OCTUA #4

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of The Ohio Bell Telephone Company for Approval of an Alternative Form of Regulation.	))))	Case No. 93-487-TP-ALT

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REBUTTAL TESTIMONY
OF
CARL E. HUNT, Ph.D.

SUBMITTED ON BEHALF
OF
THE OHIO CABLE TELEVISION ASSOCIATION

CARL E. HUNT
REBUTTAL TESTIMONY

1. Q. WHAT IS YOU NAME AND BUSINESS ADDRESS?

1. A. My name is Carl E. Hunt. My business address is 2542 Pine Street, Boulder, Colorado.

2. Q. ARE YOU THE SAME CARL E. HUNT WHO PREVIOUSLY FILED DIRECT TESTIMONY ON BEHALF OF THE OHIO CABLE TELEVISION ASSOCIATION?

2. A. Yes, I am.

3. Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

3. A. The purpose of my rebuttal testimony is to address issues of cross-subsidy between Ameritech Ohio's deregulated business activities and its regulated business activities. These issues are not addressed by Ameritech Ohio in its alternative regulation plan or testimony. Nor are these issues addressed in the Staff Report or direct testimony by the Staff.

Ameritech Ohio witness Dr. Currie states that the Total Incremental Cost (TIC) test is a sufficient safeguard against the economic cross-subsidization of competitive and non-competitive regulated services and that no special analysis is required beyond what is already proposed in the Advantage Ohio Plan. My direct testimony, the testimony of Staff witness Roger G. Montgomery and others in this case, amply demonstrate that the TIC does not provide a satisfactory test against cross-subsidization within the services covered by the Advantage Ohio Plan.

However, I do not wish to address the issue of cross-subsidy within the Advantage Ohio Plan; but rather, I wish to address the issue of cross-subsidy between legally regulated services that fall under the jurisdiction of the Public Utilities Commission of Ohio (PUCO) and those legally unregulated intrastate services that fall outside of the jurisdiction of the PUCO.

The issue of cross-subsidy between intrastate regulated and intrastate unregulated services first surfaced during cross-examination of Staff witnesses Lori Sternisha, Dan Shields and Nadia Soliman by the Ohio Newspaper Association. For example, Ms. Soliman stated under cross-examination that for unregulated services (services not under the PUCO jurisdiction) Ameritech Ohio would file no long-run service incremental cost study (LRSIC), no imputation study and no joint cost study. Ameritech Ohio will need to file such studies only for regulated services that fall under the jurisdiction of the PUCO. So, even if Dr. Currie were correct that the TIC test adequately protected against cross-subsidy, the TIC test would not be sufficient because it does not address cross-subsidy of intrastate unregulated services on an ongoing basis.

4. Q. COULD YOU EXPLAIN HOW REGULATED AND UNREGULATED COSTS ARE DERIVED TODAY?

4. A. Yes. The costs of regulated and unrelated services are derived by the process of cost separations. Cost separations are a multipart process. They begin with Ameritech Ohio's total company accounts. The first action taken is to remove unregulated federal services from the total company accounts using FCC Part 64 rules. The FCC Part 64 rules rely on a fully distributed cost (FDC) method to make this separation. The purpose of this separation is twofold: first, to take out the unregulated federal services so that their revenues, expenses and investments will not be included in developing regulated revenue requirements and rates; second, to minimize cross-subsidy of unregulated federal services by regulated services.

The second action is to remove the regulated interstate (federal jurisdiction) services from the remainder of the total company accounts (total company accounts less unregulated federal services). The interstate jurisdictional costs are separated using the FCC Part 36 rules. The FCC Part 36 rules use an FDC study to make this separation. The purpose of this separations process is to establish costs that are jurisdictional to the FCC and costs that are jurisdictional to the state so that one jurisdiction does not unduly subsidize the other jurisdiction.

Once the Part 36 separations are made (subtracted from the total company records less the unregulated federal services), the remainder is state jurisdictional.

State jurisdictional does not mean that all the remaining expenses and investments are jurisdictional to the PUCO because some of the state jurisdictional services or business activities also are unregulated or fall outside the jurisdiction of the PUCO. My understanding is that Ohio applies a separations process similar to the FCC Part 64 rules to the intrastate expenses and investments to obtain its jurisdictional or regulated expenses and investments. The PUCO's jurisdiction will include all the services Ameritech Ohio offers under its Advantage Ohio Plan. The PUCO's jurisdiction will exclude all intrastate unregulated telecommunications services, those services preempted by the FCC and other non-PUCO regulated business activities.

Again, the purpose of applying Part 64-type rules to Ameritech Ohio's intrastate records is twofold: first is to take out the unregulated state services so that the unregulated revenues, expenses and investments will not be included in developing regulated revenue requirements and rates; second is to minimize cross-subsidy of unregulated state services by regulated services.

5. Q. UNDER AMERITECH OHIO'S ADVANTAGE OHIO PLAN, WILL THIS SEPARATIONS PROCESS CONTINUE SO THAT CROSS-SUBSIDY BETWEEN REGULATED AND UNREGULATED SERVICES WILL BE MINIMIZED?

5. A. No. Neither Ameritech Ohio's Advantage Ohio Plan nor the Staff Report contemplates an evaluation of cross-subsidies between regulated and unregulated services. Such a separation was made only for total revenue requirements purposes in the complaint case. However, as time goes on and Ameritech Ohio adds unregulated activities, we can no longer reasonably be assured that regulated services do not cross-subsidize unregulated services.

6. Q. COULD YOU EXPLAIN HOW A CROSS-SUBSIDY CAN DEVELOP BETWEEN REGULATED AND UNREGULATED ACTIVITIES OVER TIME?

6. A. Yes. I will use a very simple example of a regulated utility that offers only one regulated service at the beginning of this hypothetical example. The total cost (revenue requirement) to provide the service is $100.00 of which $50.00 is fixed and $50.00 variable. For purposes of the hypothetical, depreciation will equal new investment and the rates of inflation and productivity are equal to zero. 100 units of service will be offered at the beginning period so that the per unit rate is $1.00. The number of regulated units will remain constant during this hypothetical.

In the first period of the hypothetical, a regulated revenue requirement of $100.00 with a per unit cost, of $1.00 is established by the regulatory commission. As provided under Advantage Ohio, the regulatory commission does not examine costs and revenues in any subsequent periods.

In the next period, the utility offers an unregulated service that requires the joint use of regulated investments and expenses. The unregulated service uses 30 percent of the utility's fixed investment (30% x $50.00 = $15.00) and 15 percent of the utility's variable costs (15% x $50.00 = $7.50). Thus, the unregulated service absorbs $22.50 of the heretofore regulated investment and expenses.

Without a fully distributed cost study and subsequent regulated rate adjustments, this absorption will never be recognized. Regulated rates will remain at $1.00 per unit, but they should be at $0.78 per unit. Because the unregulated service would not reflect the joint use of regulated investment and costs, the rate for that service could be under-priced, thereby giving the utility a competitive advantage in offering the unregulated service. The problem is exacerbated to the extent that the utility's competitors require interconnection with the utility's regulated service to offer the unregulated service in competition with the utility; for the independent competitors would have to pay for using the utility's regulated service, while the utility's unregulated service may not.

7. Q. IS THIS EXAMPLE REALISTIC?

7. A. Obviously, this hypothetical is very simplified, but it points out a very real problem -- one that greatly concerns OCTVA. The way Ameritech Ohio's alternative regulation plan is currently structured, once the plan is in place, Ameritech Ohio could divert part of its regulated network to provide unregulated cable television service without recognizing in the rate for its unregulated service the joint use of the regulated network, and therefore the full cost of the facilities used to provide the unregulated service.

However, the problem is not confined to OCTVA. Those concerns will be held by other potential unregulated competitors of Ameritech Ohio such as on line yellow pages providers, on line newspapers and magazines, answering services, burglar alarm services and others.

8\. Q. WHAT CAN BE DONE TO CORRECT THIS DEFICIENCY?

8\. A. The least that can be done is to require an LRSIC study for unregulated service offerings. The price caps of other regulated services should be adjusted to reflect the joint use of regulated investments or expenses. Such an LRSIC study would have to be adjusted annually to reflect actual usage. In addition, any use of regulated employees, facilities, equipment, information or any other item should be done by contract filed with the PUCO. If the contracts do not reflect real market values or actual costs, the PUCO should adjust the price caps or the regulated services to reflect such costs.

A preferable solution is periodically to perform an FCC Part 64 type separations and adjust the price caps or other regulated service rates to reflect the study results. The FCC Part 64 rules use an FDC method and thus, minimize the potential for cross-subsidy in the telecommunications environment.

The study and adjustments ideally should be performed annually but could be done bi-annually or tri-annually. Also, any use of regulated employees, facilities, equipment, information or any other item should be done by contract that is filed with the PUCO. If the contracts do not reflect real market values or actual costs, the PUCO should adjust the price caps or the regulated services to reflect such costs.

9\. Q. WOULD A FULLY SEPARATED SUBSIDIARY THAT PROVIDES ONLY UNREGULATED SERVICES BE ANOTHER ALTERNATIVE?

9\. A. Yes, it would be the best alternative. From a cross-subsidy and from an anti-competitive prospective, a fully separated subsidiary is a superior solution to accounting separations. However, as I pointed out in my direct testimony, a fully separated subsidiary also requires continued vigilance and action by the PUCO.

10\. Q. DOES THAT CONCLUDE YOUR REBUTTAL TESTIMONY?

10\. A. Yes.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a copy of the foregoing has been served upon parties listed below, by hand-delivery or regular U.S. mail, postage prepaid, this 7th day of September, 1994.

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