June 12, 2012

Ex Parte Notice – Via ECFS

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *Structure and Practices of the Video Relay Service Program*, CG Docket No. 10-51; *Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, CG Docket No. 03-123

Dear Ms. Dortch:

On Friday, June 8, 2012, representatives of Sorenson Communications, Inc. ("Sorenson") met with Federal Communications Commission ("FCC" or "Commission") staff to discuss the Commission's pending *Further Notice of Proposed Rulemaking* related to reform of the video relay service ("VRS") industry.[1] The Sorenson representatives at the meeting were Paul Kershisnik, Sorenson's Chief Marketing Officer; Mike Maddix, Sorenson's Director of Government and Regulatory Affairs; Chris Wright, Chad Breckinridge, and the undersigned, all from Wiltshire & Grannis LLP; and Michael L. Katz, Sorenson's outside expert economist who prepared reports filed with Sorenson's comments and reply comments in this proceeding. The FCC representatives at the meeting were Sean Lev (OGC), William Sharkey (OSP), Jonathan Chambers (OSP) and, by telephone, Tom Brown (OSP).

The discussion followed the points presented in the attached presentation, which was distributed at the meeting. Among other topics, the participants discussed the validity and viability of rate tiers and the point at which VRS providers can achieve all the benefits of scale operations. With respect to tiers, Dr. Katz explained that providers' incentives are largely dependent on the marginal rate—that is, the revenue they can earn for serving an additional

[1] *See Structure and Practices of the Video Relay Service Program and Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Further Notice of Proposed Rulemaking, CG Docket Nos. 10-51 & 03-123 (rel. Dec. 15, 2011) ("FNPRM").

customer. Tiers distort incentives by giving providers smaller returns if they successfully attract more customers. With respect to economies of scale, Dr. Katz explained that the predominant source of costs in provider VRS—call center operations and interpreter wages—scales together with the number of minutes provided and/or number of users served. Because fixed costs are relatively low and efficiencies related to call queuing can be achieved even with relatively few minutes of service, the benefits of scale operations are exhausted at relatively low call volumes.

The participants also discussed the pros and cons of various approaches for determining the initial rate under a price cap regime. With respect to this last point, Dr. Katz explained that a reverse auction with multiple "winners" would produce the most reliable indication of an efficient market-based rate but that, considering the time needed to design and conduct such an auction, the Commission should use the current average blended rate as an interim measure.

The FCC staff also asked Dr. Katz for his views on how to prevent discrimination against high-volume users under a per-user rate regime, and he suggested that the FCC monitor providers' average minutes-of-use per customer every month. If a particular provider's numbers were out of line with others, or if they spiked in one direction or another in a given month, the FCC would have reason to investigate further.

The FCC staff also asked how the Commission should account for providers' costs of capital in setting rates. Dr. Katz and the other Sorenson representatives stated that the precise figures in any particular cost category (e.g., capital costs versus operating costs) should play no role in setting rates. Instead, the Commission should adopt a compensation system that mimics the workings of a competitive market to the greatest extent possible. Competitive pressures do not differentially apply to specific cost categories. Instead, a service provider faces pressures to reduce the sum of all of its costs. Consequently, a firm with higher operating costs than its rivals will be able to compete successfully if its capital costs are enough lower to compensate. Indeed, there may be tradeoffs: a capital-intensive strategy may result in lower operating costs but higher financing costs. A competitive market would allow providers to make independent judgments as to the right strategy.

What the Commission needs to do is to set a single compensation rate that ensures the delivery of functionally equivalent VRS services in an efficient manner. To do that, the Commission should transition to a unified single VRS compensation rate, then set an initial rate for a price-cap approach—either through an auction or based on the current average rate—and then allow providers to operate competitively, relying on market forces to spur innovation and efficiency. Both Dr. Katz and Sorenson noted that an initial price-cap rate that approximated the market result expected in an auction in an industry in which firms had different cost structures would reflect the N+1 lowest provider's costs, with N being the number of desired VRS providers. Sorenson's representatives noted that Sorenson—the industry's lowest cost provider—already operates with very thin margins, and cutting rates from their current levels will therefore have a negative impact on all consumers because experience following the 2010 rate cuts shows that operating costs cannot further be cut without affecting service quality. Moreover, the rest of the VRS industry is unlikely to have the capacity to provide high-quality services to a significantly increased number of VRS users as compared to their present subscribers. Migration of users from Sorenson because of service quality issues would likely cause other providers' service to deteriorate as well.

Sincerely,

/s/

John T. Nakahata
Counsel to Sorenson Communications, Inc.

Enclosure

cc (by email):
Sean Lev
Jonathan Chambers
William Sharkey
Tom Brown