Attorney General
Betty D. Montgomery

June 7, 1996

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Via Overnight Mail

Office of the Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D. C. 20554

Re: *In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services*

Dear Mr. Caton:

DOCKET FILE COPY ORIGINAL

Enclosed please find the original and twelve copies of **Reply Comments of the Public Utilities Commission of Ohio In the Matter of Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services** in the above-referenced matter. Please return a time-stamped copy to me in the enclosed stamped, self-addressed envelope

Thank you for your assistance in this matter.

Respectfully submitted,

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Before the

FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

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In the Matter of	)	
	)	
Allocation of Costs Associated with	)	CC Docket No. 96-112
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

EXECUTIVE SUMMARY OF THE
REPLY COMMENTS OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

The Public Utilities Commission of Ohio (PUCO) maintains that the Federal Communications Commission (FCC) should adopt a fixed factor cost allocation of 25 percent to regulated accounts and 75 percent to unregulated accounts for all new loop plant installed after the FCC's adoption of the revised rules in this proceeding. Concerning embedded loop plant, the PUCO submits the FCC should adopt a 50 percent to 50 percent cost allocation split. The PUCO notes that these proposed cost allocations should apply only to that loop plant that has the capability of providing video service.

The PUCO submits that excess loop capacity should be allocated to regulated and nonregulated accounts on a 50 percent to 50 percent basis. The PUCO believes that the FCC should continue to utilize its current methodology, which is based on peak loads, to arrive at the cost allocation for excess switch capacity.

The PUCO recommends that its cost allocation recommendations in this proceeding should be adopted by the FCC (on an interim basis) as a starting point only. The PUCO further recommends that the FCC adopt a recur-

ring biennial analysis of its then-current cost allocation rules to re-examine the efficacy of those rules.

Regarding incumbent local exchange companies (ILECs) subject to price caps regulation, the PUCO maintains that the FCC must take into consideration whether exogenous adjustments are necessary as a result of its rule changes adopted in this proceeding. Finally, the PUCO does not believe that a repeal of the FCC's Part 64 requirements is appropriate at this time.

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In the Matter of	)	
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Local Exchange Carrier Provision of	)	
Video Programming Services	)	

REPLY COMMENTS OF
THE PUBLIC UTILITIES COMMISSION OF OHIO

INTRODUCTION (NPRM SECTION I)

The Public Utilities Commission of Ohio (PUCO) hereby submits its reply comments pursuant to the Federal Communications Commission's (FCC's) Notice of Proposed Rulemaking (NPRM) in CC Docket No. 96-112 (In the Matter of Allocation of Costs Associated With Local Exchange Carrier Provision of Video Programming Services). Specifically, the FCC's NPRM in this investigation proposes rules to allocate costs between local exchange carriers' (LECs') regulated and nonregulated activities.

By way of these reply comments, the PUCO submits its recommendations to the FCC concerning cost allocations for the local loop, cost allocations for excess switch and trunk capacity, the continued need for the FCC to maintain Part 64 cost allocation rules, and the need for the FCC to review periodically its Part 64 cost allocation rules and procedures. Reply comments in this proceeding are due at the FCC on June 10, 1996.

BACKGROUND (NPRM SECTION II)

Section 651 of the Telecommunications Act of 1996 (1996 Act) affords common carriers the option to enter into the video service market place via four alternative approaches: (1) common carriers can enter into video programming on a common carrier basis under Title II of the 1996 Act; (2) common carriers may provide video programming service through radio communication subject to Title III of the 1996 Act; (3) common carriers may provide video programming service as a cable system subject to Title VI of the 1996 Act; or (4) common carriers may provide video programming service though an "open video system" subject to Section 653 of the 1996 Act.

On May 10, 1996, the FCC adopted its NPRM in the above-captioned proceeding. In its NPRM, the FCC proposes to re-examine its rules concerning cost allocations between regulated and nonregulated activities to take into consideration that some incumbent LEC's (ILEC's) Title II regulated network facilities will be used to provide nonregulated video programming service not subject to Title II regulation. NPRM at Paragraph 2.

DISCUSSION (NPRM SECTION IV)

A. Goals and Purposes (Paragraphs 22-26)

In its NPRM, the FCC notes that the purpose of this proceeding is to facilitate competitive telecommunications service offerings; to effectuate LEC entry into video distribution and programming services markets; and, to ensure that ratepayers pay telephone rates that are just and reasonable. NPRM at Paragraph 22. The FCC notes that the rules promulgated as a result of this proceeding will result in a significant part of the LECs' common costs being allocated to nonregulated services. NPRM at Paragraph 23. In particular, the FCC notes that it seeks to establish cost allocation principles that inhibit carri-

ers from imposing on regulated rates the costs and risks of competitive, non-regulated ventures. The FCC further notes that such cost allocation principles must balance the following objectives of: administrative simplicity; adaptability to evolving technologies; uniform application among ILECs; and consistency with economic principles of cost causation. NPRM Paragraph 24. The FCC seeks comments on these goals and any other additional goals that should be considered in this proceeding. NPRM at Paragraph 26.

The PUCO concurs with the FCC's proposal to modify its cost allocation rules to inhibit carriers from imposing on regulated ratepayers the costs and risks of competitive, nonregulated ventures while balancing the principles of administrative simplicity, adaptability to evolving technologies, uniformity in application among ILECs, and consistency with economic principles of cost causation. The PUCO does not, however, concur with any initiative to repeal or exempt ILEC's from adhering to FCC Part 64 requirements, as amended.

The PUCO believes that cost allocations between regulated and non-regulated service offerings will continue to be a viable and necessary regulatory tool for the foreseeable future. The PUCO also believes that, until the transition is complete from a rate of return regulatory environment to a regulatory environment comprising fully competitive, nonregulated services, the potential for cross subsidization will continue. The continuation of FCC prescribed cost allocation rules is, therefore, paramount.

Moreover, the PUCO views the instant proceeding as the first in a series of examinations to deal with cost allocation issues between an ever-increasing array of nonregulated services to be offered by the LECs and regulated services already offered. As mentioned in more detail later in these reply comments, the PUCO recommends that the FCC re-examine its cost allocation rules on a biennial basis.

B. Cost Pools and Allocation Methods (NPRM Paragraphs 28-42)

B.1. Loop Plant

B.1.a. Direct Assignment

The FCC seeks comment on the extent to which a direct assignment methodology can be used to allocate the costs of loop plant when such plant is used for services subject to regulation under Title II and other nonregulated services such as video programming. NPRM at Paragraph 28.

The PUCO notes that direct assignment of costs associated with the loop for both video and telephony services is difficult to accomplish since the loop will be furnishing both regulated and nonregulated services over one common nontraffic sensitive facility. Expressed another way, the PUCO agrees with the FCC that direct assignment is best accomplished when accounting records demonstrate that particular facilities are dedicated to either regulated or nonregulated activities. NPRM at Paragraph 28. In addition, the PUCO further notes that direct assignment of loop costs is not consistent with the FCC 's goal of establishing a loop plant allocation method that is administratively simple to accomplish.

B.1.b. Allocation based on usage measurements

The FCC has tentatively concluded that allocation factors based on usage measurements may produce results inconsistent with the goals of the 1996 Act and the guidelines for Part 64. NPRM at Paragraph 23.

The PUCO agrees with the FCC's tentative conclusion on this matter. In particular, the PUCO agrees that usage characteristics of video programming services and voice-grade services could result in disproportionate cost allocations that are inconsistent with the goals of the 1996 Act and the guidelines for Part 64.

B.1.c. Allocations based on a ratio of directly assigned plant

The FCC seeks comment on whether a ratio of directly assigned plant would result in an appropriate allocation method for loop costs. NPRM at Paragraph 34.

The PUCO believes that the development of a ratio of directly assigned plant as a method to determine a direct allocation of loop plant would be burdensome and overly complex. Specifically, the PUCO does not believe that relying on such a cost allocation method meets the FCC's goals concerning administrative simplicity.

B.1.e. Cost allocations based on fixed factors

The FCC tentatively concludes that it should prescribe a fixed factor for allocating loop plant common costs between regulated and nonregulated activities. NPRM at Paragraph 40. The FCC seeks comment on specific allocation factors that would assign costs of loop plant between regulated and nonregulated activities. NPRM at Paragraph 39. The FCC proposes, for discussion purposes, requiring a cost allocation of 50 percent to regulated and 50 percent to nonregulated.

The PUCO believes that a fixed allocation method to determine loop cost allocations is most appropriate. The PUCO further supports the establishment of a cost allocation method that prohibits carriers from imposing on regulated ratepayers the costs and risks of competitive, nonregulated ventures, including but not limited to nonregulated video service ventures. Moreover, the PUCO believes that an allocation based on fixed factors will meet the goals identified by the FCC in paragraph 24 of its NPRM. Specifically, the PUCO submits that an allocation based on fixed factors will meet the following criteria of: administrative simplicity, adaptability to evolving technologies, uniform application among ILECs, and to the extent

possible adheres to principles of cost causation. Moreover, a fixed factor allocation for loop plant cost allocation set at an appropriate level would further discourage the over building of loop facilities and/or the early retirement of loop plant adequate for regulated activities (i.e. voice-grade services).

Taking into consideration the ubiquitous availability of in-place regulated loop plant, which currently may or may not support video services, it is reasonable to assume that future loop plant installations will support the LECs' nonregulated ventures (e.g., video services) to a greater extent than regulated activities. That is, in-service loop plant normally must be upgraded to accommodate the provision of video services necessary to carry broadband video services. Upon arriving at the appropriate cost allocations based on fixed factors, the FCC must take into consideration that loop investment allocated to nonregulated activities will serve to discourage the subsidization of nonregulated activities by regulated services.

The PUCO also notes that demand for telephone service is at present highly inelastic. Barring either regulatory intervention or effective competition, ILECs have the ability to shift to regulated telephone ratepayers a large portion of the cost of facilities used for both regulated and nonregulated activities. Such a result is contrary to the 1996 Act's requirement that ratepayers of regulated service not bear the costs or risks of competitive ventures. The PUCO maintains that the fixed loop plant allocation factors recommended below balance these concerns while simultaneously meeting the FCC's goals for revising these rules. NPRM Paragraph 24.

As a result of the above-mentioned considerations, the PUCO recommends that a pre- fixed allocation factor applied to the applicable loop plant or cost pool, 50% regulated and 50% nonregulated, splitting the costs of current or pre- loop plant equally between regulated and nonregulated activities. A

post- fixed allocation to be applied to future or post-loop plant likewise should be established with an assignment to nonregulated activities greater than the assignment recognized in the pre- total loop fixed allocation factor. For the post- fixed loop allocation factor, the PUCO believes the NCTA's recommended fixed allocation factor of 25% regulated and 75% nonregulated may be more appropriate. The PUCO recognizes that, as did AT&T in its comments in this proceeding, regardless as to what revised loop plant cost allocator is ultimately adopted by the FCC, the allocator adopted should be applicable to only those loops capable of providing video services.

The PUCO finds support for its proposed allocators in the National Cable Television Association's (NCTVA's) comments indicating that a 75% cost allocation to video services will not necessarily eliminate cross-subsidization; it merely affords a measure of protection. If the FCC wishes to spare regulated telephone ratepayers the threat of cross subsidization in every instance, it must concern itself as to whether fixed factor costs allocations assigned to deregulated loop plant can meet a stand-alone costing test of providing a state-of-the art telephone system (e.g., digital loop carrier service).

The PUCO notes that its proposal on loop plant allocation should be adopted by the FCC, on an interim basis, as a starting point only. In particular, as mentioned earlier in these reply comments, the PUCO recommends that the FCC adopt a recurring biennial analysis of its then-current cost allocation rules to re-examine the efficacy of those rules. The PUCO maintains that the FCC must consider, at a minimum, the following upon arriving at a revised allocator for loop plant: (1) The number and percent of total customers with video capabilities; (2) the number of customers subscribing to video services; and, (3) the amount of loop plant in service replaced to provide video services.

D. Other General Allocation Issues

D.1. Allocation of Spare Capacity (NPRM Paragraphs 51-54)

The FCC seeks comments regarding the allocation of investments in spare capacity (or excess capacity) of network plant between regulated and nonregulated activities. The FCC believes that "Congress did not intend that the telephone exchange service or exchange access subscribers pay rates designed to recover the costs of spare capacity that eventually will be used for video programming and other services that may be competitive." NPRM at Paragraph 53.

The PUCO agrees with the FCC that customers who pay the ILECs for access should not be burdened with rates that recover excess capacity investments (i.e., investments that would be mostly used in the future for nonregulated activities). NPRM at Paragraph 53.

The PUCO recommends that the FCC continue to use its current methodology in computing the allocated costs in switching investment between regulated and nonregulated activities. The PUCO submits that a methodology based on the peak "relative regulated and nonregulated usage" is a sound methodology. However, the previously used three-year usage projection period is in the PUCO's opinion too long, given the current dynamic regulatory, competitive, and technological environments. Alternatively, the PUCO believes that the allocation of excess capacity in shared switching facilities should be based on projected usage of no more than two years.

The PUCO further recommends the use of fixed factors in allocating excess capacity of interoffice plant. A 50% allocation of current excess capacity in trunk plant for regulated activities at the outset is agreeable to the PUCO as a ceiling. In addition, current projections of demand for competitive services of this kind have displayed exponential growth trajectories. As a result, the

PUCO recommends that the FCC review, on a biennial basis, its then-current cost allocation rules concerning excess capacity to ensure that regulated end users are only required to pay for that level of capacity that is reasonably required for the provision of regulated telephony.

TREATMENT OF COST ALLOCATION UNDER PRICE CAP REGULATION (NPRM SECTION VI)

The FCC, in its NPRM, notes that a strict reading of its price cap rules could presume that costs due to changes in the Part 64 cost allocation process are exogenous and would only apply to amounts reallocated from regulated to nonregulated activities. NPRM at Paragraph 60. The FCC, therefore, seeks comment on whether all such reallocations to nonregulated activities should trigger decreases in related price cap indices. NPRM at Paragraph 60.

The PUCO does not agree with those who have indicated that adjustments to regulated rates will not be necessary in a price caps environment. The PUCO notes that while there may not be a direct correlation between costs incurred and prices subject to a price cap, the FCC's final decision in this docket potentially may have a significant impact on the pricing of services and regulatory review of some of the price cap companies. In particular, the PUCO observes that the FCC's decision in this docket may significantly affect these LECs' total service long run incremental cost studies for loop plant services, and will further affect the requisite level of assistance necessary in high cost service areas. As a result, these cost allocation changes must be taken into account for all ILECs providing video services, regardless as to the type of price regulation to which they are subject.

Additionally, the PUCO maintains that a LEC's use of regulated common equipment to provided nonregulated service offerings should result in economies of scale that are beneficial to both regulated and nonregulated sub-

scribers of the company. The PUCO is still reviewing LRSIC costs of price caps companies. The allocation of loop is a critical component of those studies. As a result, the PUCO maintains that the FCC must take into consideration whether these cost allocation revisions will necessitate exogenous adjustments on behalf of price cap carriers. In the event the FCC determines exogenous adjustments to be appropriate, the PUCO submits that the adjustments should be limited to downward adjustments only. Likewise, as it concerns non-price cap LECs, the PUCO maintains that the FCC should ensure that these LECs' end users' rates will not increase as a result of the final rules adopted in this proceeding.

The FCC further requests comment on whether there are any conditions under which its cost allocation rules will not be necessary. NPRM at Paragraph 63.

The PUCO supports the FCC's efforts to revise and simplify its cost allocation rules. However, the PUCO does not believe that a repeal of Part 64 obligations, at this time, is appropriate. The PUCO believes that, until complete competition exists for every customer class, the potential for cross subsidization exists, which necessitates Part 64. In addition, the PUCO, continues to regulate, on an intrastate basis, all but one of the LECs operating in Ohio, on a rate of return based system. This form of rate regulation relies heavily on the information provided by the Part 64 rules.

In further support of its recommendation on this matter, the PUCO notes that Ameritech, which currently is the only LEC operating in Ohio under an intrastate price cap plan, stipulated in that plan that after five years, "any person or party may propose any type of replacement plan..." In fact, in reviewing any future price cap plan for intrastate regulated retail services, the statutes of Ohio require the PUCO to analyze the company's costs. The PUCO

believes that the cost information provided by Part 64, will be vital in reviewing the merits of an Ameritech replacement plan.

On a final matter, the PUCO disagrees with those who have commented in this proceeding that cost allocation procedures are an onerous overly burdensome process to the LECs. In support of this conclusion, the PUCO notes that Ameritech, upon responding to the Review of Affiliate Transactions at Ameritech Service, Inc., stated in a formal section heading that, "Assigning costs to Part 32 accounts and specific cost pools is not a difficult process." (Ameritech's Response to the Report of the Joint Audit Team's Review of Affiliate Transactions at Ameritech Services, Inc., May 1995; pp. 11-14). Ameritech further states in this section of its response that, "The Part 32 and Part 64 classifications are not difficult to determine if the individual has sufficient experience with Part 32 and Part 64 rules, and access to information regarding the work encompassed by the work profile."

CONCLUSION

In closing, the PUCO wishes to thank the FCC for the opportunity to file reply comments in this docket.

Respectfully submitted,

The Public Utilities Commission
of Ohio
By Its Attorneys

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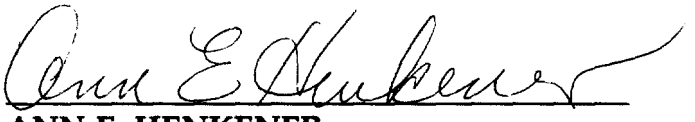

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