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May 3, 2019

VIA ELECTRONIC FILING (ECFS)

Marlene H. Dortch, Esq.
Secretary
Federal Communications Commission
445 Twelfth Street, SW
Washington, DC 20554

RE: **EX PARTE PRESENTATION**
Misuse of Internet Protocol (IP) Captioned Telephone Service;
Telecommunications Relay Services and Speech-to-Speech Services for
Individuals with Hearing and Speech Disabilities
CG Docket Nos. 13-24, 03-123

Dear Ms. Dortch:

On May 1, 2019, Dixie Ziegler, Vice President of Hamilton Relay, Inc. ("Hamilton"), Coleman Bazelon and Brent Lutes of The Brattle Group (consultants to Hamilton), Rachel Wolkowitz (outside counsel) and the undersigned counsel (by telephone) on behalf of Hamilton, met with Commission staff from the Consumer & Governmental Affairs Bureau ("CGB"), Office of Economics and Analytics ("OEA"), and the Office of the Managing Director ("OMD"). Commission staff present at the meeting were Barbara Esbin, Eliot Greenwald, Michael Scott, and Robert Aldrich of CGB; Virginia Metallo, Joseph Calascione, Chuck Needy (by telephone), and Susan Lee (by telephone) of OEA; and Andrew Mulitz and David Schmidt (by telephone) of OMD.

Meeting participants discussed the points in the attached slide deck.¹ Hamilton also reiterated the points made in its April 1, 2019 written ex parte filing, in particular that: 1) the

¹ The attached deck is the redacted version of the slide deck, which was also shared with Ms. Ziegler, Ms. Wolkowitz, and the undersigned, all of whom have not signed the Acknowledgement pursuant to the Third Protective Order in this proceeding. The Brattle Group, which has filed the Acknowledgement, provided the meeting participants with a confidential, unredacted version of the deck during the meeting. A confidential, unredacted copy of the deck was previously filed with the Secretary by The Brattle Group on May 2, 2019. Ms. Ziegler, Ms. Wolkowitz, and the undersigned did not participate in any discussion of highly confidential information under the Third Protective Order.

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Commission should freeze the interim rate at \$1.75; and 2) the recent Brattle whitepaper confirms that a price cap style methodology is the best permanent rate methodology for Internet Protocol Captioned Telephone Service (“IP CTS”).²

This filing is made in accordance with Section 1.1206(b)(1) of the Commission’s rules, 47 C.F.R. § 1.1206(b)(1). In the event that there are any questions concerning this matter, please contact the undersigned.

Respectfully submitted,

WILKINSON BARKER KNAUER, LLP

/s/ David A. O’Connor

Counsel for Hamilton Relay, Inc.

Enclosure

cc (via email):

Barbara Esbin
Eliot Greenwald
Michael Scott
Robert Aldrich
Virginia Metallo

Joseph Calascione
Susan Lee
Chuck Needy
Andrew Mulitz
David Schmidt

² *Ex Parte* Letter from David A. O’Connor, Counsel for Hamilton Relay, Inc., to Marlene H. Dortch, CG Docket Nos. 13-24, 03-123 (April 1, 2019) (discussing The Brattle Group, “Economic Considerations of IP CTS Rate Structure and Methodology,” CG Docket Nos. 13-24, 03-123 (filed Mar. 27, 2019)).

REDACTED

Economic Considerations of IP CTS Rate Structure and Methodology

PRESENTED TO
Federal Communications
Commission

PREPARED AT THE REQUEST OF
Hamilton Relay, Inc.

PRESENTED BY
Coleman Bazelon & Brent Lutes,
The Brattle Group

April 30, 2019 & May 1, 2019

THE **Brattle** GROUP

Disclaimer

This presentation reflects the perspectives and opinions of the presenters and does not necessarily reflect those of The Brattle Group's clients or other consultants. However, we are grateful for the valuable contributions of many consultants of The Brattle Group. Where permission has been granted to publish excerpts of this presentation for any reason, the publication of the excerpted material must include a citation to the complete presentation, including page references.

Background

- Title IV of the Americans with Disabilities Act (“ADA”) stipulates that TRS services must
 - Be provided “in a manner that is functionally equivalent” to the services available to individuals who are not deaf or hard of hearing; and
 - Be provided at no additional cost to the user
- TRS is funded through contributing carriers (interstate and international revenues) via the TRS Fund
- Commission charged with
 - Balancing ADA stipulations and user interests with its fiduciary duty to Fund contributors
 - Setting TRS reimbursement rates
- Until recently IP CTS rates have been constructed using a market-based mechanism known as MARS
- In a June 2018 Further Notice of Proposed Rulemaking, the FCC
 - Proposed departing from MARS for IP CTS only and compensating IP CTS providers using a cost-based rate;
 - Set an interim reduced compensation rate of \$1.75 per minute (a roughly 10% decrease) with another scheduled reduction to \$1.58 per minute in July 2019; and
 - Invited commenters to both respond to the proposal and submit alternative methodologies.
- We have discussed the concerns with cost-based rates for IP CTS in several white papers and also proposed a price cap rate structure as a reasonable alternative
- Other parties have proposed different rate structures

Agenda

- 1) Concerns with cost-based rates for IP CTS
- 2) A price cap would be more efficient than a cost-based rate
- 3) A tiered rate structure is not necessary or appropriate for IP CTS
- 4) Proposed tiered rate structures appear to be self-serving and detrimental to competition
- 5) Auction-based methods are difficult to apply to IP CTS

Cost-Based Rates

Cost-based rates are inefficient:

- Cost-based rates are based on the costs reported by providers plus some appropriate margin
- Discourages providers from engaging in cost-savings innovations and activities
 - Providers earn higher profits by incurring higher costs
 - Providers have weaker incentives to innovate along such lines as ASR
- Incomplete information makes effective rate setting difficult
 - Well known difficulties with developing accurate and complete cost data (e.g., persistent ambiguity with respect to the parameters of allowable costs)
 - Can lead to inappropriate reimbursement rates
- The ramifications of selecting a rate based on an inaccurate understanding of costs may be substantial (as was the case in IP Relay)
- Empirical evidence demonstrates that provider costs tend to be higher under cost-based rates than under alternative methodologies (See p. 35 of Brattle Report for discussion)

Price Cap

A price cap rate is a more efficient alternative to cost-based rates

- A price cap rate methodology starts with an initial rate that is annually adjusted for inflation and for efficiency gains (the “X-factor”)
- The X-factor remains constant over the price-cap period (typically 3-5 years)
- The base rate and X-factor can then be recalibrated at the end of a price-cap period in order to realign projected efficiency gains with realized efficiency gains

Price Cap

Proposed rate structure:

$$PCR_t = PCR_{t-1} * (1 + GDPPI_t - X)$$

Where,

PCR_t = The price cap rate in the current time period;

PCR_{t-1} = The price cap rate in the previous time period;

$GDPPI_t$ = The inflation between time $t - 1$ and t ;

X = 1.1% (the X – factor);

PCR_1 = The initial PCR in the first time period.

- X-factor should remain at 1.1% (recent cost reduction experience) for the first four years, then be recalibrated if necessary
- Suggested initial PCR: \$1.9467 (an appropriate starting point because it is the last Commission-adopted IP CTS rate that was based on competitive forces)
- Initial PCR should at least exceed \$1.7630 (the MARS rate for the 2011-2012 which was the last uncontested market-based rate and hence reflective of provision costs)

Price Cap

Example Rate Calculations

| Rate Year | New Rate | Old Rate | GDPPI | X-Factor |
|-----------|-------------|------------------------------|-------|----------|
| 2018-2019 | \$ 1.7630 | | | |
| 2019-2020 | \$ 1.7524 = | \$1.7630 x (1 + 0.5% - 1.1%) | | |
| 2020-2021 | \$ 1.7524 = | \$1.7524 x (1 + 1.1% - 1.1%) | | |
| 2021-2022 | \$ 1.7559 = | \$1.7524 x (1 + 1.3% - 1.1%) | | |

Price Cap

A price cap rate structure addresses the primary shortcomings of cost - based rate regulation:

- Incentivizes provider efficiency
 - Providers can retain a portion of their cost savings for a limited amount of time which incentivizes them to engage in cost savings activities
- Limits the regulatory inefficiencies associated with incomplete information
 - A price cap incentivizes providers to reveal their true ability for cost savings through their actions
- By allowing providers to temporarily retain a portion of their costs savings, a price cap methodology reduces long-run costs
- This allows for dynamic efficiency whereas a cost-based rate can at best achieve short-run efficiency
 - Dynamic efficiency is acutely important as industry prepares for significant technology adoption of ASR

Price Cap

In constructing a price cap rate, several considerations should be taken into account:

- First, to avoid the potential for market failure, the initial rate must be set in a way that ensures a fair return for providers and does not cause a structural change in the market; the initial rate is not itself a vehicle for efficiency gains
- Second, outside of recalibration periods, the X-factor must be decoupled from providers' realized provision costs in order to incentivize providers to reduce costs
- Third, since the risks associated with setting the X-factor too high are greater than the risks associated with setting it too low, setting an overly aggressive X-factor may be counterproductive
- Finally, it is likely more efficient to reimburse exogenous costs on top of the price cap rate rather than being built into the rate (with the caveat that recurring and predictable exogenous costs should eventually be built into the price cap rate)

Tiered Rates are Unnecessary and Inefficient

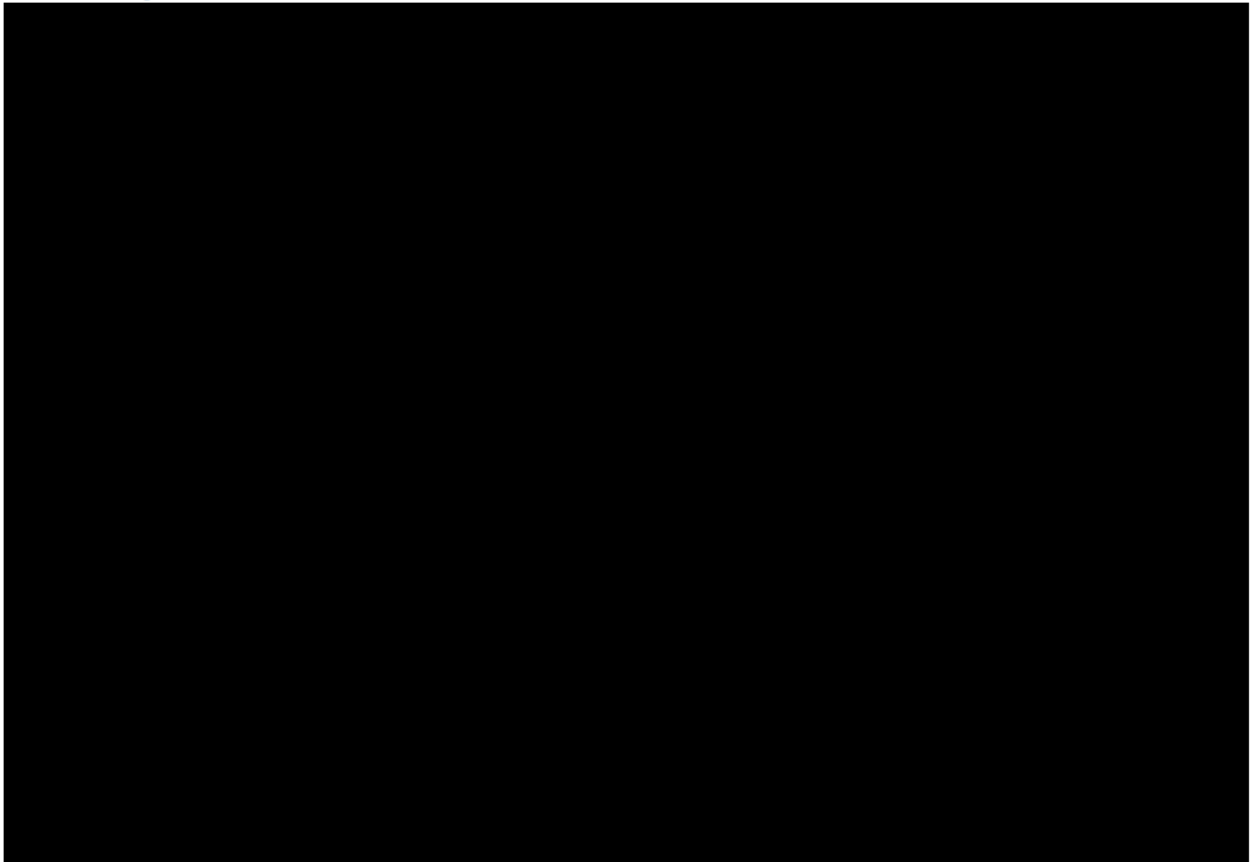
A tiered rate structure is not economically justified in the case of IP CTS

- A tiered structure subsidizes inefficient providers, which increases the burden on the TRS fund
- Not needed to spur entry given the availability of capital markets
- Providers have successfully entered the market in the absence of a tiered structure
- The argued benefit of a tiered structure is critically premised on a clear and persistent relationship between cost and volume
 - The idea is that small providers will be subsidized at lower tiers until they can achieve lower costs through scale
 - The premise that provision costs continue to shrink with scale is inconsistent with available evidence

Tiered Rates are Unnecessary and Inefficient

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Projected 2018-19 IP CTS Provider Per-Minute Costs and Total Minutes

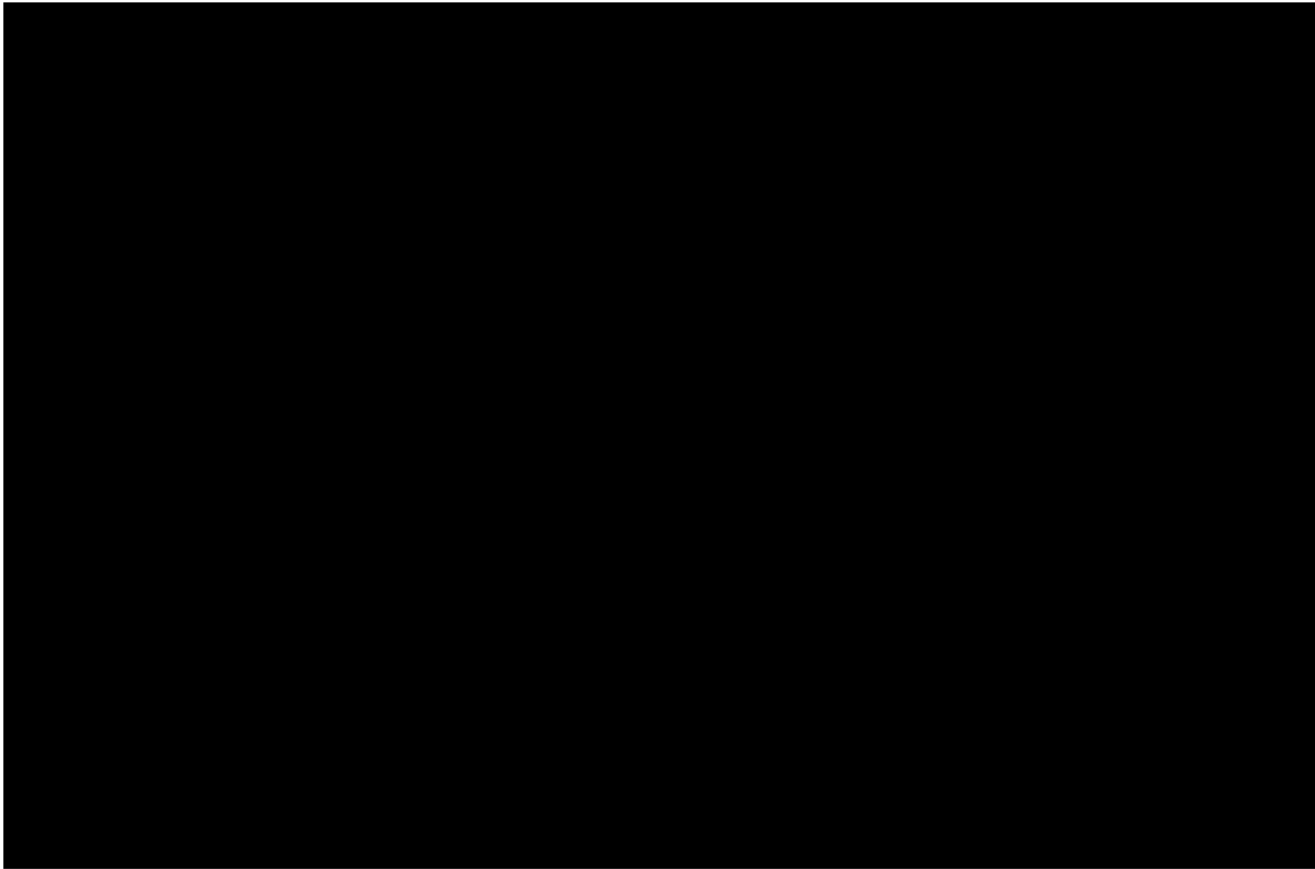


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Proposed Tiered Structures Are Biased in Favor of Proposing Providers

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InnoCaption’s Proposed Rate Compared to ClearCaption’s Proposed Rate



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ClearCaptions' Recent Comments On Tiered Rates

ClearCaptions' recent comments with respect to the Brattle Report are inaccurate:

- ClearCaptions and InnoCaption's entry underscores the point that if the rate is sufficient to hold the potential for future profits, providers can and will enter without any sort of tiered or special rate
- ClearCaptions claims the Brattle Report ignores how ClearCaptions' proposal will affect the overall TRS fund
 - It is naïve to suggest changing a rate proportionally changes the fund
 - Market dynamics will change provider participation, costs, and ultimately fund costs
 - The Brattle Report discusses how a tiered rate will affect the TRS Fund in the long run insofar as tiered rates subsidize inefficiency and can result in a greater burden on the TRS Fund
- ClearCaptions implies that the empirical evidence which suggests there is no consistent relationship between provider scale and costs should be discounted because some providers rely on subcontractors
 - Such an implication is inconsistent with economic logic and our observations

A Reverse Auction would be Difficult for IP CTS

Although auctions are often an economically desirable approach, the particular circumstances of IP CTS are not well-suited to auction-based rates

- If the auction assigned the right to serve specific users, competition and consumer choice would be eliminated
- While a reverse auction may be thought of as a market simulating mechanism, it is typically appropriate when other competitive forces are not present
 - When geographic monopoly exists, as in CAF II, the customer and the price bid is connected
 - With IP CTS, all providers compete for all customers – an effective auction mechanism would have to eliminate that market place competition for customers
- An auction approach may be problematic in the face of potentially disruptive ASR technology

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