building
10 West Broad Street, Suite 2100
Columbus, OH 43215

Robert A. Ganton, Attorney at Law
Department of the Army
901 North Stuart Street
Arlington, VA 22203-1837

Judith B. Sanders

Bell, Royer & Sanders Co., LPA
33 South Grant Avenue
Columbus, OH 43215-3927

Dennis K. Muncy, Esq.
Meyer, Capel, Hirschfield, Muncy, Jahn &
Aldeen
P.O. Box 6750
Champaign, IL 61826-6750

Stephen M. Howard
Vorys, Sater, Seymour and Pease
P.O. Box 1008
Columbus, OH 43216-1008

Samuel C. Randazzo
McNees, Wallace & Nurick
Fifth Third Center
21 East State Street, Suite 910
Columbus, OH 43215

Daniel A. Malkoff, Attorney at Law
Assistant Attorney General
30 East Broad Street
Columbus, OH 43215-3428

Karin W. Riley
Assistant Attorney General
Ohio Department of Education
P.O. Box 1001
Columbus, OH 43255-0101

Sheldon A. Taft
Vorys, Sater, Seymour and Pease
P.O. Box 1008
Columbus, OH 43216-1008

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

Michelle Mistler
Cincinnati Bell Telephone Company
P.O. Box 2301; Room 910
Cincinnati, OH 45201

Craig I. Smith, Attorney at Law
2824 Coventry Road
Cleveland, OH 44120

Dane Stinson, Esq.
Arter & Hadden
One Columbus Building
10 West Broad Street, Suite 2100
Columbus, OH 43215

Sally W. Bloomfield
Bricker & Eckler
100 South Third Street
Columbus, OH 43215

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

Gregory J. Dunn, Esq.
Schottenstein, Zox & Dunn
41 South High Street, Suite 2600
Columbus, OH 43215

John W. Bentine
Chester, Willcox & Saxbe
17 South High Street, Suite 900
Columbus, OH 43215

John C. Klein, III; Assistant City Attorney
90 West Broad Street
Columbus, OH 43215

Jonathan E. Canis
Kelly Drye & Warren, LLP
1200 19th Street, NW; Suite 500
Washington, DC 20036

Jean Gibbons
Swidler & Berlin
3000 K Street, NW, Suite 300
Washington, DC 20007

Bruce Weston, Attorney at Law
169 West Hubbard Avenue
Columbus, OH 43215

Kerry Bruce
Department of Public Utilities
420 Madison Avenue, Suite 100
Toledo, OH 43604-1219

Lucas County Commissioners
One Government Center, Suite 800
Toledo, OH 43604-2256

Shelley Beregassi
Pry C.P.A. Services, Inc.
P.O. Box 1106
Findlay, OH 45839-1106

Patricia Peoples
Washington County Board of Education
Route 2; Box 1A
Marietta, OH 45750-9614

Andrew S. McEwan
90 West Broad Street, Room 106
Columbus, OH 43215

Angela F. Cook
8066 State Route 177
Camden, OH 45311

Carole F. Hoover
The Growth Association of Cleveland
200 Tower City Center
50 Public Square
Cleveland, OH 44113-2291

Evelyn Schaeffer, Coordinator
Ashtabula County Telephone Coalition
1211 Route 45
Austinburg, OH 44010

Clyde Scoles
Toledo-Lucas County Public Library
325 Michigan Street
Toledo, OH 43624-1628

Donald E. Jakeway, Director
Ohio Department of Development
77 South High Street, 29th Floor
Columbus, OH 43215

Gary M. Hallock, Attorney at Law
4017-A Sunset Boulevard
Steubenville, OH 43952

James S. Aussem
Brouse & McDowell
1001 Lakeside Avenue, Suite 1600
Cleveland, OH 44114

Carleton S. Finkbeiner, Mayor
City of Toledo
One Government Center, Suite 2200
Toledo, OH 43604

Kathleen Greenan
3000 K Street, NW; Suite 300
Washington, DC 20007

Larry B. Mixon, PhD
Columbus Public Schools
270 East State Street
Columbus, OH 43215

Francis Haley
Ohio Library Council
35 East Gay Street, Suite 305
Columbus, OH 43215-3138

Major Robert L. Duecaster
U.S. Army Litigation Center
901 North Stuart Street, Suite 400
Arlington, VA 22203

Susan Weinstock
A.A.R.P. - State Legislation Department
601 E Street, NW
Washington, DC 20049