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Power by Association℠

Edison Electric Institute

March 22, 2011

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
Office of the Secretary
445 12th Street, S.W.
Washington, DC 20554

Re: *Implementation of Section 224 of the Act, Amendment of the Commission's Rules and Policies Governing Pole Attachments*, WC Docket No. 07-245; *A National Broadband Plan for Our Future*, GN Docket No. 09-51

Dear Ms. Dortch:

The Edison Electric Institute (EEI) hereby responds to an ex parte letter submitted by Steven F. Morris of the National Cable & Telecommunications Association (NCTA) on March 14, 2011 with regard to the declarations and findings of economists enlisted by EEI in the above-referenced matter.[1] In attempting to challenge the conclusions and results of this work, Mr. Morris misinterpreted and/or misrepresented several of its key points as explained below:

With respect to the economic consequences of reducing pole attachment rates, Mr. Morris challenges the assertion that a reduction in pole attachment rates will not have a significant impact on broadband deployment. Mr. Morris asserts that an increase in the cable rate could make broadband service "prohibitively expensive." However, Mr. Morris fails to address the fundamental point made by Jon Orszag and Allan Shampine in their Declaration that pole attachment rates comprise an insignificant share of capital and operating expenses for cable companies. However, even the pole attachment fee increases estimated by Dr. John Pelcovits, which are substantially higher than comparable estimates cited by the Federal Communications Commission (FCC or Commission), would amount to less than one percent of these total expenses. See Caldwell Presentation. Hence, it is incomprehensible how an increase of this relative magnitude could make broadband service "prohibitively expensive." Similarly, it is doubtful that a decrease in the attachment rates for telecommunications providers will

[1] See Declaration of Jonathan Orszag and Allan Shampine, filed as Attachment A of Reply Comments of the Edison Electric Institute and Utilities Telecom Council, in the above-referenced matter on October 4, 2010 (Declaration); and Supplemental Declaration of Jonathan Orszag and Allan Shampine (Supplemental Declaration) and Report of Kaustuv Chakrabarti (Chakrabarti Report), in the above referenced matter on December 14, 2010; See also ex parte presentation of John W. Caldwell, filed in the above-referenced matter on February 28, 2011 (Caldwell Presentation).

significantly increase the adoption of broadband in rural areas. Orszag and Shampine cite surveys indicating that other factors are at play in preventing broadband adoption in these areas, such as lack of computer equipment, lack of computer literacy, and lack of interest.

Further, the assertion that “where utilities fully recover their costs there is no subsidy” is incorrect, and based upon a specious argument that sidesteps the entire issue of equitable cost sharing and cost accountability. The existence of a subsidy is not premised on whether costs are being fully recovered or not, but rather on whether one or more classes of customers or beneficiaries are contributing less than their proper share of costs, at the expense of one or more other classes who are paying more than their proper share.

Mr. Morris employs the same faulty logic about complete cost recovery by arguing that because regulated utilities are “guaranteed” to earn a return on their investment in pole infrastructure, then a reduction in pole attachment rates should not result in a disincentive to provide extra space on poles for third attachers. In fact, regulated utilities are allowed, not “guaranteed,” to earn a return, and as both investor-owned businesses and regulated entities, utilities have strong incentives from both their investors and regulators to avoid engaging in infrastructure investment activity that is beyond the level required to provide reliable service to their customers at reasonable rates. To the extent that utility pole capital and operating costs are being recovered through electricity rates, full cost recovery is not guaranteed, because it is contingent upon electric sales meeting or exceeding test year levels. As Orszag and Shampine argue, lowering third-party attachment rates (and thereby shifting a greater share of the cost burden to electricity customers) would provide real incentives to utilities to invest in smaller poles, and only replace them as needed with larger poles when required by third-party attachers, which would then have to pay make-ready charges for the complete replacement of the pole. The Chakrabarti Report makes clear that such complete replacements currently make up a very small share of total make-ready work (with most of it merely involving the much less expensive rearrangement of existing attachments) and so an increase in this type of activity would result in higher up-front costs to third-party attachers and a consequent negative effect on broadband deployment, contrary to Mr. Morris’s assertion that this claim constitutes a “bewildering” argument on the part of EEI and its economists. Additionally, Mr. Morris incorrectly suggests that there is a contradiction between statements by Mr. Chakrabarti in his economic study on this issue and comparable statements made by Jon Orszag and Allan Shampine. A full and impartial reading of both sets of remarks clearly shows that they are in complete agreement regarding the impact of reduced pole attachment rates on the size of the pole. Stating that electric utilities do make space available for joint use agreements with ILECs is merely confirmation of the fact that the levels of compensation for joint use generally inherent in these voluntary agreements constitute sufficient incentive to make that space available.

Mr. Morris challenges several conclusions of the Chakrabarti Report, and in particular his critique of Patricia Kravtin’s proposed adjustments to the telecom rate formula, contending in fact that Mr. Chakrabarti engaged in “mischaracterizations” of Ms. Kravtin’s proposals. A careful examination of his specific criticisms, however, indicates that Mr. Morris either misunderstands or is himself intentionally mischaracterizing the results of Mr. Chakrabarti’s analyses.

First, Mr. Morris claims that Patricia Kravtin, in her testimony of August 28, 2010, has "demonstrated" that use of the FERC data prescribed in the current FCC formula for maintenance expense estimation overstates these expenses. But she in fact does no such thing, and Mr. Chakrabarti explains why her conclusions are based on faulty premises, including the assumption that the level of maintenance which ILECs expend on poles is comparable to that of electric utilities. Further, after comparing the ratio of maintenance to net investment between ILECs and electric companies, and analyzing a three-year time frame (rather than the single year used in Ms. Kravtin's analysis), Mr. Chakrabarti demonstrates that the ratios are very close, and in fact in some cases those for ILECS actually exceed those for electric companies.

Second, in a similar vein, Mr. Morris contends that Mr. Chakrabarti's critique of the Kravtin proposed adjustment to Administrative and General (A&G) expenses is "without merit," but in the ensuing discussion completely mischaracterizes the basis of that critique. What Mr. Chakrabarti demonstrates, in fact, is that an application of the Kravtin adjustment as described in her testimony would actually result in a significant *increase* to the administrative element in the current FCC formula. Mr. Chakrabarti points out an inconsistency between this prescribed approach and the actual sample calculation that she does in Appendix C of her testimony that uses, as the denominator, total electric operations and maintenance expenses, rather than "direct operations expense" as prescribed in her testimony. Mr. Chakrabarti correctly points out that using a ratio of overhead line maintenance expenses to total company operations and maintenance expense is clearly inconsistent, and that even if total electric maintenance expenses were used in the denominator instead, then in most cases this modified formula would result in an administrative element that would be higher than that obtained with the current FCC formula. To claim, as Mr. Morris does, that this important observation is "without merit" is disingenuous.

Finally, Mr. Morris states that Mr. Chakrabarti's critique of the proposed Kravtin adjustment to the rate of return is "unconvincing," claiming that EEI's "only argument" is that the proposed IRS rate is lower than the rate used by the FCC and the Surface Transportation Board in prior cases. In fact, Mr. Chakrabarti calls attention to an important precedent set by the Commission, in that when payments are of a unidirectional nature (i.e., from a third party to the utility) then the utility's own cost of capital would be more appropriate to use than the Internal Revenue Service (IRS) rate. The IRS rate (currently at about 3.5%) is not representative of an electric company's weighted average cost of capital which, as Mr. Chakrabarti explains, is a weighted average of a utility's cost of equity, cost of debt, and cost of preferred stock.

Additionally, Mr. Morris concludes that "nothing in EEI's submissions should cause the Commission to veer from the path proposed in the Further Notice." This is a remarkable claim, and not simply because the bulk of his reasoning for this conclusion is merely unsubstantiated assertions and/or misrepresentations of the declarations and study results presented by the economists enlisted by EEI. It is also a remarkable claim, given that the letter fails to address some of the fundamental arguments made by these economists, such as 1) that the cable rate constitutes an untargeted subsidy, with the majority of the benefits flowing to existing attachments rather than new ones (particularly to new ones that will be occurring in areas where broadband service does not exist) and hence constitutes an economically wasteful diversion of resources, and 2) that trends in broadband deployment as well as the existing level of availability indicate that a such a subsidy is not warranted to begin with.

In this important debate on the appropriate policy for pole attachment rates, it is essential that the arguments, findings, and counterarguments be based upon sound reasoning and demonstrable evidence. It does a disservice to the general discussion when one party misrepresents the arguments and evidence of another, and we hope that the Commission is cognizant of this as it weighs the facts, arguments, and evidence before arriving at its final conclusions on this matter.

If you should have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted

/s/ John W. Caldwell

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