BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of Intrastate Carrier Access Reform Pursuant to S.B. 162.	))	Case No. 10-2387-TP-COI

REPLY COMMENTS OF THE OFFICE OF THE OHIO CONSUMERS' COUNSEL

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January 19, 2011

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I. INTRODUCTION AND EXECUTIVE SUMMARY

The Office of the Ohio Consumers' Counsel ("OCC") provides these reply comments on "the framework for proceeding in this matter,"[1] in which the Public Utilities Commission of Ohio ("PUCO" or "Commission") has requested comment on a PUCO staff proposal that would (a) reduce incumbent local exchange companies' ("ILECs'") intrastate access charges to equal their interstate access charges; and (b) allow the ILECs to recoup the revenues lost from these access charge reductions through an intrastate Access Recovery Fund ("ARF").[2] If intrastate access charges are reduced, the statute requires "revenue neutrality," so there will be rate increases for customers.

The Commission has required the filing of these comments and reply comments without requiring the filing of data or allowing discovery.[3] That may be the reason why there is so little data supporting the comments filed by the members of the

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[1] Entry (December 8, 2010) ("December 8 Entry") at 4.

[2] Entry (November 3, 2010) ("November 3 Entry") at 2. The proposal is set forth in the November 3 Entry as Appendix A; the questions posed for response are set forth as Appendix B.

[3] December 8 Entry at 4.

telecommunications industry.[4] Thus the comments include at best high-level generalizations regarding the current level of intrastate access charges, the impacts of that current level,[5] and the impacts of reducing the current level.[6] Indeed, we do not even have facts showing which ILECs actually have intrastate access charges that are higher than their interstate charges.

There is also no data on the level of revenues that would be recovered under the PUCO staff proposal, or on the possible sources of such revenue recovery.[7] There is also no data on other issues that some commenters claim are crucial considerations in this proceeding, for example the level of so-called "phantom traffic" that does not pay access charges,[8] and the costs imposed on ILECs by the carrier-of-last-resort ("COLR") obligation.[9] And there certainly is no data to support the allegations of the industry about "above cost" and "below cost" rates.

In the face of this yawning data void, it is again unclear on how helpful the industry comments can be for the Commission. But we will do our best to sort through the various unsupported claims and assertions.

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[4] OCC filed Initial comments, as did the AT&T Entities ("AT&T"); Cincinnati Bell Telephone Company LLC, Cincinnati Bell Extended Territories LLC, Cincinnati Bell Wireless, LLC and Cincinnati Bell Any Distance Inc. (collectively "Cincinnati Bell"); Frontier North Inc. and Frontier Communications of Michigan, Inc. ("Frontier"); the MACC Coalition ("MACC"); the Ohio Cable Telecommunications Association ("OCTA"); the Small Local Exchange Carriers Group ("SLECs"); Sprint Communications Company L.P., Sprint Spectrum, L.P. and SprintCom, Inc. d/b/a Sprint PCS, Nextel West Corp., Inc., and NPCR, Inc., d/b/a Nextel Partners (collectively, "Sprint"); T-Mobile Central, LLC and VoiceStream Pittsburgh, LP ("T-Mobile"); United Telephone Company of Ohio and CenturyTel of Ohio, Inc. ("CenturyLink"); Verizon; and Windstream Ohio and Windstream Western Reserve, Inc. ("Windstream")

[5] E.g., Sprint Comments at 1.

[6] E.g., AT&T Comments at 4-6. It should be noted that AT&T's Comments include a red-lined version of the PUCO staff's proposal. Many of the edits, however, are not explained in the text of AT&T's comments.

[7] See OCTA Comments, Declaration of Joseph Gillan ("OCTA/Gillan"). ¶ 21.

[8] See, e.g., Frontier Comments at 3-4; SLECs Comments, n.25.

[9] See, e.g., CenturyLink Comments at 3.

Among the notable things with regard to the comments is that none of the comments is completely wrong. On the other hand, none of the comments is completely right. Thus OCC neither completely disagrees with nor completely agrees with any of the comments. The remainder of this summary will crystallize and contrast some of those positions.[10]

In brief, OCC's position is as follows:

- There is no need for the Commission to act now to reduce intrastate access charges.[11]
    - The upcoming Federal Communications Commission ("FCC") action will supersede any PUCO order and may not take such action into account.[12]
    - This is also because there is no demonstrable harm caused by the current level of intrastate access charges.[13]
        - There has been no showing that intrastate access charges subsidize basic service rates.[14]
        - There has been no showing that any ILECs that have low basic service rates have been able keep their rates low as a result of excessive intrastate access charges.[15]
        - There has been no showing that arbitrage is a substantial problem for Ohio intrastate calls.[16]

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[10] Also included are citations to OCC's initial comments on these issues, as well as citations to the discussion in these reply comments. Where the comments of others are contradicted by OCC's position, the citations to others' comments are signaled as "but see."

[11] See Windstream Comments at 1; Cincinnati Bell Comments at 2, 3, 5, 15; OCTA Comments at 3, 7 and Gillan, ¶ 13; T-Mobile Comments at 12. See OCC Comments at 23-26 and Section II. below.

[12] See OCC Comments at 25 and Section II.A. below

[13] See OCC Comments at 23-26 and Section II.B. below. But see T-Mobile Comments at 3; AT&T Comments at 4-6; Verizon Comments at 3; Sprint Comments at 1, 2.

[14] See Section II.B.1. below and Reply Affidavit of Trevor Roycroft ("Roycroft Reply Affidavit"). But see AT&T Comments at 3; Windstream Comments at 2; Cincinnati Bell Comments at 3-4; T-Mobile Comments at 1; Sprint Comments at 1, 2; Verizon Comments at 3, 12, 15; MACC Comments at 3-4.

[15] See Section II.B.2. below. But see Cincinnati Bell Comments at 3; Sprint Comments at 3.

[16] See OCC Comments at 25 and Section II.B.3. below. But see AT&T Comments at 5.

    - ILECs’ recovery of costs entirely from their own end-users improperly allows other carriers (and their customers) to use the ILECs’ network free of charge.[17]

- **If** the Commission does reduce intrastate access charges, there should be a required flow-through of benefits to the customers who use long-distance service.[18]

- **If** the Commission does reduce intrastate access charges, the first recourse for revenue replacement should be to the carriers whose access charges are reduced; only if that source is insufficient should there be recourse to an ARF.[19]

    - This should include recognition of all of an ILEC’s sources of revenues.[20]

    - Affordability should not be the standard for assessing the level of increases to an ILEC’s basic service rates.[21]

- **If** the Commission creates an ARF, the assessment should be on the broadest lawful base of contributors.[22]

    - This should include Voice over Internet Protocol (“VoIP”) providers.[23]

    - It should also include wireless carriers, including wireless resellers.[24]

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[17] See Section II.B.4. below. See Sprint Comments at 2, 4-5; T-Mobile Comments at 3, 8; Verizon Comments at 2, 5, 12.

[18] See Cincinnati Bell Comments at 20-21. See OCC Comments at 39-40 and Section III. below.

[19] See T-Mobile Comments at 2, 3-4; Windstream Comments at 5; AT&T Comments at 8; Sprint Comments at 3; MACC Comments at 4; OCTA/Gillan, ¶ 16. See OCC Comments at 33-38 and Section IV. below.

[20] See Sprint Comments at 3; MACC Comments at 4; OCTA Comments at 4; T-Mobile Comments at 2, 5. See OCC Comments at 33-34 and Section IV.A., below.

[21] See Section IV.B. below. But see T-Mobile Comments at 2; Sprint Comments at 6; Verizon Comments at 15.

[22] See OCC Comments at 37-38 and Section V. below.

[23] See SLEC Comments at 11-12; but see AT&T Comments at 2; CBT Comments at 17-18. See OCC Comments at 37 and Section V.A. below.

[24] See Cincinnati Bell Comments at 17-18. See OCC Comments at 37 and Section V.B. below.

    - Those who assert that they should not contribute to an ARF should be required to seek waivers.[25]

    - Contributors to an ARF should not be able to establish a surcharge for collection of the contribution.[26]

- **If** the Commission creates an ARF, it must not allow ILECs to collect from customers revenues lost due to access line loss and structural declines in access minutes.[27]

- **If** the Commission creates an ARF, it must use up-to-date revenue data as the base, and the data and ARF must be reviewed at least annually.[28]

    - Proposals for less-frequent review will guarantee over-recovery.[29]

    - On the other hand, a fixed term for an ARF and onerous conditions for continuing recovery of the ILECs' intrastate access charge reductions would be contrary to the statute.[30]

- **If** the Commission creates an ARF, it should not treat price cap carriers differently than non-price cap carriers.[31]

- **If** the Commission creates an ARF, it should use a third-party administrator.[32]

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[25] See Frontier Comments at 10; MACC Comments at 7. See Section V.C. below.

[26] See OCC Comments at 37-38 and Section V.D. below. But see Cincinnati Bell Comments at 20; AT&T Comments at 8; Verizon Comments at 20.

[27] See Cincinnati Bell Comments at 8-9; OCTA Comments at 3-4; MACC Comments at 3-4; Sprint Comments at 8; Frontier Comments at 5. See OCC Comments at 30-32 and Section VI. below.

[28] See CBT Comments at 11, 19; OCTA Comments at 6 and Gillan, ¶ 17; AT&T Comments, Appendix ("App.") B at 5-6; Frontier Comments at 7; Sprint Comments at 6-7; T-Mobile Comments at 10-11. But see SLEC Comments at 9; CenturyLink Comments at 5; Verizon Comments at 23. See OCC Comments at 30-32 and Section VII. below.

[29] See Section VII.A. below. But see SLEC Comments at 11; CenturyLink Comments at 5; Verizon Comments at 23.

[30] See Section VII.B. below. But see Sprint Comments at 3, 7-8.

[31] See CenturyLink Comments at 5-6; Cincinnati Bell Comments at 12; Frontier Comments at 8; Sprint Comments at 10; Verizon Comments at 24. See Section VIII. below.

[32] See AT&T Comments, App. B at 8; CenturyLink Comments at 7; Frontier Comments at 8-9; SLEC Comments at 5-7. See Section IX. below.

- The creation of an ARF for the recovery of lost access charge revenue is a separate matter from the creation of a universal service fund to reflect high costs of service.[33]

    - The COLR obligation is real,[34] and cannot be lightly dismissed.[35]

    - But there has been no analysis of the costs the COLR obligation imposes on ILECs, and discussion of the COLR obligation typically ignores all of the revenue sources available to the ILEC.

    - The COLR obligation is best addressed through a high-cost USF.[36]

    - The ARF revenue-replacement mechanism is not a state USF, and thus does not independently allow assessment of VoIP providers.[37]

These points are explained below. But the parties' comments show that the Commission need not reduce intrastate access charges, and thus need not create an ARF to satisfy revenue neutrality.

[33] See OCC Comments at 40-41 and Section X. below.

[34] See SLEC Comments at 4-5; Cincinnati Bell Comments at 9. See Section X.A. below.

[35] See T-Mobile Comments at 2, 8-9; Verizon Comments at 17. See Section X.A. below.

[36] See SLEC Comments at 10; see also Frontier Comments at 5. See OCC Comments at 40-41 and Section X.B. below.

[37] See OCTA Comments at 5 and OCTA/Gillan, ¶ 12; but see AT&T Comments at 1-2, and App. A at 2, App. B at 1; SLEC Comments at 11-15; Cincinnati Bell Comments at 11; T-Mobile Comments at 2. See OCC Comments at 40-41and Section X.C. below.

II. THERE IS NO NEED FOR THE COMMISSION TO ACT NOW TO REDUCE INTRASTATE ACCESS CHARGES.

Verizon states, with regard to the recent Ohio legislation, "the legislature could not have provided a clearer signal that it expects the Commission to reduce the intrastate switched access charges that heretofore have escaped scrutiny."[38] That must be why the General Assembly said that "[t]he public utilities commission **may** order changes in a telephone company's rates for carrier access in this state subject to this division"[39] and said that "[**i**]**n the event that** the public utilities commission reduces a telephone company's rates for carrier access that are in effect on the effective date of this section"[40] there must be revenue neutrality. The General Assembly could have said that the Commission **shall** reduce intrastate access charges, but did not.[41] Verizon's statement strains credulity.[42]

A. The Upcoming Federal Communications Commission Action Will Supersede Any PUCO Order And May Not Take Such Action Into Account.

OCC advised the Commission that an FCC proceeding that addressed intercarrier compensation was the only means to correct the "problems" typically associated with differential access rates.[43] The superiority of addressing the issue through an FCC proceeding was also raised by the majority of the other parties. Cincinnati Bell states,

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[38] Verizon Comments at 9.

[39] R.C. 4927.15(B) (emphasis added).

[40] Id. (emphasis added).

[41] R.C. 1.42.

[42] As does Cincinnati Bell's argument that, because the General Assembly said that revenue neutrality would be in addition to the statutorily-allowed increases to basic service, "it *expected* revenue neutrality to be accomplished through rate rebalancing…." Cincinnati Bell Comments at 5 (emphasis in original).

[43] OCC Comments at 25 and Affidavit of Trevor Roycroft ("Roycroft Initial Affidavit") at 8.

"Rather than including a provision to revisit the access restructure mechanism if the FCC takes specific action, the Commission should consider deferring action on this proposal until the FCC adopts an intercarrier compensation reform plan."[44] Frontier indicates that

> [f]ederal actions taken by the FCC will likely address access reform on a national level in the near future. Any Ohio-specific action should be crafted to harmonize with those federal actions. Without knowledge of the components of upcoming federal action, any further state effort should be suspended until federal direction is known.[45]

MACC states "[Appendix B Question 7] highlights the wisdom, also advanced by other parties in this docket, of suspending this docket while the FCC undertakes extensive intercarrier compensation reform, including reform of intrastate access charges that it has proposed."[46] OCTA states that "the Commission should delay this proceeding until the results of the FCC rulemaking are known."[47] T-Mobile states: "T-Mobile strongly urges the PUCO to consider the actions of the FCC as it implements intercarrier compensation and universal service reforms. … T-Mobile urges the PUCO to hold-off implementation of a state fund."[48] Windstream offers support for the ARP, but notes "Windstream believes that the state regulatory commissions should await the Federal Communications Commission's … comprehensive national intercarrier compensation reform efforts..."[49]

These commenters all reinforce OCC's point – impending FCC action, that will address the creation of a unified interconnection pricing framework, is the only way to

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[44] Cincinnati Bell Comments at 15; see also id. at 2, 3, 5.

[45] Frontier Comments at 3.

[46] MACC Comments at 6.

[47] OCTA Comments at 7; see also id. at 3; OCTA/Gillan, ¶ 13.

[48] T-Mobile Comments at 12.

[49] Windstream Comments at 1.

slice through the Gordian Knot of intercarrier compensation reform. Indeed, on December 23, 2010, the State Members of the Federal-State Joint Board on Universal Service requested the FCC to coordinate a wide variety of data to address the "inextricably intertwined" issues of intercarrier compensation and universal service.[50]

There has been no need for immediate action shown, especially, as discussed below, no major and/or imminent harms from the current intrastate access charge rate structure. OCC again urges the Commission to suspend this proceeding pending FCC action.

B. There Is No Demonstrable Harm Caused By The Current Level Of Intrastate Access Charges.

AT&T alleges that high intrastate access charges are harming customers.[51] However, AT&T offers no support to back up this claim. In fact, AT&T also asserts that customers can find options that best suit their needs,[52] which suggests that customers can avoid these alleged harms.

AT&T states that "[o]nce the burden of high access charges is removed, wireline long-distance providers can compete more aggressively."[53] The facts do not support this statement: As Dr. Roycroft's affidavit accompanying OCC's initial comments showed, differences between interstate and intrastate access charges have no noticeable impact on

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[50] See http://fjallfoss.fcc.gov/ecfs/document/view?id=7021024740.

[51] AT&T Comments at 4-6.

[52] Id. at 5.

[53] Id. at 6.

long-distance rates.[54] And it appears that allowing AT&T to compete "more aggressively" will only further cement its substantial long-distance market share.[55]

AT&T asserts that its "wireline long-distance business has lost millions of minutes of traffic to many of these competing technologies not because of any real difference in quality, but in part because of the market distortion created by regulatory rules permitting those alternatives to not incur access costs in the same way as wireline long-distance service."[56] But the FCC and National Exchange Carrier Association data show that the access minutes of the large carriers that have reduced their access charges have reduced more quickly than those of rural carriers that have maintained higher charges,[57] showing how little an impact access charges have had.[58]

AT&T also points to alleged harms arising from the failure of ILECs to convert to all-IP networks, due to incentives provided by the receipt of access revenues.[59] This technology-suppression argument is not convincing. Access parity has existed for an extended period for AT&T and other large Ohio ILECs, but unless OCC missed the conversion, these companies continue to provide voice services on a circuit-switched basis. Again, the incentives identified by AT&T play at best a minor role on this issue.

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[54] Roycroft Initial Affidavit at 21-25.

[55] Id. at 18-19.

[56] Id. at 5.

[57] Analysis by Billy Jack Gregg of Universal Consulting of Hurricane, West Virginia. Mr. Gregg is the former Director of the Consumer Advocate Division of the West Virginia Public Service Commission. In that position, he served on the Federal-State Joint Board on Universal Service as the representative of the National Association of State Utility Consumer Advocates.

[58] And it should be noted that the "market distortion" is likely to be that the other carriers – especially VoIP and wireless – do not pay their fair share for the use of the local networks.

[59] AT&T Comments at 4.

Verizon alleges that absent regulatory intervention, some ILECs will charge unjust and unreasonable access rates.[60] Certainly, unjust and unreasonable rates, if they exist, can be said to be imposing harms. However, Verizon offers no evidence to support the proposition that any intrastate access rate is unjust or unreasonable. The mere fact that access rates are not set equal to their federal equivalents is not a demonstration of rates that are unjust and/or unreasonable.

Along those lines, Verizon also points to FCC policy as demonstrating the need for state action. While there is no question that the FCC has engaged in a long and meandering path to the current status of interstate access charges, the culmination of this journey – the CALLS and MAG Orders[61] – is not a model for this Commission to follow. These negotiated agreements do not result in cost-based interstate access rates, and, as discussed below, they inappropriately shift the recovery of non-traffic-sensitive costs to end-users.

1. There has been no showing that intrastate access charges subsidize basic service rates.

The most common theme throughout the industry comments is that intrastate access charges "subsidize" or "provide a subsidy to" the basic service rates of the ILECs that have intrastate access charges higher than their interstate access charges.[62] This "conventional wisdom" is supposedly a reason why intrastate access charges must be

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[60] Verizon Comments at 3.

[61] See OCC Comments at 16-17. The CALLS Order is *In the Matter of Access Charge Reform*, CC Docket Nos. 96-262 et al. (96-262), Sixth Report and Order (rel. May 31, 2000); the MAG Order is *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, CC Docket No. 00-256, Report and Order, FCC 04-31 (rel. February 26, 2004).

[62] See AT&T Comments at 3; Cincinnati Bell Comments at 3-4; Sprint Comments at 1, 2; T-Mobile Comments at 1; Verizon Comments at 3, 12, 15; Windstream Comments at 2,

reduced. As discussed at length in Dr. Roycroft's attached Reply Affidavit, however, the use of the terms "subsidy" and "cross-subsidy" have distinct meanings that are entirely ignored by the commenters.[63] In order to demonstrate subsidy or cross-subsidy, determining costs is necessary; no such analysis has been done by industry commenters.

As Dr. Roycroft shows, the claim that access service is subsidizing basic service requires three things to be true: (1) basic service must be shown to be priced below its incremental cost; (2) access service must be shown to be priced above its stand-alone costs; and (3) the ILEC must not be earning above-normal returns.[64] Further, as Dr. Roycroft discusses, given the elimination of profit oversight, the only tractable analysis that can be done regarding subsidy is the evaluation of whether a service is priced below its incremental cost.[65] And given the limited information on costs that is available, it appears that there is no cross-subsidy "problem" in Ohio.[66] Because they are not based on any cost information, the claims made by various parties regarding subsidy and cross-subsidy are entirely hollow.

Indeed, Dr. Roycroft's analysis based on publicly-available data, using very conservative assumptions, shows that eligible ILEC basic service rates are above incremental cost,[67] and thus do not receive subsidies. Indeed, most provide a contribution to the ILECs' joint and common costs.[68] On the other hand, again using very

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[63] Roycroft Reply Affidavit at 1-4.

[64] Id. at 5-6.

[65] Id. at 11-12.

[66] Id. at 12-16.

[67] Id. at 12-13.

[68] Id. at 14.

conservative assumptions, access charges are not above stand-alone cost.[69] Thus they are not being subsidized.

Sprint argues that "all intercarrier compensation charges should be set at the incremental cost of providing one more minute of service on an existing network."[70] OCC is entirely in favor of this principle, **as long as it is equally applied to all network services and users, including local service customers.** However, as explained in Dr. Roycroft's accompanying Reply Affidavit, such an approach is entirely untenable. Incremental cost is defined without reference to any joint or common costs.[71] This convention does not make joint and common costs "disappear," but is simply the result of the economic methodology associated with making a quantifiable determination of the existence of subsidy. Unfortunately, with any service that is produced in an industry with high fixed costs, **if all of the firm's prices were set based on incremental costs, the firm would be unsustainable.** Thus, rate setting requires cost allocation. However, allocating all costs to the end user, which continues to be the FCC's approach to avoiding responsibility on this matter,[72] is unacceptable. This Commission has a responsibility to ensure that basic rates contribute to no more than a reasonable share of joint and common costs. As the Commission is well aware, the 1996 Telecommunications Act specifies that basic service bear only a reasonable allocation of joint and common costs.

> The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary

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[69] Id. at 14-16.

[70] Sprint Comments at 1.

[71] Roycroft Reply Affidavit at 5-6.

[72] The *National Broadband Plan* (at 148), reiterates the FCC's objective, originally stated in *Decision and Order, MTS and WATS Market Structure, CC Docket No. 78-72 and Amendment of Part 67 of the Commission's Rules,* CC Docket No. 80-286, 50 Fed. Reg. 939 (1985), to shift all non-traffic sensitive costs to end users.

> cost allocation rules, accounting safeguards, and guidelines to ensure that services included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.[73]

Sprint's proposal is unacceptable in light of this responsibility.

T-Mobile offers a variation on the theme that interconnecting carriers should be allowed to pay as little as possible for terminating traffic – so-called "bill and keep."[74] The term is used because each carrier bills only its own end-use customers, and keeps all that revenue, rather than charging other carriers. While T-Mobile claims that such an arrangement will prevent "gaming" of traffic flows,[75] the T-Mobile proposal simply shifts all the gaming up front.

Under a bill and keep arrangement each carrier is responsible for the costs of originating and terminating traffic to end-users on its own network. Bill and keep seems like a simple solution, and it is, as long as carriers have similar cost structures and exchange similar traffic volumes. Under a bill and keep arrangement, interexchange carriers ("IXCs") that have no end user facilities get the best deal as they are freed from contributing to last mile facilities on either end of their customer's call. Wireless carriers like T-Mobile also benefit as they can avoid any contribution to the higher costs of terminating traffic on wireline networks. Wireless carriers do not provide ubiquitous service, especially in high cost areas, but wireless callers receive the benefits of being able to reach wireline subscribers served by ILECs in high-cost areas. T-Mobile's proposal allows it to ride for free on all terminations. As discussed in Dr. Roycroft's

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[73] 47 U.S.C. §254(k).

[74] T-Mobile Comments at 3.

[75] Id.

initial affidavit, wireless carriers already pay minimal intercarrier compensation to ILECs.[76]

Unfortunately, bill and keep ultimately results in a solution that, like Sprint's incremental cost proposal, unfairly shifts all joint and common cost recovery to end-users. Cost-based interconnection rates that address the joint and common cost issue provide a solution superior to the approach identified by either Sprint or T-Mobile.

2. There has been no showing that any ILECs that have low basic service rates have been able to keep their rates low as a result of excessive intrastate access charges.

In the first place, none of the comments other than OCC's contained any comprehensive data on the Ohio ILECs' basic service rates.[77] So it is entirely premature for any commenter to assert that any ILEC's basic service rates are unreasonably low, and especially that the ILEC's basic service rates are unreasonably low **because of unreasonably high intrastate access charges.**[78] (Which is not to say that some ILECs' local service rates are not relatively low, which could possibly be a basis for assessing a surcharge on the ILEC's customers after the ILEC's non-basic rates are increased, as OCC argued.[79])

Further, as discussed in Dr. Roycroft's Reply Affidavit, there is little evidence that intrastate access rates are a source of subsidy, or have been providing an excessive contribution to joint and common costs.[80] The comments that insinuate that basic rates

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[76] Roycroft Initial Affidavit at 48.

[77] Cincinnati Bell mentioned two ILECs' rates. Cincinnati Bell Comments, n.3.

[78] See id. at 3; Sprint Comments at 3.

[79] See OCC Comments at 34-35.

[80] Roycroft Reply Affidavit at 14-16.

are unreasonably low due to high access charges are devoid of any cost foundation, and also ignore the fact that the SLECs receive considerable federal universal service support to keep basic rates affordable.

3. There has been no showing that arbitrage is a substantial problem for Ohio intrastate calls.

OCC discussed the lack of evidence regarding potential arbitrage problems associated with differential state and interstate access rates, as showing the lack of justification for undertaking intrastate access "reform."[81] The comments provide little additional insight into the magnitude of the arbitrage issue. AT&T indicates that arbitrage creates "harmful incentives,"[82] but provides no detail on the magnitude of the harm. The SLECs, perhaps the party with the most to tell on the harms of arbitrage, offer a muted assessment of the "problem":

> As set forth in their tariffs, when terminating calls, the SLECs frequently rely upon the delivering interexchange carrier to identify the "percent interstate use" otherwise known as the PIU. Most carriers accurately report their usage, but some do not.[83]

The SLECs provide no further information regarding the potential dollar value of the problem, but it seems likely that if the problem were significant, the SLECs would have provided some estimate of the dollar magnitude of their losses due to the misreporting of intrastate traffic as interstate. The SLECs also state:

> It is worth noting, however, that parity is not a panacea to many of the arbitrage schemes that certain carriers have concocted. For example, some carriers refuse to pay any access charges

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[81] OCC Comments at 25 and Roycroft Initial Affidavit at 11-13.

[82] AT&T Comments at 5.

[83] SLEC Comments at 8.

> whatsoever on various grounds, VoIP-origination, for example. Nor does parity resolve issues relating to phantom traffic....[84]

This statement is entirely consistent with Dr. Roycroft's conclusions on these matters.[85]

The SLECs sum up their argument for access charge parity as follows: "In summary, there is no overwhelmingly compelling reason to set intrastate rates specifically at unity [with interstate], but it is reasonable to do so, provided that the lost revenues are recovered via the ARF...."[86] The SLECs' comments certainly identify no potential benefits associated with the PUCO staff's proposal in the area of arbitrage. The SLECs' position can be summarized as follows, "We don't see any identifiable benefits from parity, however, if you make us whole, we can live with the policy." This emphasizes that there is no compelling reason to address parity issues at this time.

4. ILECs' recovery of costs entirely from their own end-users improperly allows other carriers (and their customers) to use the ILECs' network free of charge.

Many of the commenters assert that it is somehow improper for long-distance carriers (including wireless carriers) to be required to contribute to the costs of the local networks on which the long-distance carriers terminate their calls.[87] (Or, indeed, that the long distance carriers be required to contribute to the costs of the local networks from which the calls they carry originate.) As explained in Dr. Roycroft's initial and reply affidavits, if the local networks did not exist, the long-distance carriers would be required to create their own networks in order to connect with their customers, and the customers

[84] Id.

[85] Roycroft Initial Affidavit at 12-13.

[86] SLEC Comments at 8.

[87] See Sprint Comments at 2, 4-5, 7; T-Mobile Comments at 3, 8; Verizon Comments at 2, 5, 12.

their customers want to call.[88] Thus it is entirely appropriate for the long-distance carriers to be required to contribute to the costs of those local networks.

Verizon argues that recovery of ILEC costs from other carriers, rather than end users has been identified by the FCC as creating "irrational access rate structures" that have led to "'inefficient and undesirable economic behavior'" – citing the CALLS Order as support.[89] But the "irrational and undesirable economic behavior" that the FCC was discussing was not related to access charge parity, but to alleged inefficiencies associated with recovering non-traffic-sensitive costs through usage-based charges: "Inefficient rate structures lead to inefficient and undesirable economic behavior, and create an implicit subsidy between high volume users and low-volume users."[90] Thus Verizon's out-of-context quote does not support the proposition that this Commission must take action to reduce intrastate access charges.

III. IF THE COMMISSION DOES REDUCE INTRASTATE ACCESS CHARGES, THERE SHOULD BE A REQUIRED FLOW-THROUGH OF BENEFITS TO THE CUSTOMERS WHO USE LONG-DISTANCE SERVICE.

Interestingly, only Cincinnati Bell of the many industry commenters asserted that, if intrastate access charges are reduced, the long-distance carriers that benefit from the reductions should be required to flow through those reductions to their customers.[91] OCC, on behalf of customers, had made that same argument.[92]

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[88] Roycroft Initial Affidavit at 7; Roycroft Reply Affidavit at 6.

[89] Verizon Comments, p. 5, citing to CALLS Order at ¶129.

[90] CALLS Order at ¶129.

[91] See Cincinnati Bell Comments at 20-21.

[92] See OCC Comments at 39-40.

As Dr. Roycroft's initial affidavit showed, not all long-distance carriers have intrastate rates that are higher than their interstate rates.[93] As OCC noted in initial comments, unless the Commission takes action, it is more than likely that many long-distance carriers will take their reductions in intrastate access charges paid as contributions to their bottom line, as opposed to attempting to underprice intermodal rivals who may be paying rates that are even lower than the reduced intrastate access charges.[94]

As a result, the Commission should require long-distance carriers, to the extent that they still have per-minute intrastate rates, to reduce those rates. Similarly, for long-distance carriers that no longer market services with a state/interstate distinction, the Commission should require that the unified per-minute rate be reduced by the corresponding reduction in intrastate access, adjusted for the portion of their overall traffic that terminates under the new lower rates.[95]

IV. IF THE COMMISSION DOES REDUCE INTRASTATE ACCESS CHARGES, THE FIRST RECOURSE FOR REVENUE REPLACEMENT SHOULD BE TO THE CARRIERS WHOSE ACCESS CHARGES ARE REDUCED; ONLY IF THAT SOURCE IS INSUFFICIENT SHOULD THERE BE RECOURSE TO AN ACCESS RECOVERY FUND.

Most of the commenters believe, like OCC, that, before a carrier that reduces its intrastate access charges should be able to draw from an ARF, the carrier should be

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[93] Roycroft Initial Affidavit at 21-25.

[94] OCC Comments at 40.

[95] For example, suppose that a carrier charges an "any distance" per minute rate of $0.25, and sells Ohio customers 400 minutes that are terminated out of state or to in-state ILECs that are already at parity, and 100 minutes that are terminated in-state to the carriers that currently do not maintain parity. Assuming that the imposition in parity results in an average per-minute access rate reduction of $0.05, then the carrier's "any distance" rate should be reduced by $0.01 (i.e., 100 minutes subject to the access price reduction divided by the 500 total minutes multiplied by the $0.05 per minute access price reduction).

required to seek "revenue neutrality" from its own end-user or retail customers.[96] Some of those commenters so strongly object to the creation of an ARF that they assert that **all** revenue neutrality must come from the eligible carrier's own customers.[97] As discussed in OCC's initial comments, OCC takes a more moderate position, recognizing that, given the (at this point unknown) amounts of lost revenues, it may not be feasible for an eligible ILEC to recover all of those revenues from its own customers. These ILECs must attempt it, however.

The SLECs, perhaps understandably but entirely unreasonably, seek to define "revenue neutrality" as having the replacement revenues come entirely from other carriers (and their customers).[98] The SLECs state, "Revenue neutrality involves completely substituting the dollars lost to interstate parity in order to maintain the financial position of the ILECs."[99] But there is no reason why the substitution should not come, in the first place, from the carriers that are reducing their access charges. The SLECs also state:

> Revenue neutrality must provide the SLECs with the *realistic* opportunity to increase revenues from sources that are regulated by this Commission, in a manner which will offset access reductions on a dollar-for-dollar revenue basis. The proposed ARP accomplishes this legislative objective.[100]

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[96] See T-Mobile Comments at 2, 3-4; Windstream Comments at 5; Sprint Comments at 3; MACC Comments at 4; OCTA/Gillan, ¶ 16. See OCC Comments at 33-36. Interestingly, AT&T sees "the opportunity for revenue neutral rate rebalancing" as an integral part of PUCO staff's plan (AT&T Comments at 8), a feature apparently overlooked by the other commenters, but AT&T makes changes in the ARP to make it more explicit.

[97] See T-Mobile Comments at 4-5; Verizon Comments at 2.

[98] See SLEC Comments at 8-9.

[99] Id. at 9.

[100] Id. (emphasis in original).

Those sources could well be from within the ILEC itself.

"Complete substitution" under the SLECs' theory, means that no eligible carrier would have to contribute to revenue neutrality, whether for itself or for any other eligible carrier. And the "sources that are regulated by the Commission" clearly are sources other than the eligible ILEC.[101]

The SLECs assert that without such revenue replacement there will be "confiscation."[102] This assertion also overlooks that confiscation does not merely involve loss of revenues, but loss of revenues below a level that fails to give the utility a reasonable opportunity to compensate its investors.[103] And the question of confiscation is especially complicated when most of the utility's rates are no longer regulated, and the profit constraint is removed, as is the case under current Ohio law.[104]

Indeed, the SLECs propose that they be exempted from even contributing to the ARF itself.[105] This takes the concept of "revenue neutrality" to a whole new dimension.

OCC has been unable to locate any state where "revenue neutrality" has been interpreted so as to excuse the carrier reducing rates from any responsibility for replacement revenues, **in the absence of specific legislative language directing that result.** First, we should note that the Commission has previously addressed this issue

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[101] The SLECs also assert that access line losses must be compensated for. Id. at 10. This is discussed in Section VI. below.

[102] SLEC Comments at 9.

[103] See, e.g., *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 311 (1989).

[104] R.C. 4927.03(D).

[105] SLEC Comments at 17.

only on an intracompany basis.[106] In Florida,[107] New York,[108] and Pennsylvania,[109] this issue has been addressed without intercompany revenue transfers. By contrast, in Nebraska, state law required the state commission to offset access charge reductions with state USF support.[110] Clearly, Ohio law does not require what the PUCO staff proposes or what the SLECs support, that is, the absolution of the ILEC reducing its intrastate access charges from any internal responsibility to make up the revenue loss.[111]

OCC had proposed the use of the weighted statewide average basic service rate as the basis for calculating a surcharge (if the replacement revenues could not be obtained through non-basic service rates increases).[112] OCC continues to recommend that approach, which yielded a benchmark of $15.07. Cincinnati Bell proposes a benchmark of "the average retail rate of the ILECs whose intrastate access rates already mirror their

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[106] See discussion in OCC Comments at 17-18; see also *In the Matter of the Application of Ameritech Ohio to Revise Its Tariff, P.U.C.O. 20, to Implement the Provisions of the First Report and Order Under FCC 97-158,* Case No. 97-1562-TP-ATA at ¶1 (Jan. 22, 1998).

[107] *Charles J. Crist, Jr. v. Lila A. Jaber*, Florida Public Service Commission Case Nos. SC04-9; SC04-10; SC04-946, 2005 Fla. PUC LEXIS 498 at 2 (July 7, 2005).

[108] *Tariff Filing by Delhi Telephone Company to Modify Current Basic Local Service Rates and Custom Calling and CLASS Feature Prices in a Revenue-Neutral Manner*, New York Department of Public Service Case No. 09-C-0570, 2009 N.Y. PUC LEXIS 888 at *1 (August 20, 2009).

[109] *Investigation Regarding Intrastate Access Charges and IntraLATA Toll Rates of Rural Carriers and The Pennsylvania Universal Service Fund*, Pennsylvania Public Utility Commission Case No. I-00040105, 2010 Pa. PUC LEXIS 216 at *40-55 (July 27, 2010). Indeed, in the Pennsylvania case, the Attorney Examiner found that it was "unreasonable to expect other carriers and their customers to fund the RLECs' operations through an expanded PA USF in today's competitive environment." *Id.* at*232.

[110] *In the Matter of the Nebraska Public Service Commission to conduct an investigation of Qwest Corporation's Proposed Switched Access Charge Rates*, Public Service Commission of Nebraska Case No. C-3945/NUSF-60.02/PI-128, 2009 Neb. PUC LEXIS 24, at *17-18 (Feb. 3, 2009).

[111] See Bluhm, P., Bernt, P., and Liu, Jing, State High Cost Funds: Purposes, Design and Evaluation, National Regulatory Research Institute 10-04 (January 19, 2010) ("NRRI High Cost Paper").

[112] OCC Comments at 35.

interstate rates."[113] OCC calculates that (weighted) average as $15.26, not much different from OCC's proposal.

It should also be noted that the PUCO staff proposal requires that price-cap ILECs offset their draw from the ARF by imposing a $0.50 per line per month surcharge on end-users.[114] AT&T proposes to increase this surcharge five-fold to $2.50, for each year of the three-year period that AT&T proposes that the ARF will be in effect.[115] This would allow price-cap ILECs to increase the surcharge to $7.50 per month by the end of the three years.[116] The Commission should flatly reject AT&T's proposal. AT&T offers no evidence as to why a uniform increase of $7.50 per month for all eligible ILECs has any relationship to the level of access revenues that would need to be offset due to the implementation of parity for an individual carrier. AT&T's proposal has no relationship to costs, or to other sources of revenues that price-cap ILECs can utilize to achieve revenue neutrality.

AT&T also proposes a similar mechanism for the non-price-cap ILECs, but with a $0.50 per month surcharge, which is only imposed if the non-price-cap ILEC's basic rate is "below the comparable rate of the largest ILEC in the state.[117] AT&T's approach is exactly backwards from what might be reasonable.

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[113] Cincinnati Bell Comments at 14.

[114] November 3 Entry, Appendix A at 4 [¶ 16(A)(ii)].

[115] AT&T Comments, App. A at 3, 4-5 and App. B at 6.

[116] AT&T opines that "increases in reduction of $2.50 would not be overly burdensome on eligible price cap ILECs." In providing this assessment AT&T overlooks the burden placed on end-users. Id., App. B at 6.

[117] AT&T Comments, AT&T App. A, at 3, 5. That "largest ILEC" is, of course, AT&T.

While OCC does not believe that any action should be taken at this time, OCC offered a reasonable approach to revenue neutrality should the Commission decide to pursue the ARF. As OCC pointed out in its initial comments, the first recourse for revenue neutrality should be the non-basic rates of the ILECs that are required to reduce their intrastate access charges.[118] OCC also recommended that if the ILEC reducing access charges still experiences a revenue shortfall, a customer surcharge should be allowed so that the sum of the basic rate and the surcharge did not exceed the statewide average BLES rate – $15.07.[119] AT&T's proposal, even if it was constrained only to the amount of the access charge reduction (which it is not), results in the largest rate increases for the customers who already have basic rates that are above or close to the statewide average. Oddly, the AT&T proposal would keep the basic rates for smaller ILECs far below the statewide average in most cases. AT&T's flawed approach should be rejected. If the Commission does pursue the ARF, the OCC's approach to a basic rate surcharge, imposed only after non-basic rates have been tapped as a revenue offset, provides a superior alternative.

A. All Of A Carrier's Sources Of Revenues Should Be Recognized.

Many of the commenters noted, as did OCC,[120] that the SLECs have recourse to a wide variety of revenue sources from which neutrality can be sought. For example, Sprint seeks "rationalization of retail rates and consideration of other revenues from

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[118] OCC Comments at 33.

[119] Id.; Roycroft Initial Affidavit at 39.

[120] OCC Comments at 33-34.

provision of service over the common network, such as bundles, broadband and video."[121]

T-Mobile

> calls for close review of a company's financial data for all services it offers using joint and common facilities before considering more subsidies to that company. It is essential for the PUCO to consider that RLECs today offer a combination of services that are driving higher average revenue per user (ARPU). In today's market, most RLECs are capable of recovering the full costs of providing those services from their own end user customers. Indeed, the NRRI Report acknowledges the propriety of recognizing such revenues in determining the need for high-cost support. The existence of "unregulated Internet or video revenue using common network assets" is one of the factors listed in the NRRI Report as reducing the need for a state universal fund.[122]

MACC and OCTA are in accord.[123] Thus the initial focus for revenue neutrality should not be – especially now that most ILEC rates are deregulated – on the ILECs' basic service rates.

B. Affordability Should Not Be The Standard For Assessing The Level Of Increases To An ILEC's Basic Service Rates.

Some of the carriers assert that it would be acceptable to focus on increases to the eligible ILECs' basic service rates for revenue neutrality. Verizon acknowledges that "ensuring the universal availability of some form of basic telephone service at an affordable price is important."[124] And T-Mobile says that "intermodal competition will continue to ensure that basic local exchange service functionality is available at

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[121] Sprint Comments at 3. It is not clear what Sprint means by "rationalization"; presumably, in Sprint's view, "rational" rates are those that minimize its costs.

[122] T-Mobile Comments at 5, citing NRRI High Cost Paper at 48-49 and 72; see also T-Mobile Comments at 2.

[123] MACC Comments at 4; OCTA Comments at 4.

[124] Verizon Comments at 15.

affordable rates."[125] Both of these postulations ignore the statutory **requirement** that ILECs provide the statutorily-defined basic local exchange service.

Sprint asserts that in order to receive support from other carriers, an ILEC "must be required to demonstrate that its rates would exceed reasonable affordability benchmarks."[126] In other words, the ILEC must be required to increase its rates to just below the point where they would become **unaffordable**.[127] That is certainly not the standard for federal universal service support mechanisms[128]; neither should it be the standard for an Ohio universal service mechanism **or**, as here, an ARF.

V. IF THE COMMISSION CREATES AN ACCESS RECOVERY FUND, THE ASSESSMENT SHOULD BE ON THE BROADEST LAWFUL BASE OF CONTRIBUTORS.

AT&T asserts that "all providers, regardless of technology (including wireless and interconnected VoIP providers) and including those ILECs eligible to receive universal service support from the Access Recovery Fund ('ARF'), should be contributors into the Fund."[129] This is one thing on which OCC agrees with AT&T.[130]

[125] T-Mobile Comments at 2.

[126] Sprint Comments at 6.

[127] Sprint cites a study conducted for the Pennsylvania Office of Consumer Advocate that supposedly "showed basic local service remains affordable within the non-BOC ILEC service areas for residential customers at $32 including fees and taxes." Id. at n.5. OCC has reviewed the study and asserts that Sprint misrepresents both the purposes and the conclusion of this study.

[128] As noted in OCC's initial comments, that standard directs rural rates that are "reasonably comparable to" urban rates (47 U.S.C. § 254(b)(3)), which should yield rates that are affordable.

[129] AT&T Comments at 2.

[130] See OCC Comments at 36-37.

A. Voice Over Internet Protocol Providers Should Contribute To An ARF.

Many of the commenters object to the unexplained provision of the PUCO staff proposal that would apparently assess wholesale services provided to VoIP companies for contributions to the ARF.[131] AT&T states that all VoIP providers should be assessed,[132] but does not explain how this can be lawfully done,[133] other than by the Commission expressly declaring the ARF to be a USF.[134] Many other commenters also point to the FCC's recent finding that nomadic VoIP providers can be assessed for state USFs as a basis for including them as contributors to the ARF.[135] As explained in Section X.D. below, however, the access revenue replacement fund is not a USF. Thus the FCC's findings on state USFs are irrelevant here.

But what is relevant is the provision in the new Ohio statutes that "permits the Commission to assess an ARF contribution requirement upon interconnected VoIP service providers where 'necessary for the protection, welfare, and safety of the public…'"[136] Requiring such contributions from interconnected VoIP providers is clearly necessary for those purposes.[137]

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[131] E.g., SLEC Comments at 15; Frontier Comments at 6; MACC Comments at 4-5; OCTA/Gillan, ¶ 19; Sprint Comments at 9.

[132] AT&T Comments at 2; see also Frontier Comments at 6.

[133] AT&T's red-lined edits to the PUCO staff proposal define interconnected VoIP as follows: "Interconnected VoIP shall not be considered an intrastate telecommunications service but its providers shall be required to contribute to the fund, and their assessable revenues shall be determined in a manner similar to commercial mobile service." AT&T Comments, App. A at 1; see also id. at 3. This does not answer the question of how the Commission can lawfully require these providers to do so.

[134] Id., App. B at 2.

[135] E.g., SLEC Comments at 12-15; AT&T Comments at 2; CenturyLink Comments at 4; Windstream Comments at 4.

[136] SLEC Comments at 12, quoting new R.C. 4927.03(A).

[137] This should address MACC's and OCTA's concerns. MACC Comments at 4; OCTA Comments at 5-6.

Those commenters who argue that VoIP providers should not be assessed do so for various reasons. Verizon asserts that "[p]ublic policy dictates that the Commission should not require providers of new, innovative services – including wireless and VoIP – to finance the business models of other telephone companies."[138] Wireless will be addressed in the next section, but as for VoIP, public policy would not support freeing VoIP providers from any responsibility to help make up these lost revenues – especially because the business models of most VoIP providers are based on their ability to avoid paying access charges to the ILECs on whose networks VoIP calls terminate.[139]

B. Wireless Carriers, Including Wireless Resellers, Should Also Contribute To An ARF.

As noted above, Verizon argues that no wireless carriers should be assessed, supposedly because wireless is a new and innovative service.[140] It should be recalled that this "new" service is now the one that has more subscribers than does wireline service. And the wireless companies have long taken advantage of the fact that their requirement for payment to terminate calls on other networks is **lower** than other carriers'.[141]

Cincinnati Bell correctly notes that the Commission should also assess wireless resellers. As Cincinnati Bell states, "Revised Code § 4927.03(B(1)(b) gives the Commission express authority over both wireless service and resellers of wireless

[138] Verizon Comments at 19.

[139] And the "burden" of ARF contributions (see id.) will be much less on all market participants if the burden is shared as broadly as possible.

[140] Verizon Comments at 19; see also T-Mobile Comments at 12.

[141] Roycroft Initial Affidavit at 48.

services for purposes of § 4927.15(C), the authority the Commission relies on to conduct this proceeding."[142]

C. Those Who Assert That They Should Not Contribute To An ARF Should Be Required To Seek Waivers.

As discussed above and in OCC's initial comments, the contribution base for an ARF should be as broad as legally possible. This means that the Commission should include in its revenue calculation and assess at least all ILECs, CLECs, IXCs, wireless carriers (both facilities-based and resellers), and VoIP providers (both fixed and nomadic). Any of these providers that assert they should not be assessed should be required to seek a waiver for the PUCO to rule on whether the provider can be exempted from contributing to the ARF.[143]

D. Contributors To An ARF Should Not Be Able To Establish A Surcharge For Collection Of The Contribution.

OCC stated in its comments that while the PUCO staff's ARF imposed a tax on retail telecommunications service providers, the ARF will amount to a new "tax" being imposed on already cash-strapped Ohio customers.[144] The comments confirm that if an ARF is imposed on service providers, those service providers will seek to recover those costs from end users through a surcharge.[145] Cincinnati Bell requests the Commission to confirm that "contributing carriers could pass the cost of their contributions through to end users."[146] AT&T states that carriers not only should be able to recover their

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[142] Cincinnati Bell Comments at 18.

[143] See Frontier Comments at 10; MACC Comments at 7.

[144] OCC Comments at 13.

[145] AT&T Comments at 8; Verizon Comments at 20; Windstream Comments at 3.

[146] Cincinnati Bell Comments at 20.

contributions, but that they should also "have the flexibility in how they can achieve such measure."[147] These requests point to the validity of OCC's position, and to the need for oversight of how end-users are assessed for their service provider's contribution. OCC is wary regarding AT&T's request for flexibility. The Commission must ensure that customers are not unfairly disadvantaged through the recovery practices of the assessed carriers. This is another reason not to create an ARF, with these inherent problems.

E. Both The Access Charge Reductions And The Recovery Mechanisms Should Be Phased-In.

AT&T asserts that there should be an "immediate, flash-cut to parity with interstate rates."[148] This is supposedly because of consistency with the immediate change implemented by the four largest ILECs when they reestablished rate parity…."[149] Of course, when those ILECs decreased their intrastate access charges, two (AT&T and Cincinnati Bell Telephone) did not even have to increase their own rates as a result of the reductions, and the other two (Embarq and Verizon) were able to achieve some (but not complete) revenue replacement within each company. And none of those changes were made in the context of a statute that required revenue neutrality.

On the other hand, the SLECs assert that there should be no access charge reductions until replacement mechanisms are fully in place.[150] Combined with the SLECs' other proposal for a review no sooner than five years after the ARF's enactment,

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[147] AT&T Comments at 8.

[148] AT&T Comments at 2.

[149] Id.

[150] SLEC Comments at 19. Indeed, as mentioned above, the SLECs even seek exemption from having to contribute to the ARF.

this virtually guarantees a substantial overrecovery for these companies, rather than revenue neutrality.

OCC's position is for a middle ground: **If** the Commission reduces intrastate access charges, there should be a phase-in of both the access charge reductions and the revenue replacement mechanisms. With regard to the former, the eligible ILECs' intrastate access charges have been at their current levels for almost ten years. Given the lack of benefits shown from those reductions,[151] contrary to AT&T's assertions, there is no pressing need for a flash-cut. And whether the Commission accepts the recommendation of OCC and numerous other commenters, and requires the eligible ILECs first recourse to be to their own rates, or whether the Commission inappropriately allows recovery of all the lost revenues through an ARF, the impact on customers will be eased with a phase-in.

VI. IF THE COMMISSION CREATES AN ACCESS RECOVERY FUND, IT MUST NOT ALLOW ILECS TO COLLECT FROM CUSTOMERS REVENUES LOST DUE TO ACCESS LINE LOSS AND STRUCTURAL DECLINES IN ACCESS MINUTES.

The SLECs assert that an ARF must compensate a carrier that has been required to reduce its intrastate access charges not only for the revenues lost as a result of those reductions, but also for revenues lost from the loss of access lines.[152] As discussed elsewhere, this confuses the statutory requirement of revenue neutrality if there are access charge reductions with possible universal service solutions.[153]

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[151] See OCC Comments at 23-28.

[152] SLEC Comments at 10.

[153] See AT&T Comments, App. B at 1.

OCC's initial comments extensively discussed the structural changes in the telecommunications industry that have resulted in the loss of access lines and the loss of access minutes – in the absence of any access charge reductions.[154] Neither of those sources of revenue loss should be compensated for through an ARF.

Most of the commenters agree that the ARF should not compensate an ILEC for access line loss.[155] Verizon asserts that

> [i]f a fund is established, it should be recalibrated periodically to account for access line and access minute losses. Current access lines and minutes should be used as the basis for calculating only current recovery from any fund.[156]

This is the only way to ensure that the statutory requirement that "**[i]n the event that** the public utilities commission reduces a telephone company's rates for carrier access that are in effect on the effective date of this section, that reduction **shall be on a revenue-neutral basis under terms and conditions established by the public utilities commission…"**[157] is accomplished, but no more.

VII. IF THE COMMISSION CREATES AN ACCESS RECOVERY FUND, IT MUST USE UP-TO-DATE REVENUE DATA AS THE BASE, AND THE FUND MUST BE REVIEWED AT LEAST ANNUALLY.[158]

Most of the commenters that address this issue support the use of the most up-to-date revenue data as the basis for calculating an ARF (if one is necessary), rather than the

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[154] OCC Comments at 30-32 and Roycroft Initial Affidavit at 16-25.

[155] See Cincinnati Bell Comments at 8-9; OCTA Comments at 3-4; MACC Comments at 3-4; Sprint Comments at 8; Frontier Comments at 5; Windstream Comments at 3.

[156] Verizon Comments at 21.

[157] R.C. 4927.15(B).

[158] See OCC Comments at 30-32.

2009 data that is part of the PUCO staff proposal.[159] Indeed, Cincinnati Bell correctly notes that the use of such outdated revenues would be contrary to the statute.[160]

Even more commenters that address this issue support a review of that data – including both the revenue calculation and the contribution calculation – at least every year, if not more often.[161] Only a few of the commenters support the two-year review in the PUCO staff proposal.[162]

A. Proposals For Less-Frequent Review Will Guarantee Over-Recovery.

The SLECs support the use of 2009 data for beginning the ARF,[163] and oppose the biennial review contained in the PUCO staff proposal, because it factors in line losses.[164] As discussed in Section VI. above, revenue losses due to access line losses are not the result of reduction in intrastate access charges, and must be factored out of any "revenue neutrality" calculations.

It is clear, however, from the SLECs' discussion that their main concern is with public policy and the "stranded cost" issue.[165] But that issue is not part of the statutory requirement for revenue neutrality; it is more properly a universal service issue, as discussed in Section X. below.

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[159] AT&T Comments, App. B at 5; OCTA/Gillan, ¶ 17.A.; Sprint Comments at 6-7.

[160] Cincinnati Bell Comments at 19.

[161] AT&T Comments, App. B at 5-6; Cincinnati Bell Comments at 11; Frontier Comments at 7; OCTA/Gillan, ¶¶ 17.B., 18; Sprint Comments at 7; Verizon Comments at 23.

[162] CenturyLink Comments at 5; Windstream Comments at 5. Perhaps CenturyLink takes this position because it has had the advantage of Embarq's never-reviewed $4.10 access recovery surcharge. See OCC Comments at 32.

[163] SLEC Comments at 9.

[164] Id. at 10.

[165] Id.

The SLECs do grudgingly concede that if the Commission "believes that periodic recalculation should occur … recalculation be performed at the longer interval of five years."[166] According to the SLECs, "[a] longer recalculation period has the benefit of capturing predictable receipts over a longer period…."[167] The problem is that the available data shows that those receipts have predictably declined, as discussed in OCC's initial comments.[168] Thus a five-year review period would predictably guarantee, not revenue neutrality, but revenue over-recovery.

B. On The Other Hand, A Fixed Term For An ARF And Onerous Conditions For Continuing The ILECS' Recovery Of Intrastate Access Charge Reductions Would Be Contrary To The Statute.

The SLECs apparently argue for a perpetual revenue replacement mechanism, even asserting that the inclusion of language anticipating termination of the ARF is "unnecessary, unduly restrictive and may fuel baseless efforts and unnecessary litigation to terminate the Fund prematurely…."[169] OCC believes that the General Assembly intended recognition only of the impacts of intrastate access charge reductions ordered by the Commission; eventually those impacts will be swallowed up by structural and regulatory changes, including the FCC action or the adoption of an intrastate USF, as recognized by the PUCO staff proposal.[170]

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[166] Id. at 11.

[167] Id.

[168] OCC Comments at 30 and Attachment C. As also stated in OCC's initial comments and here, more data is needed for the Commission to make its policy decisions in this proceeding.

[169] SLEC Comments at 20-21.

[170] Which is why the SLECs' proposal that the ARP explicitly state that "if ARF funding is discontinued, access rates will return to their current, pre-ARF levels…" (id. at 22) is also unnecessary, although the possibility should not be ignored.

On the other hand, Sprint takes a draconian approach to continuation of the ARF. Sprint says that the duration of the fund must be limited to no more than four years; after that,

> [a] ILEC may seek an extension of ARF distributions past the four year period upon a showing to the Commission that it has exhausted all measures to adapt its business to a non-ARF environment, it will likely go out of business unless ARF distributions are extended, and consumers will have no ability to make and receive calls if the ILEC ceases to exist as a going concern.[171]

The "going out of business" and the "no ability to make and receive calls" tests go well beyond any implication of the statute or the public interest. Sprint's position must be rejected by the Commission.

VIII. IF THE COMMISSION CREATES AN ACCESS RECOVERY FUND, IT SHOULD NOT TREAT PRICE CAP CARRIERS DIFFERENTLY THAN NON-PRICE CAP CARRIERS.

The commenters are in substantial agreement that the Commission should not treat price-cap ILECs differently than non-price-cap ILECs.[172] OCC agrees. This recognizes that the "price cap" regulation referred to is an artifact of federal interstate, rather than Ohio intrastate, regulation. AT&T is the one commenter that supports differential treatment; its proposals in this regard were addressed in Section IV. above.

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[171] Sprint Comments at 3; see also id. at 8

[172] See CenturyLink Comments at 5-6; Cincinnati Bell Comments at 12; Frontier Comments at 8; Sprint Comments at 10; Verizon Comments at 24.

IX. IF THE COMMISSION CREATES AN ACCESS RECOVERY FUND, IT SHOULD USE A THIRD-PARTY ADMINISTRATOR.

The commenters that express an opinion on this issue are in agreement that if the Commission creates an ARF, it should use a third-party administrator for the task.[173] OCC agrees. Of course, the expense of administering a fund is an additional reason for not requiring the access charge reductions that give rise to the need for a fund.[174]

X. THE CREATION OF AN ACCESS RECOVERY FUND FOR THE RECOVERY OF LOST ACCESS CHARGE REVENUE IS A SEPARATE MATTER FROM THE CREATION OF A UNIVERSAL SERVICE FUND TO REFLECT HIGH COSTS OF SERVICE.

A. The COLR Obligation Is Real, And Cannot Be Lightly Dismissed.

The SLECs correctly note that

> [i]t is the SLECs who are the [ETCs] for their service territories and they are the carrier of first (and only) resort. The SLEC network also remains a backbone of service for each of these competitors, since without the SLEC network, access to rural customers and their use of the internet, wireless service, and data transfer would all be diminished.[175]

The SLECs also correctly note the specific obligations that Sub. S.B. 162 placed on COLRs.[176] A COLR is required to provide service throughout a service territory, not just in the locations where the company decides that profit can be made.[177] As the SLECs also point out, "Customers located outside of the 'denser' town centers served by the SLECs generally are more likely to lack competitive alternatives and continue to rely

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[173] See AT&T Comments, App. B at 7-8; CenturyLink Comments at 6-7; Frontier Comments at 8-9; SLEC Comments at 5-7.

[174] See Cincinnati Bell Comments at 14; MACC Comments at 6.

[175] SLEC Comments at 4.

[176] Id. at 4-5.

[177] R.C. 4927.11(A).

upon the SLECs for service."[178] OCC agrees with the SLECs that the COLR obligation is real. But the ARF is not designed to address the COLR issue; as discussed below, the burden of that obligation should fall to an intrastate USF.

Some of the parties that oppose the ARF do so, in part, because of their disregard for the COLR obligation.[179] Verizon states that

> only if an Ohio ILEC can conclusively demonstrate that no other provider is able to offer service at affordable rates to consumers in its service area should the Commission consider other mechanisms to be necessary to assure universal service. … [T]o the extent ILECs face financial problems as a result of legacy regulatory obligations, those obligations can be eliminated as responsibility for serving customers passes to the competitive market.[180]

This ignores the recent landmark statutory enactment of the COLR obligation in Ohio – an obligation that no competitor bears – and also ignores the statutory process whereby an ILEC must seek a waiver from the obligation.[181] As discussed in the next section, however, the ARF is not the means to deal with the costs of the COLR obligation.

B. There Has Been No Analysis Of The Costs The COLR Obligation Imposes On ILECS, And Discussion Of The COLR Obligation Typically Ignores All Of The Revenue Sources Available To The ILEC.

The SLECs cite to "intense competition from a variety of alternative providers, including CLECs, wireless, cable, and Internet-based VoIP."[182] But the assertions about the state of competition in Ohio overstate the impact on the SLECs, and understate the

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[178] Id. at 4. That agreement does not mean that OCC buys into all of the SLECs' arguments as to the burden of the obligation, as discussed in the next section.

[179] See T-Mobile Comments at 2, 8-9.

[180] Verizon Comments at 17.

[181] R.C. 4927.11(A) and (C).

[182] SLEC Comments at 3.

opportunities available to the SLECs themselves. For instance, of the fifty-four CLECs actively marketing in Ohio,[183] how many are competing against SLECs that by and large retain their exemption against the interconnection obligations of the 1996 Telecommunications Act?[184] Many of the SLECs also offer video service and all offer broadband service.[185] (The "Vonage-type VoIP" cited by the SLECs[186] requires a broadband connection, which may well be purchased from the SLEC.)

In OCC's initial comments, the fact that there has been no data provided on the costs of being a COLR was discussed.[187] The record remains devoid of such data. As also discussed, the record also contains no data on the level and impact of intrastate access charge revenues, which is all that the ARF purports to address.[188] The costs of the COLR obligation need to be addressed through a high-cost USF, as discussed in the next section.

C. The COLR Obligation Is Best Addressed Through A High-Cost Universal Service Fund.

As CenturyLink notes, "the ARF fails to address ILEC recovery of the ongoing cost of fulfilling the provider-of-last-resort obligation."[189] That failure was deliberate, given the specific purpose of R.C. 4927.15(B) to address only revenues lost from intrastate access charge reductions.[190] On the other hand, CenturyLink "encourages the

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[183] Id.

[184] See 47 U.S.C. § 251(f).

[185] See Attachment D to OCC's Comments.

[186] SLEC Comments at 4.

[187] OCC Comments at 40-41; see also T-Mobile Comments, n.7.

[188] See November 3 Entry, Appendix B, Question 1.

[189] CenturyLink Comments at 3.

[190] See November 3 Entry, Appendix B, Question 1.

Commission to consider a separate fund to help ILECs offset the significant cost of providing service in high-cost, low-density population rural areas of the state."[191] As OCC has discussed, however, very little is known about the true cost of the COLR obligation; further, when the Commission considers the creation of a fund such as that suggested by CenturyLink, it must also consider all of the revenues available to an ILEC to help offset the high cost of service in rural areas.[192]

D. The ARF Revenue-Replacement Mechanism Is Not A State USF, And Thus Does Not Independently Allow Assessment Of VoIP Providers.

Many of the commenters equate the ARF to a "universal service" fund.[193] The Commission should reject these claims outright. This distinction on the nature of the ARF is not mere semantics. As noted in Dr. Roycroft's opening Affidavit, the ARF is a make-whole fund for lost access revenues,[194] and as such is not a universal service fund concerned with protecting universal service.[195] Federal law shows the proper parameters of a universal service fund; the ARF is not such a fund.[196]

As discussed in more detail in Dr. Roycroft's Reply Affidavit, any revenues above the cost of providing access are not automatically channeled to offset basic service

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[191] Id.

[192] Notably, the United portion of CenturyLink has maintained for many years a basic service rate structure that tends to charge lower rates in rural areas, due to more limited local calling areas, and higher rates in urban and suburban areas, and has charged uniform rates for most other services. If a company has done little to base its rates on differential costs of service, it is hard to see why customers of other companies should be asked to support those higher costs.

[193] See AT&T Comments at 2, 7, 8, 9; Cincinnati Bell Comments at 11; SLEC Comments at 13-15; T-Mobile Comments at 2, 6, 7, 8. Apparently AT&T thinks that calling the ARF a USF is enough to make it one. AT&T Comments, App. A at 2.

[194] Roycroft Initial Affidavit at 35, 36, 40, 41, 42.

[195] See also OCTA/Gillan, ¶ 15.

[196] See 47 U.S.C. §§ 254(b), (c), (f).

rates.[197] Rather, the SLECs have utilized this excess (if it exists) as a means to recover legitimate joint and common costs, or to fund varied aspects of their operations. If excessive revenues exist, these revenues could be flowing to shareholders or to investments in the ILECs broadband or video networks – they also could be allowing the ILECs to maintain lower rates for non-basic voice services that they offer over their network.

Those commenters that imply that there is some sort of dollar-for-dollar trade-off to be made between lowered access rates and higher basic rates can only make this statement by ignoring the multiple services that are now provided over ILEC networks, including the local loop. This is why OCC has recommended that a high-cost fund would be a better approach.[198] Such a fund would examine costs and evaluate all revenues that are available to offset those costs. Only with such an approach can a "universal service fund" be created that reasonably balances the interests of customers who might be called upon to finance the fund and the ILECs that will receive support.

XI. CONCLUSION

At this point, it should be crystal clear that the Commission cannot proceed further without more data, and without a hearing that is based on that data. Only upon such a review will the Commission be able to decide whether it is in the public interest to further reduce intrastate access charges of the smaller Ohio ILECs, and if that reduction is necessary, how the revenue neutrality dictated by the new law should be accomplished.

[197] Roycroft Reply Affidavit at 14-16.

[198] OCC Comments at 41.

OCC submits that, at this point, the harms of intrastate access charges higher than interstate access charges have been shown to be minimal, and the benefits of reducing the intrastate charges are even more minimal. This is especially true when the costs of imposing revenue neutrality are considered, costs that Ohio customers will be required to pay.

The General Assembly did not require the Commission to reduce intrastate access charges. The Commission should not do so at this time.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing *Reply Comments* was served by electronic mail to the persons listed below, on this 19th day of January, 2011.

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BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Commission's	**)**	
Investigation into Intrastate Carrier	**)**	**Case No 10-2387-TP-COI**
Access Reform Pursuant to Sub. S.B. 162	**)**	

Reply Affidavit

of

Trevor R. Roycroft, Ph.D.

on behalf of

The Office of the Ohio Consumers' Counsel

January 19, 2011

Table of Contents

I. Introduction

I am the same Trevor R. Roycroft whose affidavit was filed with OCC's opening comments. In this reply affidavit I will address statements made by various parties regarding alleged subsidies associated with basic service and intrastate access rates.

II. Cross-Subsidy Claims

Most of the industry parties raise the issue of subsidy and point to what they refer to as implicit subsidies that are alleged to exist in access charges, especially when intrastate access charges have not been set to parity with federal charges.[1] These parties argue that high access charges have provided "cross subsidies"—i.e., basic rates that are alleged to be below cost are supported by access rates that are allegedly above cost. The solution offered by these parties to these claimed cross subsidies is to have the eligible incumbent local exchange carriers ("eligible ILECs") recover the costs of their services only from "their own customers,"[2] that is, the eligible ILECs' retail customers. The statements made by these parties regarding implicit subsidies are contrary to the facts and economic theory on many levels. Indeed, based on an analysis of the eligible ILECs basic service rates, access revenues, and estimates of costs, it appears likely that most, it not all, of the eligible ILECs' basic service rates are priced above incremental cost, and provide a contribution to the joint and common costs of the company, and thus are not subsidized in the economic sense.[3]

[1] AT&T Comments, p. 3; MACC Comments, pp. 2, 3, and 4; T-Mobile Comments, pp. 5-6; Sprint Comments, p. 1; Verizon Comments, p. 3.
[2] Sprint Comments, p. 5; T-Mobile Comments, p. 8. This advice is somewhat ironic as it ignores the fact that the companies that terminate traffic on ILEC networks are in fact also customers of the ILEC.
[3] The distinction between economic subsidy and universal service support must be carefully understood. As will be discussed further below, the key test regarding economic subsidy is whether prices are above incremental costs. Universal service support is not based on the economic costs of eligible ILECs, thus, the existence of federal universal service support should not be confused with the existence of economic subsidy.

III. Cost Analysis is Needed to Quantify Subsidy Claims

As will be discussed in more detail below, the quantification of subsidy or cross subsidy requires cost analysis. Thus, the first problem with the various parties' claims is that they are made without the benefit of any cost foundation. Apparently these parties have a "gut feeling" that the access rates charged by the non-parity ILECs are "above cost" and that basic service is "below cost." Apparently the parties further believe that the repetition of their opinion will convince the Commission that it is true. Of course, these parties do not take the time to explain what they are talking about when it comes to cost or subsidy, and it takes more than repetition to develop convincing economic evidence that supports the claim that cross subsidization exists.

A. Basic Service Does Not "Cause" Joint and Common Costs

It appears that these parties may also hold the naïve assumption that basic telephone service alone results in the ILEC's joint and common costs (including the cost of the local loop) being incurred, thus making basic service the "cost causer" for all joint and common costs (including the loop costs). Such a position is unsupportable. The ILEC's joint and common costs were incurred as a result of the full range of business decisions made by the ILEC. The ILEC made the decision to invest in the facilities (including local loops) needed to provide services based on the anticipation that a **variety** of services would be sold over the loops—local, long distance, vertical features, enhanced services, and access. ILECs correctly anticipated that customers would have demand for these various services. Furthermore, we no longer live in a world where ILECs provide only voice services. ILECs today provide broadband services, and in some cases video services, over the same facilities that are used to provide basic voice and toll access. Consumers can seek to satisfy their demand for broadband Internet access, and in some cases video programming, from the ILEC, which can utilize its local plant to deliver these services. Thus all of these services must contribute to the recovery of the joint and common costs of the telephone company.

B. When Profit Constraints are Removed, Cross Subsidy is Difficult to Establish

It is also important to note that the relaxation of regulatory oversight for certain services has a substantial impact on the evaluation of costs, prices, and subsidy. Some parties make arguments that basic voice service customers are the beneficiaries of access rates that are set too high.[4] These claims, however, are based on the implicit assumption that the profits of the ILECs are constrained to ensure that these firms earn no more than "normal" economic profits. Given the increasingly deregulatory environment in Ohio over the past several years, this is certainly no longer the case. And for all of the ILECs, the elimination of pricing constraints resulting from Substitute Senate Bill 162 appears to have eliminated the profit constraint.

If profits are not constrained, then the evaluation of prices and subsidies must also include the potential of shareholders earning above-normal returns, which represents another use of the revenues from prices that are set "above cost." As will be discussed in more detail below, evaluation of specific subsidy flows becomes much more difficult once the profit constraint is removed.

Sprint recognizes that claims that access rates are "too high" cannot be solely attributed to low rates for basic local service, and that the removal of the profit constraint makes the tracking of cash flows within the ILEC more difficult:

[4] T-Mobile Comments, 4; Verizon Comments, p. 3.

> In today's market a subsidized ILEC can use the subsidy to 1) create artificially low rates for its own retail services in order to undercut its competition; 2) invest in non-regulated services like broadband and video in order to gain a competitive advantage over carriers that must invest in these capabilities with their own funds without the benefit of subsidies; and 3) enrich the shareholders and executives of the ILEC at the expense of their competitors and Ohio consumers.[5]

Sprint correctly admits that there are possibilities other than "keeping local rates below cost" that could result from access rates being set "above cost." However, Sprint, like all other parties that address the alleged subsidization of basic service by "above-cost" access rates, offers no analysis of costs or subsidies that are alleged to be at the root of the "problem" of high access charges. Thus, neither Sprint nor any other party offers proof that basic rates are "below cost."

IV. Economic Analysis of Subsidies

For cross subsidies to exist at all the firm in question must obviously be a multi-product firm, i.e., it must produce more than one product or service. ILECs are in fact multi-product firms, thus it certainly is possible to conduct cross-subsidy analysis. It is likely that any multi-product firm will have some costs which are not directly attributable to a specific product or service. These costs are described by economists as "joint and common" costs.[6] To determine whether or not cross subsidies exist, analysis must be undertaken that evaluates the costs that are directly attributable to a product or service, and the costs which are joint and common to the production of the various products or services produced by the firm.

[5] Sprint Comments, p. 2.
[6] Joint and common costs arise where shared production facilities are present. Joint costs are more narrowly defined in that they are associated with fixed proportions in production—the classic example being the cost of feed for producing beef and hides. Common costs are associated with variable proportions in the relationship between inputs and outputs, and are more representative of conditions in telecommunications. See for example, Rodriguez Pardina, M., Schlirf Rapti, R., and Eric Groom, E. *Accounting for infrastructure regulation: an introduction*, World Bank, 2008, p. 49.

A. Incremental Costs and Stand-Alone Costs

The economic test for cross-subsidy requires the definition of two key terms. The first term is **incremental cost**. Incremental cost is the cost of adding (or subtracting) a product line to a multi-product firm's operations. Measuring incremental cost for a multi-product firm begins conceptually with the estimation of the total cost to meet demand for a set of products. For example, if a firm produces three products "A", "B", and "C", the total cost of producing "A", "B", and "C" together can be calculated. The information on the total cost can then be used to calculate the incremental cost. For example, the incremental cost of product "A" can be expressed as follows:[7]

$$IC(A) = TC(A, B, C) - TC'(B, C)$$

Where: IC = Incremental Cost

TC = Total Cost associated with producing all products.

TC' = Total Cost associated with producing only B and C.

This expression represents the calculation of the incremental cost of "A" by first calculating the total cost of all three product lines, and then subtracting from that total cost the alternate total cost of producing only two of the product lines, thus excluding product line "A".[8] This approach will capture the incremental costs of adding "A" to the firm's set of products, and will exclude the joint and common costs of plant and equipment that "A" will share with the other services.

[7] Economic cost analysis does not make jurisdictional distinctions, thus the general discussion that follows addresses costs on a total company, unseparated, basis. Jurisdictional separations are, of course, relevant to regulatory decisions in telecommunications.
[8] This example makes the simplifying assumption that the products produced have zero cross-price elasticities, i.e., they are not economic substitutes or complements. If cross-price elasticities across product lines are non-zero, the level of demand may shift for the remaining products as a result of the exclusion of one of the products. Addressing this issue in cost studies is not difficult, but is ignored here to keep the discussion as straight-forward as possible.

To use a simplified example, if "A" is basic local exchange service; "B" is toll service; and "C" is access service, the incremental cost of basic local exchange service excludes all of the joint and common costs of providing the service (including the local loop). Part of the simplification here is that we ignore the many vertical, enhanced, broadband and any video services that are also offered over that joint and common plant.[9]

With regard to the subsidization question, evaluation of incremental cost provides the ability to conduct a key test for cross-subsidy. If the revenues associated with the service in question are below incremental costs, then the service is **receiving** a subsidy.[10]

The other key element of cross-subsidy analysis is the **stand-alone cost** of a product or service. The stand-alone cost of a service is the total cost of producing the service in isolation—thus the stand-alone cost includes both the incremental cost of a service and all joint and common costs. Under certain conditions, if a service is priced above its stand-alone costs, the service can be said to be **providing** a subsidy.[11]

It is also important to understand the level of **contribution** to joint and common costs that a service is providing. The difference between the revenues produced by a service and the incremental cost of a service identifies the contribution provided by the service. A service generating revenues above incremental cost does not mean that the service's price is excessive.

[9] This example focuses on total incremental costs. In order to determine the relationship of unit prices to unit incremental costs, projected demand volumes can be divided into the total incremental costs, resulting in unit incremental costs.
[10] As will be discussed further below, the demonstration of cross-subsidy is also dependent on whether or not the firm is under profit regulation. If a firm does not have the ability to maintain "normal" economic profits, e.g., through a request for rate relief, then a price below cost may not result in cross-subsidy—it may result in lower shareholder profits.
[11] Here again, if profit regulation is eliminated, prices above stand-alone costs do not necessarily suggest subsidy—excessive shareholder profits may also be the result.

A multi-product firm like an ILEC has substantial joint and common costs, thus each service should provide some contribution to joint and common costs.[12]

B. Example of the Cross-Subsidy Test

To demonstrate whether a service like access service is providing cross-subsidy to another service like basic local exchange service, two things must be demonstrated: (1) The price of basic local exchange service must be shown to be priced below its incremental cost; and (2) the price of access service must be shown to be above its stand-alone cost. This evaluation of cross-subsidy must also examine the incremental and stand-alone costs of products and services in combination, which makes the analytical process more complex.[13]

To illustrate the proper approach to economic cross-subsidy analysis, again using the highly simplified three-service example, suppose that for a hypothetical ILEC the incremental cost of producing basic local service is $50, the incremental cost of producing toll service is $50, and the incremental cost of providing access service is $50.[14] Also assume that the joint and common cost of providing any (or all) of the three services is $100. Thus, the total cost of producing all three services is $250 (i.e., $50 + $50 + $50 + $100 = $250), and the respective stand-alone costs for local, toll, and access are $150 each (i.e., to provide any service alone, all the joint and common costs [$100] and the service's incremental costs [$50] must be incurred). Suppose that the regulator sets the prices so the firm just covers the economic cost of service (including the

[12] The analysis of contribution should acknowledge the existence of explicit universal service support. As is discussed further below, federal universal service support is targeted at basic service. Thus, it is reasonable to conclude that this support should be counted as contribution from the basic service offering.
[13] The seminal source on the economic analysis of cross-subsidy is Faulhaber, G. "Cross Subsidization: Pricing in Public Enterprises," *American Economic Review*, Vol. 65, No. 5, (Dec. 1975), pp. 966-977. The example that follows is based on this source.
[14] In practice, incremental costs are typically calculated by applying an engineering cost model that utilizes forward-looking economic cost assumptions.

cost of capital), and total revenues equal total costs.[15] Thus, the price of basic service could be set to generate revenues of $60, toll prices could be set to generate revenues of $100, and access rates could be set to generate revenues of $90. Thus, total revenues equal total costs (i.e., $60 + $100 + $90 = $250). Table 1 illustrates the process of testing for subsidy.

Table 1: Subsidy-Free Rates

Services	Revenues	Stand-Alone Cost	Incremental Costs
Basic	$60	$150	$50
Toll	$100	$150	$50
Access	$90	$150	$50
Basic and Toll	$160	$200	$100
Basic and Access	$150	$200	$100
Toll and Access	$190	$200	$100
Basic, Toll, and Access	$250	$250	$250

It can be seen in Table 1 that these prices are subsidy-free. No service or group of services is priced below its incremental cost, and no service or group of services is priced above its stand alone costs. Because of being priced above incremental cost, each service also provides some level of contribution to joint and common costs.

This example illustrates a second critical problem with various parties' claims of subsidization—the failure to address the necessity of contributing to joint and common costs. **Access prices set above incremental cost do not demonstrate cross-subsidy.** Joint and common costs are legitimate costs reflecting investment that is needed to provide access service, and access should contribute to the recovery of joint and common costs. Thus, even if we prove that access rates are above incremental cost, we have not proved the existence of cross-subsidy. While it might be desirable from the access charge payers' point of view to pay access charges that cover only

[15]The condition of revenue equaling costs generally holds true (or is at least supposed to hold true) in the rate-of-return environment, but does not where oversight of profits has been eliminated and/or prices have been deregulated.

incremental costs,[16] there is no economic rationale to support such a pricing plan. If the regulator decides to favor long-distance carriers with incremental cost pricing, it will simply shift the recovery of joint and common costs to other services.

T-Mobile offers a variation on the theme that interconnecting carriers should be allowed to pay as little as possible for terminating traffic—bill and keep, where carriers do not pay other carriers for terminating traffic.[17] While T-Mobile claims that such an arrangement will prevent "gaming" of traffic flows,[18] the T-Mobile proposal simply shifts all the gaming up front.

Under a bill and keep arrangement each carrier is responsible for recovering the costs of originating and terminating traffic from end-users on its own network. Bill and keep seems like a simple solution, and it is, as long as carriers have similar cost structures in their access networks and also exchange similar traffic volumes. Under a bill and keep arrangement, interexchange carriers ("IXCs") that have no end-user facilities get the best deal because they are freed from contributing to last mile facilities on either end of their customer's call. Similarly, wireless carriers like T-Mobile also benefit, as they can avoid any contribution to the costs of terminating traffic on wireline networks. Wireless carriers do not provide ubiquitous service, especially in high cost areas, but wireless callers receive the benefits of being able to reach wireline subscribers served by ILECs in high-cost areas. T-Mobile's proposal would allow it to ride for free on all terminations on an ILEC network. Because termination costs and traffic flows differ, bill and keep ultimately results in a solution that, like Sprint's incremental cost proposal, unfairly shifts all joint and common cost recovery to ILEC end-users. Cost-based interconnection rates that provide reasonable contribution to joint and common costs provide a solution superior to the approach advanced by T-Mobile.

[16] Sprint Comments, p. 1.
[17] T-Mobile Comments, p. 3.
[18] T-Mobile Comments, p. 3.

C. Example of Cross-Subsidy

Given the claims that access services are subsidizing basic rates,[19] what would have to be true for this subsidy claim to be substantiated? To illustrate the necessary conditions to show that basic rates are subsidized by access service rates, suppose that the regulator adjusts prices, so that the respective revenues for basic, toll, and access are now \$40, \$100, and \$110. Table 2 below shows this outcome.

Table 2: Cross-Subsidy

Services	Revenues	Stand-Alone Cost	Incremental Costs
Basic	\$40	\$150	\$50
Toll	\$100	\$150	\$50
Access	\$110	\$150	\$50
Basic and Toll	\$140	\$200	\$100
Basic and Access	\$150	\$200	\$100
Toll and Access	\$210	\$200	\$100
Basic, Toll, and Access	\$250	\$250	\$250

Table 2 shows that this new rate design results in basic service customers experiencing prices that are below incremental costs. This suggests that basic service rates are receiving a subsidy. But the **source** of the subsidy is not clear. Table 2 also shows that toll service and access service are individually priced below their stand-alone costs. Thus, it is not possible to say that either the toll rates or the access rates are the source of the subsidy. However, because the revenues generated from toll and access combined are in excess of the combined stand alone costs of toll and access, we can say that toll and access together are the source of the subsidy (again, in this simplified three-product firm.) For access alone to be identified as a source of subsidy, the

[19] E.g., T-Mobile Comments, p. 4; Verizon Comments, p. 3.

access price would have to exceed its own stand-alone cost—i.e., its price would have to exceed the sum of both the incremental cost of access and all joint and common costs.

D. The Stand-Alone Cost Test is Unreliable When Profits are Not Constrained

The example above shows that the ability to specifically attribute subsidization in a multi-product firm like an ILEC is not as simple as some of the parties would imply. However, the picture becomes even less clear when the regulatory constraint on profits is removed. The examples above each assumed that the regulator constrained the profitability of the firm (i.e., revenues were only allowed to exactly equal the cost of production, $250). If some or all prices are deregulated, subsidy flows are more difficult to track. Suppose that toll rates have been deregulated (while basic and access remain subject to regulatory rate-setting). Assume that the combined impact of price setting by both the firm and the regulator results in the following prices for basic, toll, and access: $40, $120, and $110. Now total revenues are $270 rather than the previous $250, and the firm is earning "above normal" returns. Table 3 shows this scenario.

Table 3: Profit Constraint Removed

Services	Revenues	Stand-Alone Cost	Incremental Costs
Basic	$40	$150	$50
Toll	$120	$150	$50
Access	$110	$150	$50
Basic and Toll	$160	$200	$100
Basic and Access	$150	$200	$100
Toll and Access	$230	$200	$100
Basic, Toll, and Access	$270	$250	$250

Table 3 shows that the firm again fails the stand-alone cost test for toll and access. However, the failure of this test is not attributable entirely to service prices set below incremental cost. It is also the result of the relaxation of the regulatory constraint on the price of toll services.

This example illustrates a very important principle regarding cross-subsidy analysis when the assumption of the regulatory control of profits is relaxed—"The focus of cross-subsidy analysis shifts entirely to the IC (incremental cost) tests; the SAC (stand-alone cost) tests are not helpful under conditions of positive economic profits."[20] As previously discussed (and noted by Sprint), if above-normal profits are possible, then shareholders are among the potential beneficiaries of above-cost pricing. Without the profit constraint, the stand-alone cost test does not provide reliable information. Thus, the key focus of analysis of subsidy becomes whether or not prices are below incremental costs.

V. Are the Eligible ILECs' Basic Exchange Service Rates Below Incremental Cost?

Given the prices that the eligible ILECs are currently charging for basic service, it appears unlikely that most of the eligible ILECs' residential customers pay prices for basic service below incremental cost. While specific cost studies are needed to fully understand the relationship of the eligible ILECs' rates to incremental cost, some insight can be gained from publicly available information on costs. One source of information regarding incremental costs in Ohio can be found in results of the FCC's Hybrid Cost Proxy Model (HCPM).[21] The FCC produced runs of the HCPM for United (now part of CenturyLink) and GTE Ohio (now part of Frontier) properties.[22] While the GTE and United properties are not eligible ILECs, the HCPM results can shed some light on incremental costs. Relative to most eligible ILECs, United Ohio and GTE

[20] Faulhaber, Gerald. "Cross-Subsidy Analysis with More Than Two Services," *Journal of Competition Law & Economics* (2005) Vol. 1, No. 3, pp. 441-448.
[21] The HCPM is an engineering cost model that applies forward-looking economic cost assumptions (see, e.g., C. Bush, D. Kennet, J. Prisbrey, W. Sharkey, and V. Gupta, "Computer Modeling of the Local Telephone Network," October 1999.) There is no question that the results of the HCPM are dated. The most recent runs posted on the FCC's web site were from year-end 1999. Cost trends since then are not clear cut. According to input price data from the Bureau of Economic Analysis, changes in communications input-price trends in the intervening years shows declines in two relevant indices, and an increase in another. Of course, labor and capital costs have changed as well. Thus, updated cost studies are needed to reach final conclusions regarding the existence of economic subsidy. However, as will be illustrated below, the HCPM results can be used to provide perspective on the relationship between current rates and costs in light of subsidy claims.
[22] The HCPM results referenced are available at: http://www.fcc.gov/ccb/apd/hcpm/

Ohio are very large operations, and thus enjoy scale and/or density economies that may not be available to the most of the eligible ILECs. One would expect that the eligible ILECs have cost structures that will result in higher incremental costs of service.

The HCPM calculates the forward-looking economic cost of local switching, signaling, and transport. When combined, these forward-looking economic cost estimates of local usage provide a reasonable equivalent to the incremental cost of basic service. The HCPM results calculated by the FCC staff show the incremental cost of local usage to be $2.22 per line per month for United Ohio, and $2.61 per line per month for GTE Ohio.[23]

Eligible ILEC basic rates currently range from $4.05 to $24.65 per month. Using the more conservative benchmark of $2.61 per month local usage costs associated with the GTE studies, there are no eligible ILEC basic rates that are priced lower than this value.[24] If we increase the $2.61 benchmark by a **factor of three to $7.83**, implying that the eligible ILECs have incremental costs of local usage three times those of GTE Ohio, there are eight eligible ILECs with basic rates below the $7.83 alternative benchmark. These companies have 9,964 residential access lines, i.e., 4.0% of eligible ILEC residential access lines or 0.41% of all residential access lines in Ohio.[25] While company-specific cost studies would enable a statement made with greater confidence, it seems reasonable to conclude that the "problem" of basic service being priced "below cost" (i.e., incremental cost) by the eligible ILECs is either nonexistent or small.

[23] These incremental cost estimates are based on the sum of the weighted average costs of local switching, signaling, and transport for each company.
[24] See Attachment D to the OCC's December 20, 2010 Comments for eligible ILEC basic exchange price ranges.
[25] The companies are: Ridgeville Telephone, Telephone Service Co., Fort Jennings Telephone Co., Glandorf Telephone Co., New Knoxville Telephone, Kalida Telephone, Pattersonville Telephone, and Middle Point Home Telephone. In addition, the Chesterfield exchange of Windstream Ohio has a basic service rate below the benchmark.

VI. Basic Service Contribution to Joint and Common Costs for the Eligible ILECs

If basic service rates are above incremental costs, then these rates provide contribution to joint and common costs. However, basic service subscribers – like other subscribers – also pay the end-user common line charge ("EUCL"), [26] which was created to contribute to the recovery of non-traffic-sensitive costs.[27] NECA Tariff No. 5 identifies the EUCL charge for residential customers as $6.50 per month. When basic rates are above incremental cost, this payment results in basic service customers providing additional contribution to joint and common costs.

It is also important to consider the impact of federal high-cost support. According to the FCC, "the high-cost support mechanisms are intended to hold down local rates and thereby further one of the most important goals of federal and state regulation—the preservation and advancement of universal telephone service."[28] As discussed above, it seems reasonable to conclude that current local rates for most of the eligible ILECs are priced above incremental cost. The fact that most of the eligible ILECs' basic service rates appear likely to pass a subsidy test suggests that all other federal universal service support can reasonably be counted as contribution from basic service to offset joint and common costs (including local loops). Federal support for the Ohio eligible ILECs ranges from $0.73 to $143.14 per line per month, with a simple average of $21.63 per line per month.[29]

[26] The EUCL is also known as the Subscriber Line Charge (SLC).
[27] *In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, CC Docket No. 96-262, CC Docket No. 94-1, CC Docket No. 91-213, CC Docket No. 95-72, FCC 97-158, First Report and Order, May 16, 1997, ¶34.
[28] *Universal Service Monitoring Report*, CC Docket 98-202, December 2010, p. 3-1.
[29] Federal support from USAC HC01 report to FCC, fourth quarter 2009, annualized. Line counts used in the calculation from Attachment C to OCC Opening Comments.

In sum, basic rates for most eligible ILECs appear to be providing contribution to joint and common costs. Adding the EUCL revenues only increases this contribution. Federal universal service support further adds to the contribution associated with the basic service offering.

VII. Is There Evidence that Access Rates are Above Stand-Alone Costs?

As discussed above, stand-alone costs include the direct incremental cost of the service and all joint and common costs. To evaluate whether there is evidence that any eligible ILECs are currently collecting access revenues in excess of the stand-alone cost of access service, I will again use the information from the FCC HCPM on the United and GTE properties. This is a highly conservative assumption as these companies are much larger, and serve higher density areas than most of the other eligible ILECs. I expect that most of the eligible ILECs have higher costs than are shown in the GTE and United HCPM data.

To consider the stand alone cost of access, data on both the incremental cost of access usage and the joint and common costs of access are needed. Because the HCPM does not produce an estimate of the incremental costs of intrastate access usage, I will make the very conservative assumption that the incremental cost of intrastate access usage is zero. This assumption makes it easier for access service to fail the stand-alone cost test and therefore to be shown to be providing subsidy. With regard to the level of joint and common costs associated with the loop and port, I will apply the more conservative loop and port cost estimate of $31.95 associated with the United Ohio HCPM results. Thus, the stand-alone cost test will compare the eligible ILECs' intrastate access revenue per line to the $31.95 loop and port cost. By using the lower figure for the loop and port costs, it will be easier for the access service to fail the stand-alone cost test—i.e., a lower level of access revenues will result in the stand-alone cost test showing that access is providing a source of subsidy. If the intrastate access revenue per line exceeds this estimate of the loop and port cost, then further investigation may be warranted.[30]

The data shows that there are only six eligible ILECs that have intrastate access revenues greater than (or close to) $31.95 per line per month.[31] These companies serve a total of 6,227 residential access lines, i.e., 2.5% of eligible ILEC residential lines, and 0.26% of all residential switched access lines in Ohio. Here again, under highly conservative assumptions the problem of access charges providing a cross-subsidy appears to be small, if it exists at all. In addition, given the absence of a profit constraint, linking any excess contribution from access charges to basic service customers is problematic. Only one of these six eligible ILECs has basic rates below the $7.83 incremental cost of local usage benchmark discussed above.[32] If there is contribution from access charges in excess of stand alone cost, it may be going to support investment in other services or shareholder returns for these six small companies.

VIII. Conclusion

The analysis above provides some perspective on the cross-subsidy "problem." While the Commission will need to develop complete cost information to fully address the subsidy question, given the information available, it appears that the evidence supporting the proposition that eligible ILEC basic rates are below cost is weak. Rather, most eligible ILEC basic rates are likely providing contribution to joint and common costs, and the EUCL payment and federal universal service support only adds to that contribution. As shown above, under a conservative

[30] As was the case with the earlier examples, specific cost estimates are required to reach any definitive conclusions.
[31] Five companies with access revenues per line greater than $31.95 are Bascom Mutual Telephone, Doylestown Telephone , Farmers Mutual Telephone, Nova Telephone, and Ridgeville Telephone. Oakwood Mutual Telephone (with 1,065 access lines) shows access revenue per line just below the assumed benchmark at $31.91 per line per month. See Appendix C to the OCC's December 20, 2010 Comments for a listing of the eligible ILECs' access revenue per line.
[32] Ridgeville Telephone has basic rates of $7.75 per month for some of its 492 residential customers. Bascom Mutual has basic rates just above the $7.83 benchmark, at $7.90 per month for its 1,042 residential customers.

set of assumptions, only a small number of eligible ILEC access lines might have a problem associated with rates below incremental cost. In addition, under a very conservative set of assumptions, only a small number of access lines may be associated with the access service providing excessive contribution. However, given the size of these companies, it is likely that their loop and port costs are much higher than those associated with the United Ohio costs used in the stand-alone cost analysis. Thus, I believe that it is reasonable to expect that the excessive contribution "problem" is actually much smaller, if it exists at all. The analysis discussed above lends further support to the conclusion stated in my opening Affidavit—it is unlikely that the benefits of implementing the Access Recovery Fund will exceed the costs. The Commission cannot reasonably count on fixing a "cross-subsidy" problem as a benefit of the Staff proposal.

VERIFICATION

The undersigned, being first duly sworn, hereby affirms under oath that the information in the attached affidavit is true and correct to the best of his knowledge, information and belief.

Trevor R. Roycroft

Patricia Sylvia-Gonsalves

Notary Public

PATRICIA L. SYLVIA-GONSALVES
NOTARY PUBLIC
Commonwealth of Massachusetts
My Commission Expires
August 29, 2014

Subscribed and sworn to me this 19th day of January, 2010

My commission expires 8/29/2014