COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN INVESTIGATION INTO THE INTRASTATE SWITCHED ACCESS RATES OF ALL KENTUCKY INCUMBENT AND COMPETITIVE LOCAL EXCHANGE CARRIERS	) ADMINISTRATIVE))	CASE NO. 2010-00398

COMMENTS OF CINCINNATI BELL TELEPHONE COMPANY LLC

By Order dated November 5, 2010, the Commission established this administrative case to examine the switched access rates of Kentucky incumbent and competitive local exchange carriers. The stated purpose of the Commission's examination is, *inter alia*, to determine if the switched access rates of Kentucky telecommunication carriers include above-cost implicit subsidies. The Commission stated that it will determine if these subsidies exist and, if so, whether they qualify as anti-competitive. The Commission also stated that it will determine whether it should develop a regulatory scheme that establishes a methodology for charging intrastate switched access rates. The Commission cited certain inter-carrier complaints related to access charges as part of the impetus for commencing this proceeding.[1]

Upon its own motion, the Commission made all ILECs, including Cincinnati Bell Telephone Company LLC ("CBT"), parties to this proceeding without the need to seek intervention. The Commission ordered all ILECs to file their current intrastate access rate tariffs into the record of this proceeding. CBT is attaching its Kentucky intrastate access charge tariff as an Exhibit to these comments.

[1] None of the cited complaints involved CBT.

I. THE COMMISSION DOES NOT HAVE JURISDICTION TO INVESTIGATE OR CHANGE INTRASTATE ACCESS RATES OF "ELECTING UTILITIES."

The Commission cites KRS 278.030 as its basis for asserting jurisdiction over intrastate switched access rates. The Commission contends that nothing in state or federal law has eliminated its jurisdiction over intrastate access rates. While the Commission acknowledges that KRS 278.543 was enacted in 2006 and placed a cap on the intrastate switched access rates of electing carriers, the Commission contends that the statute also preserved its authority to investigate and determine if a carrier's intrastate access charges were fair and reasonable and to order reductions of those rates if necessary. CBT respectfully disagrees. The Commission is without jurisdiction to order any changes to an electing carrier's intrastate switched access rates.

KRS 278.543 allows any Kentucky telephone utility to voluntarily elect to adopt the price regulation plan set forth therein.[2] Part (2) of KRS 278.543 caps the rates for basic local exchange service for sixty months and specifies a process for rate changes at the end of the sixty months (except for small telephone utilities who are only capped for twelve months and are subject to part (9) thereafter). Part (3) requires electing utilities to retain tariffs on file with the Commission for basic local exchange service and intrastate switched-access services. With respect to intrastate switched-access services, Part (4) prohibits such rates from exceeding the rates in effect on the day prior to the filing of the notice of election. Part (5) grants the Commission jurisdiction over complaints *as to basic local exchange service* but *not* intrastate switched-access service. Part (6) declares that an electing utility's rates "shall be deemed to be just and reasonable under KRS 278.030" upon election.

KRS 278.030 is the general statute requiring that every utility's rates be "fair, just and reasonable." But KRS 278.543(6) provides that, upon election, the electing utility's rates are

[2] CBT made the election pursuant to KRS 278.543 effective July 12, 2006.

automatically deemed to be just and reasonable under KRS 278.030. So the substantive rate standard that is being relied upon by the Commission for its jurisdiction in this proceeding is automatically satisfied. KRS 278.030 only sets the standard for rates, but it has nothing to do with the process whereby rates are set. There are three ways under Kentucky law whereby utility rates can be changed: the utility may propose new rates, a ratepayer may file a complaint claiming that a rate is unreasonable, or the Commission may on its own motion choose to investigate a utility's rates. Each of those procedures for changing rates is governed by its own independent procedural statute. When a utility itself seeks to establish new rates, KRS 278.190 applies. If a customer complains that an existing rate is unreasonable, the procedure in KRS 278.260 applies. And, if the Commission on its own motion chooses to investigate and change a utility's rates, KRS 289.270 applies.

KRS 278.543(6) expressly exempts electing utilities from KRS 278.190, KRS 278.260 and KRS 289.270. Hence, the sole provision upon which the Commission bases this proceeding, KRS 278.030, is automatically deemed satisfied for electing utilities under KRS 278.543(6) and the electing utility is exempt from all three procedural mechanisms under Kentucky law by which rates may be changed. There is no other express grant of jurisdiction anywhere else in KRS 278.541 through 278.544 giving the Commission specific jurisdiction over intrastate switched access rates.

The Kentucky Legislature expressly preserved the Commission's jurisdiction over rate complaints with respect to *basic local exchange service* in KRS 278.543(5), but in the same sentence the legislature expressly stated: "the commission shall ***not*** have jurisdiction to set, investigate, or determine rates as to any electing telephone utility other than a set forth in this section." (emphasis added)

To be complete, there is another provision in the alternative regulation statute that preserves some aspects of the Commission's normal jurisdiction with respect to electing utilities, but none of them reach intrastate switched access rates. KRS 278.542 preserves the Commission's jurisdiction with respect to a very specific list of topics, notwithstanding the general prohibitions contained in KRS 278.541 through 278.544. However, none of the matters enumerated in KRS 278.542 pertains to setting rates for intrastate switched-access service.[3]

[3]The matters over which the Commission's jurisdiction is preserved are as follows:

(a) Any agreement or arrangement between or among ILECs;

(b) Any agreement or arrangement between or among ILECs and other local exchange carriers;

(c) Consumer complaints as to compliance with basic local exchange service obligations, and the quality of basic voice-grade service transmission for basic and nonbasic services, consistent with accepted industry standards for telecommunications services;

(d) The emergency 911 telephone service as set forth in KRS 65.750 to 65.760 or wireless enhanced emergency 911 systems as set forth in KRS 65.7621 to 65.7643;

(e) Accuracy of billing for telecommunications services, in accordance with the truth-in-billing regulations prescribed by the Federal Communications Commission;

(f) Assessments as set forth in KRS 278.130, 278.140, and 278.150;

(g) Unauthorized change of telecommunications providers or "slamming" under KRS 278.535;

(h) Billing of telecommunications services not ordered by or on behalf of the consumer or "cramming" to the extent that such services do not comply with the truth-in-billing regulations prescribed by the Federal Communications Commission;

(i) The federal Universal Service Fund and Lifeline Services Program and any Kentucky state counterpart;

(j) Any special telephone service programs as set forth in KRS 278.547 to 278.549;

(k) Tariffs, except as expressly provided for in KRS 278.541 to 278.544;

(l) Setting objectives for performance as to basic local exchange service; except that the objectives shall not exceed existing commission standards or associated penalties as of July 12, 2006;

(m) Prohibiting price differences among retail telecommunications customers to the extent that such differences are attributable to race, creed, color, religion, sex, or national origin; or

(n) Ensuring that a telephone utility furnishes safe, adequate, and reasonable basic local exchange service to customers within that utility's service area.

There is also an exception to electing carriers' exemption from KRS 278.190, 278.260 and 278.270 *if* jurisdiction is otherwise granted by KRS 278.542(1)(a) or (b). But those sections have no application here. KRS 278.542(1)(a) only addresses agreements or arrangements *between or among ILECs*. By definition, switched access rates are not agreements or arrangements between ILECs; they are arrangements between ILECs (or CLECs) on the one hand and IXCs on the other.[4] KRS 278.542(1)(b) addresses agreements or arrangements between or among ILECs and other local exchange carriers. That does not describe intrastate switched access rates either. Arrangements between ILECs and CLECs are typically interconnection agreements over which the Commission has jurisdiction pursuant to Sections 251 and 252 of the Telecommunications Act of 1996.[5] Access charges do not fit under either KRS 278.542(1)(a) or (b), so no complaint jurisdiction was preserved.

Hence, nothing in KRS 278.543 confers jurisdiction and nothing in KRS 278.542 preserves Commission jurisdiction with respect to the intrastate switched-access charges of electing telephone utilities. For these reasons, this proceeding must be restricted to a review of the rates of the non-electing utilities and the issue of what, if anything, to do if non-electing utilities are eventually be found to be charging unreasonable intrastate switched access rates.

[4] "Intrastate switched access services are wholesale services provided by the local exchange carriers ("LEC") generally to wireline long-distance providers for originating and terminating intrastate long-distance calls." Order, p. 2 (footnote omitted).

[5] 47 U.S.C. §§ 251, 252.

II. MAJOR POLICY ISSUES TO BE ADDRESSED

In its Order, the Commission identified a non-exhaustive list of the major issues it expects to consider during this proceeding. The remainder of CBT's comments are organized in response to those questions.

1. Should Kentucky transition to a cost-based system for access rates?

CBT believes the answer to this question is different for electing and non-electing telephone utilities. For electing utilities, the Kentucky Legislature has already dictated that intrastate switched access charges are subject to a simple price caps approach. Per KRS 278.543(6), an electing utility's rates are deemed just and reasonable under KRS 278.030 and administrative regulations promulgated thereunder upon election. Thereafter, the only regulation of intrastate switched access rates is in KRS 278.543(4), which prohibits rates from exceeding the rates that were in effect on the day prior to the date the utility filed its notice of election. Thus, for electing carriers, the rate setting mechanism for electing utilities has been established and the Commission has no jurisdiction to alter it. A cost-based system could not be imposed.

CBT expresses no opinion whether the Commission should transition to a cost-based system for non-electing telephone utilities. At the federal level, several different cost-based and price caps mechanisms have co-existed for many years. Certain carriers were mandated to migrate to a price caps system, some carriers have been allowed the option of going to price caps and other carriers have been permitted to remain in a rate of return regime. Therefore, there is no reason that the Commission could not maintain different pricing regimes for different classes of carriers.

For non-electing utilities, whether or not to transition to a cost-based system is a complex question that may be company-specific. It is hard to imagine how such a regime could be

imposed on intrastate access service in isolation from other local services. Historically, telephone rates were established based upon the company's overall revenue requirements. Upon determining the cost of providing service and a reasonable return on investment, rates for individual services were set in order to raise the projected amount of revenue necessary overall. Some rates may be above cost and others may be below cost, but it is a complex and somewhat subjective undertaking to attempt to determine the cost of individual services that utilize common network components.

a. If yes, then how should carriers be allowed to recover the revenue lost by the transition to a cost-based system (i.e., increasing local rates, establishment of a universal service or rate re-balancing fund, etc.)?

In the event that the Commission requires non-electing telephone utilities to transition to cost-based intrastate switched access rates, CBT believes it is mandatory for the Commission first to maximize cost recovery through the rebalancing of the rates of that company, by raising local rates or rates for other services, before establishment of any universal service or rate re-balancing fund is considered.

Before rebalancing local rates or creating a state fund to subsidize non-electing carriers who are required to reduce intrastate access charges, the Commission should first determine whether it is necessary to replace the lost revenue at all. This analysis would have to be done at the individual company level to determine whether the company would meet reasonable revenue requirements after the mandated access charge reductions. If so, nothing more need be done.

If the company deserved a rate increase to replace some or all of the lost access revenue, that revenue should first be raised through increases in the rates for local or other intrastate services, at least until those rates reached the average rates charged by electing carriers. It is well known that many of the smaller carriers in Kentucky have extraordinarily low local service rates as compared to the rates of the larger carriers. Before the Commission considers creating

new intercompany subsidies such as a universal service or rate re-balancing fund to benefit carriers with low local rates, it should require those companies to rebalance their own rates and raise their local service rates to levels comparable to the larger Kentucky carriers. The Commission noted in the very Order initiating this proceeding that the Federal Communications Commission ("FCC") has encouraged state commissions to move forward in completing a "rebalanc[ing] of local rates to offset the impact of lost access revenues . . . as doing so would encourage carriers and states to 'rebalance' rates to move away from artificially low $8 to $12 residential rates that represent old implicit subsidies to levels that are more consistent with costs."[6] If the Commission decides to remove implicit subsidies that are built into current intrastate access rates of non-electing carriers, it should not create new subsidies by initiating a universal service or rate rebalancing fund.

b. How much time should carriers be given to transition to a new cost-based system and adapt to the new methods for revenue recovery?

If the Commission imposes a cost-based intrastate switched access rate requirement on non-electing telephone utilities, the time necessary to make that transition likely depends upon individual circumstances. First, before ordering any individual company to reduce intrastate access rates, state law requires the Commission to afford that company a formal public hearing to determine whether its rates are reasonable.[7] The result of that hearing would be a determination of what access rates would be reasonable. From there, the Commission would have to determine (i) the revenue impact of a reduction from current rates to the rates deemed to be reasonable, (ii) what other rates of that company could be increased to offset the revenue loss, (iii) the

[6] *Connecting America: The National Broadband Plan*, 2010 WL 972375 (Mar. 16, 2010) at 135.

[7] When the Commission acts upon complaints about utility rates, "[n]o order affecting the rates or service complained of shall be entered by the commission without a formal public hearing." KRS 278.260. Similarly, where the Commission acts on its own motion, it may only do so "after a hearing had upon reasonable notice." KRS 78.270.

magnitude of rate increases necessary to replace the revenue, and (iv) the impacts on ratepayers of such changes in rates.

The Commission should not automatically replace revenues lost by non-electing utilities whose intrastate switched access rates are found to be unreasonable after a formal hearing. The next step should be to determine the revenue requirements of that company. If the Commission finds that the company would have a fair opportunity to earn a reasonable overall rate of return at the reduced access rates without revenue replacement, the inquiry should end there. There is no need for rate rebalancing (unless that company wishes to do so voluntarily) and certainly no need for an inter-company subsidy to a company that is earning a sufficient return on its own.

Only if a company is not capable of earning a fair rate of return at reduced access rates without increasing other rates should the Commission mandate rate rebalancing. For companies in that scenario, the Commission should establish benchmark rates for local service and other non-switched access rates. These benchmarks should create floors to which the affected company would be required to raise their rates before the Commission would entertain any sort of universal service or rate re-balancing fund to assist that company. The Commission may find it necessary to transition from current rates to the benchmark rates over time in order to reduce rate shock to customers. That transition time, however, is not a reason to create a subsidy fund. The solution would be to synchronize the lowering of access rates with the transition to higher local rates, i.e., the access rates should not be reduced to the new cost-based rates immediately, but over the same period of time used to rebalance local service rates.

c. What are the competitive advantages or disadvantages of having one revenue recovery method versus another?

In a fully competitive environment, each carrier would recover the cost of providing its services from its own customers.[8] If the Commission finds that there are subsidies in non-electing utilities' intrastate access charges and chooses to remove those subsidies, then that cost recovery should ideally come from the utility's own customers. Access rate subsidies are either funding underpriced local service or carrier profits or both. If local service rates are below cost, those rates should be increased to a reasonable level that covers cost. Otherwise, new entrants who attempt to compete and who must bear their own costs of providing service would continue to be disadvantaged. Subsidies to underpriced services should be removed and the rates adjusted upwards. That would create a more level playing field for all competitors.

The alternative to rate rebalancing, to create a universal service or access reform fund, would improperly shift these subsidies away from the IXCs and impose them on customers of other Kentucky utilities that have no relationship at all to the underlying costs. That would not only preserve the competitive advantages to the non-electing ILECs from having subsidized local rates, it would place competitive disadvantages on all of the other carriers that would have to contribute to the fund by raising their customers' rates.

2. Would competition suffer greater harm by having higher access rates, higher local exchange rates, or having other higher intrastate rates?

Unfortunately, there is no simple answer to this question that would universally apply to every carrier and every market. A several step analysis on an individual company basis is necessary to reach the appropriate result. First, it is yet to be established that any carrier's access rates are excessive. That determination needs to be made first before any decision can be made

[8] The term "customer" does not necessarily mean the end-user. With respect to switched access charges, the customer is the IXC.

whether it is better to leave those rates alone or to reduce them and increase some other rate. Second, assuming some access rates are properly found to be excessive and are ordered lowered, the next question is whether any other rates need to be adjusted. This would turn on the earning levels of the affected carrier. If that carrier is earning more than a fair rate of return, the solution may be just to lower the access rates and stop there. Third, assuming that an affected carrier is found not to be earning a fair rate of return if access rates are reduced, a revenue requirement would have to be established. It is only at this third stage that the Commission would face the question of where to raise the necessary revenue.

If the Commission finds that certain rates, such as local exchange rates, are priced below cost, then those rates should absolutely be increased to cover their costs. Raising those rates would not cause harm to competition, but should improve competition. As discussed above, where local rates are subsidized and below cost, competitors cannot efficiently enter those markets and the markets remain monopolistic. Competition could only be improved by raising local rates above cost. Raising local rates to appropriate levels should incent competitors to enter new markets and compete with the ILECs.

3. Federal regulation currently requires CLECs to mirror the interstate access rates of ILECs, unless specific cost-justification is provided for having higher interstate rates. Should Kentucky implement this same policy for the intrastate rates for CLECs?

CBT agrees that this would be a rational policy for Kentucky. The rationale for this policy is that the ILEC rates are presumed reasonable, so the same rates charged by CLECs in the same areas would also be reasonable. It also relieves CLECs of the obligation to create cost studies if they are satisfied with the ILEC rates. If a CLEC believes it has higher costs, such that the ILEC access rates would not be compensable, it has the option of proving its actual costs and charging higher rates, so the CLEC cannot be harmed by using the ILEC access rates as price

caps. This approach seems to have worked fairly well at the interstate level and there is no obvious reason to CBT why it would be inappropriate at the intrastate level.

4. Should the Commission establish a goal of ultimately moving to a zero rate for access charges?

CBT believes this would be drastic and premature. First, as stated above, the Commission has no jurisdiction over the access rates of electing utilities, so this approach could only be taken with respect to non-electing utilities. Second, the FCC has had comprehensive access reform under consideration for a number of years. Proposals have been made in that proceeding that would eliminate access charges. The FCC has been reluctant to do so for a number of reasons, including the complexity of the existing system and the difficulty of transitioning to a new system that would be fair to all participants. There can be no doubt that there are costs associated with originating and terminating interexchange calls, whether interstate or intrastate. The overriding question has always been how to recover those costs. Access rates have been the traditional answer, that is, to have the IXCs pay for the cost of using the local network, with some of those costs shifted to end users through the end user common line ("EUCL") or subscriber line charge ("SLC"). But until the FCC comes up with a comprehensive solution to all intercarrier compensation issues, the Commission should not make a decision to move to a zero rate for access charges. *If* the FCC eventually does so at the interstate level and suggests that states do the same, then the Commission might consider that. However, now is not the time.

Respectfully submitted,

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