$5.07 would reduce the size of the Fund by approximately 5 percent—or over $24 million per year.[43]

It may be that the Commission is implicitly drawing an analogy to wireline telephone service, where small companies serving only rural areas typically receive more compensation than large companies serving urban areas. But that is because the cost of serving sparsely populated areas necessarily exceeds the cost of serving densely populated areas, not simply because the rural companies are small. Unlike local exchange carriers, VRS providers essentially offer service to the same population—all deaf, hard-of-hearing, and speech-disabled Americans—across all geographies. There is therefore no comparable justification for paying more per unit of service (whether per minute or per user) to one VRS provider than another.

Moreover, the purported cost numbers provided by Purple and ZVRS to justify their claims of scale economies are not remotely reliable—indeed, so far as appears on the record, many of those figures are completely made up. For example, ZVRS submitted a power point deck entitled "Economies of Scale" that concluded that the cost of providing service ranges from $11.29 per minute at 50,000 minutes per month to $4.51 at 5,000,000 minutes per month.[44] ZVRS does not explain or support these figures in the deck or the one-page ex parte letter accompanying it, however, and they are not endorsed by any expert economist. Nor does the confidential data that ZVRS submitted purporting to back-up its public claims shed any further light on the derivation of its numbers.[45] It appears that ZVRS extrapolates from its current costs and assumes that some of its costs other than interpreter costs would remain the same if its minutes of service were to increase, while other costs would rise somewhat. But ZVRS does not

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[43] *See 2011 VRS Reform FNPRM*, 26 FCC Rcd. at 17,382-83 ¶ 24.

[44] *See* ZVRS July 10 Letter, Attachment 1 at 8.

[45] *See* ZVRS July 24 Letter.

explain which costs "stay flat as minutes increase" and which costs are "[p]artially fixed" and presumably increase to some unexplained extent as the number of minutes of service increases.[46] One thing is certain—most of the numbers on ZVRS's charts are not based on actual experience since ZVRS has never come close to providing five million minutes of service per month. In the absence of any explanation of the assumptions underlying ZVRS's projections—such as an explanation of which costs stay entirely flat as minutes increase, which increase somewhat or on some other basis (such as the number of users) and by how much, and the rationale for the projected increase—they provide no basis on which to set rates.

In addition, ZVRS's most detailed projection is so obviously inaccurate as to cast grave doubt on its other projections. Specifically, ZVRS's detailed public projection singles out "phone cost" and shows it decreasing from 51 cents per minute to 11 cents per minutes as minutes of service hypothetically increase from 50,000 to 5,000,000.[47] But if the undefined phrase "phone cost" relates to the cost of providing equipment, this dramatic 80 percent decrease is utterly implausible on its face. There is no evidence anywhere in the record—and ZVRS certainly has not provided any—suggesting that a VRS provider serving the fixed and relatively small market of deaf and hard-of-hearing consumers could possibly reach the scale necessary to generate volume discounts of this magnitude. While there may be some reduction in cost as the provider procures devices in greater quantify, any decrease in the per-minute cost of equipment would be incremental and not plausibly in the neighborhood of an 80 percent reduction.

In an ex parte filing on July 10, 2012, ZVRS proposed a Tier 1 rate of $6.02, a Tier 2 rate of $5.86, and a Tier 3 rate of $4.56.[48] These proposals are brazenly self-serving, even if credit is

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[46] *See* ZVRS July 10 Letter, Attachment 1 at 3.

[47] *See id.*, Attachment 1 at 6.

[48] *See id.*, Attachment 2 at 13.

given to ZVRS's unsubstantiated projections. With respect to providers of 50,000 minutes of service per month, ZVRS estimates their costs at $11.29 per minute but proposes to pay them just $6.02. In other words, ZVRS estimates that Tier 1 providers (*i.e.*, those that do not provide any Tier 2 or Tier 3 minutes) face costs that are approximately 36 percent higher than Tier 2 providers' costs, but it proposes a Tier 1 rate that is only about two percent higher than the Tier 2 rate. While it proposes a notably small spread between Tier 1 and Tier 2 despite data suggesting a material difference in providers' costs between the tiers, it also proposes a widening gap between Tier 2 and Tier 3 (growing from $1.16 today to $1.30 under ZVRS's proposal) even though it offers no substantiated information on the costs faced by providers who handle millions of minutes per month.

ZVRS made another confidential filing on July 24, 2012, arguing that it needs a rate above the $5.14 unitary rate proposed by Sorenson in order to continue providing service at its current level of quality.[49] That confidential filing literally does nothing, however, to bolster ZVRS's proposal for a Tier 3 rate of $4.56. To the contrary, it provides no reliable data at all pertaining to the $4.56 rate and instead shows only that reducing rates below $5.14 would cause widespread harm for providers of any size. ZVRS's argument that *it* needs a rate above $5.14 thus actually supports Sorenson's argument that the rate should not be reduced substantially below $5.14 at this time for *any* provider. Moreover, in ZVRS's view, tiers apparently should be a permanent feature despite the drawbacks articulated in the record.

Purple has proposed a tiered rate structure that would remain in effect for three to five years under which providers would receive $5.92 per minute for their first one million minutes

[49] *See* ZVRS July 24 Letter, Attachment at Tab 2.

each month, \$4.94 per minute for their next million, and \$4.27 for every additional minute.[50] Purple has stated that "Sorenson is 7x larger" than Purple,[51] and it therefore argues that Purple should be paid \$5.92 for most or all of its minutes of service and Sorenson should receive just \$4.27 for most of its minutes of service. Thus, by expanding the size of the first two tiers so that they apply to a provider's first two million minutes of service (rather than just 500,000, as in the existing tiers), Purple proposed a difference of \$1.65 between the rate it will receive for most minutes of service and the rate Sorenson will receive, compared to the current gap of \$1.16—and thus is even more self-serving than ZVRS's proposal.

In support of its proposed Tier 3 rate of \$4.27, Purple merely stated that "Purple believes if it were operating at a minute volume greater than 2 million per month, it could operate profitably under this proposed waterfall rate plan even with the tier 3 rate being set at \$4.27 per minute."[52] Like ZVRS, however, Purple provided literally no analysis or empirical data in support of that claim; it was nothing more than a statement of what "Purple believes." And there is little prospect of Purple's beliefs being put to the test because, if Purple provides one-seventh of the number minutes that Sorenson provides, Purple is far below two million minutes per month.[53]

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[50] *See* Purple Apr. 19 Letter, Attachment at 3.

[51] Purple Sept. 18 Letter, Attachment at 4.

[52] Reply Comments of Purple Communications, Inc., at 10-11, CG Docket Nos. 10-51, 03-123 (filed Mar. 30, 2012) ("Purple FNPRM Reply Comments").

[53] According to RLSA, total VRS minutes have been averaging around 9 million minutes-of-use ("MOU") per month. *See* Rolka Loube Saltzer Associates, Interstate TRS Fund Performance Status Report, February 2012, *available at* http://www.r-l-s-a.com/TRS/reports/2012-02TRSStatus.pdf (last accessed Nov. 13, 2012). Thus, even if the only two providers were Purple and Sorenson, with a 1:7 ratio, Purple's total minute volume could not exceed 1.2 million MOU per month.

Purple made an ex parte filing on September 18, 2012, that purports to provide support for its proposed $4.27 Tier 3 rate.[54] But it fails to do so. The first column of its confidential chart shows Purple's current costs of providing service. But the other columns on that one-page chart, like ZVRS's submissions, do not present real numbers. Instead, they merely estimate what Purple supposes its costs would be if it provided more minutes of service. Like ZVRS, Purple provides no explanation of the basis for its projections, and no economist endorses the numbers or explains how they were derived. Rather, Purple's chart provides categories of "semi-fixed costs," "operating costs," and "depreciation" costs that are largely unexplained and raise more questions than they answer. In light of these fundamental shortcomings, the FCC could not reasonably rely on these filings to continue the use of tiers or to establish a Tier 3 rate along the lines Purple suggests. Simply put, these filings are not "evidence" on the record—they are mere unsupported speculation.

The best actual *evidence* in the record relating to tiers comes in the form of declarations prepared by Professor Katz during the comment cycle. In addition to showing that tiers serve no valid purpose, Professor Katz demonstrated through rigorous and unrebutted data analysis that any economies of scale relating to "queuing efficiencies"—that is, efficiencies flowing from serving a larger number of customers with a pool of interpreters—are relatively small, "largely exhausted by the time a VRS provider's traffic volume reaches 250,000 minutes per month," and "just one percent once providers reach the scale achieved by Purple and ZVRS."[55] Purple and ZVRS have not disputed Professor Katz's economic analysis—which was submitted on March 9, 2012—with a declaration from another expert. Instead, as described above, they have simply

[54] *See* Purple Apr. 19 Letter, Attachment at 3.

[55] Katz FNPRM Declaration ¶¶ 28, 35.

provided some back-of-the-envelope calculations based on unexplained assumptions that are at best doubtful on their face.

In short, the record provides no basis for the Commission to depart from its proposal to abolish the tiered rate system. Purple appears to recognize that fact by its concession that a "unitary" rate is warranted after a three-to-five year phase-in.[56] (Purple does not say what that unitary rate should be, however.) Sorenson concurs that, to provide for transition, tiers should be eliminated gradually over such a period. But the Commission should not, as both ZVRS and Purple proposed, start that process by exacerbating rather than narrowing the disparity in rates among the tiers. Instead, the rational approach would be to lower Tier 1 and 2 rates until they reach the Tier 3 rate.[57]

In no case, however, should the Commission eliminate tiers by moving to a unitary rate of $3.40, as RLSA contemplates. As explained below, such a rate would destroy VRS. Accordingly, as also explained below, the Commission should move the Tier 1 and Tier 2 rates down to $5.14 over a period of years and adopt a price cap to govern future rates.

### E. The Commission Cannot Make the Substantial Cuts Proposed by RLSA at this Time Without Violating Its Statutory Obligations.

As Sorenson has previously pointed out, Section 225—passed in 1990 as part of the ADA—contains four fundamental requirements relevant here. Specifically, the Commission must ensure that deaf, hard-of-hearing, and speech-disabled individuals enjoy (1) nationwide "availab[ility] … to the extent possible"; (2) of "functionally equivalent" relay services; (3) that are made available "in the most efficient manner"; (4) pursuant to FCC rules that do not

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56 *See* Purple Sept. 18 Letter, Attachment at 3.

57 *See* Sorenson Sept. 17 Letter, Attachment at 6; Letter from Christopher Wright, Counsel to Sorenson, to Marlene Dortch, Secretary, Federal Communications Commission, Attachment 2 at 6, CG Docket Nos. 10-51, 03-123 (filed July 25, 2012); Sorenson FNPRM Comments at 25-26.

discourage the ongoing "development of improved technology" for the delivery of such services.[58] In addition, the Commission must also ensure that "users of [VRS] pay rates no greater than the rates paid for functionally equivalent voice communication services."[59] In regulating VRS, the Commission's discretion is constrained by its duty to advance these explicit statutory directives.

### 1. Functional Equivalence.

Adopting a unitary rate substantially lower than $5.14 at this time, particularly if implemented in a short period of time, will make it impossible for the Commission to honor its statutory obligations. Most fundamentally, the deep rate cuts proposed in the PN would prevent deaf Americans from receiving the functionally equivalent communications services to which they are entitled under the ADA.[60]

The FCC's rate cut in 2010—billed as an "interim" rate—illustrates the harm that the current proposal would have on functional equivalence. In that process, the Commission slashed the Tier 3 rate by 18 percent—to just $5.07 per minute—which resulted in a blended rate for Sorenson over all three tiers of $5.14. As a result of that cut, Sorenson terminated approximately ****BEGIN CONFIDENTIAL**** [redacted] ****END CONFIDENTIAL**** employees. It forced its interpreters to work harder than interpreters had ever worked before, and yet Sorenson's average speed-of-answer nearly doubled. ****BEGIN HIGHLY CONFIDENTIAL****

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[58] *See* 47 U.S.C. § 225(b)(1) (availability and efficiency requirements), (a)(3) (functional equivalence requirement), and (d)(2) (technology requirement).

[59] 47 U.S.C. § 225(d)(1)(D).

[60] *See* Sorenson FNRPM Comments at 34-36; Sorenson FNPRM Reply Comments at 35-37.

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Outside independent auditors have confirmed that all of Sorenson's costs of providing service are real, even if they are not considered "allowable." There is no fat to cut—certainly not to the level of an immediate flash-cut to $4.51 per minute with future cuts to reach $3.40 per minute. Sorenson's actual total VRS costs as of December 31, 2011—again, costs documented by outside auditors—were approximately ****BEGIN HIGHLY CONFIDENTIAL**** ****END HIGHLY CONFIDENTIAL**** per minute, leaving a margin of less than ****BEGIN HIGHLY CONFIDENTIAL**** ****END HIGHLY CONFIDENTIAL**** percent even under current rates to address factors such as potential increases in health insurance costs or wages to retain an eroding workforce.[61] A rate decrease to $4.51 in 2013—much less a decrease to $3.40 in 2015—would likely drive Sorenson into default and have a cataclysmic impact on VRS service quality.

Only two other VRS providers—ZVRS and Purple—provide any substantial amount of service, and they have filed documents showing that they are in a worse position from a cost perspective than Sorenson. Not only will they be unable to provide "functionally equivalent" service if the rate is lowered to $5.14, but they are unsure whether they can even stay in business.[62] In short, the record contains *no* evidence—as opposed to unsubstantiated speculation—that *any* VRS provider anywhere can provide service at less than $5.14.

Of course, as discussed above, Purple and ZVRS did propose that the Commission should structure rate tiers so as to compensate Sorenson (but not Purple or ZVRS) primarily at $4.23 and $4.56 per minute, depending on the tier.[63] But, again, Purple and ZVRS offered *no* evidentiary

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[61] *See* Sorenson July 11 Letter, Attachment at 11.

[62] *See* Purple Sept. 18 Letter; ZVRS Oct. 25 Letter.

[63] *See* ZVRS July 10 Letter, Attachment 2 at 13; Purple April 19 Letter, Attachment at 3.

basis for their low-ball proposals for Sorenson's compensation. Accordingly, these competitors' rate proposals regarding what *they* should receive under Tier 1 and Tier 2—proposals to which they would actually be subject—are a far more reliable guide to what they consider an adequate compensation rate that will not harm VRS users. Of course, Purple and ZVRS are both adamant that *they* cannot survive at the $5.14 rate to which Sorenson is now subject, and they thus fervently resist Sorenson's proposal that all providers should be compensated at that rate. One point warrants emphasis here. If Purple and ZVRS were arguing for a unitary rate of $4.56 next year, the Commission might reasonably conclude that $4.56 is a reasonable rate. But that is not their argument. ZVRS apparently wants tiers (applicable to it) with rates above $5.14 in perpetuity. And while Purple concedes that tiers ought to be phased out, it favors a rate scheme under which it will receive at least $5.92 for the bulk of its minutes for the foreseeable future. Accordingly, the Commission cannot reasonably point to the Tier 3 rate proposals of ZVRS and Purple and claim that VRS providers can actually provide service at those rates.

If it cuts rates below $5.14, the Commission must explain how such a rate cut is consistent with its statutory duty to ensure functionally equivalent VRS service.[64] But there is no basis in the record or elsewhere to conclude that a rate cut would not result in substantially increased wait times or other severe degradations in the quality of service provided. Sorenson is the most efficient provider of VRS, and it was forced to fire employees and increase wait times in 2010; any further rate cut necessarily will have additional negative effects on service. Given the dramatic scale of the PN's proposed cuts, those negative effects will also be dramatic.

As a matter of law, that is unacceptable. The Commission recognizes that the time in which a VRS user reaches an interpreter is analogous to the time in which a telephone user

[64] *See* 47 U.S.C. § 225.

obtains a dial tone.[65] Telephone users would not tolerate a system under which they were forced to endure lengthy waits just to obtain a dial tone, yet a further rate cut substantially below the blended $5.14-per-minute Sorenson currently receives would be certain to have such effects at the very least. The real-world impact for VRS users would be devastating, and certainly not functionally equivalent, as the Commission itself has questioned whether even a 20 or 30 second delay for certain TRS calls meets the functional equivalence requirement.[66]

In Sorenson's appeal challenging the FCC's 2010 rate cute before the Tenth Circuit, the court rejected the claim that the rate cut violated the functional equivalence standard because Sorenson did not challenge the "mandatory minimums for VRS service" and did "not claim that it would be unable to satisfy the mandatory 80/120 speed-of-answer requirement under the interim rates."[67] Accordingly, Sorenson wants to make clear that it does not believe that the 80/120 standard is a remotely plausible proxy for functional equivalence. Hearing telephone users obtain a dial tone almost immediately and would not tolerate service from a provider that approached, and sometimes exceeded, two minutes before providing a dial tone. In that connection, it bears emphasis that VRS includes hearing-to-deaf calls, and it is doubtful that hearing persons would stay on the line to wait to reach a deaf party if a call took more than a few seconds to reach an interpreter, even if deaf users were resigned to such delays. For all other TRS calls, the Commission's speed-of-answer rule is 85/10—that is, 85 percent of calls must be

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[65] *See Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Declaratory Ruling, DA 05-140, 20 FCC Rcd. 1466, 1469 ¶8 (2005).

[66] *See Telecommunications Relay Services and the American with Disabilities Act of 1990*, Second Further Notice of Proposed Rulemaking, FCC 01-89, 16 FCC Rcd 5803, 5807 ¶ 8 (2001).

[67] *Sorenson Commc'ns, Inc. v. FCC*, 659 F.3d 1035, 1043 (10th Cir. 2011) ("*Sorenson v. FCC*").

answered within ten seconds. That standard is certainly closer to functional equivalence than the 80/120 standard that applies to VRS. Under the statute, the Commission lacks authority to choose not to ensure functionally equivalent VRS because it does not want to fund it.

Moreover, it is not clear that the technical speed-of-answer standard is useful or even necessary. The Commission is required to establish a rate that ensures *functionally equivalent service*, not minimally-acceptable service. Furthermore, the standard now seems unnecessary since three VRS providers serve a substantial number of users, and competitive pressure already ensures that those providers exceed the existing standard by a wide margin. Rather than focus on amending the 80/120 rule, the Commission should recognize that multiple providers are offering minimally-acceptable service, but VRS users are nevertheless subject to substantially longer wait times than hearing telephone users. In that circumstance, a rate cut that would move service *further* from functional equivalence is impermissible.

In sum, as a matter of law, the Commission may not cut Sorenson's effective rate without violating its statutory duty to ensure functionally equivalent service.

### 2. "Availab[ility] . . . to the Extent Possible."

Section 225 requires the Commission to ensure that deaf, hard-of-hearing, and speech-disabled individuals enjoy universal service, just as hearing individuals do—*i.e.*, to ensure nationwide VRS "availab[ility] … to the extent possible."[68] This mandate is particularly powerful because the ADA is "a remedial statute … and must be broadly construed to effectuate its purposes."[69] But, of course, VRS today is *not* available to all those who would benefit from the service. Accordingly, as a practical matter, achieving the straightforward statutory goal of

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68 *See* 47 U.S.C. § 225(b)(1).

69 *Disabled in Action of Pennsylvania v. Southeastern Pennsylvania Transportation Authority*, 539 F.3d 199, 208-09 (3rd Cir. 2008).

"availab[ility] . . . to the extent possible" requires *more* outreach and training to extend service to deaf and hard-of-hearing individuals who do not yet benefit from VRS and to bring them into the economic mainstream. Yet RLSA's proposed rates would completely eliminate the ability of Sorenson—or any other provider—to extend VRS to still-unserved deaf populations, in addition to undermining functional equivalence.

The Commission has previously argued that "availab[ility] . . . to the extent possible" does *not* mean what it says, but rather that the statute impliedly gives the FCC the ability to dilute the availability mandate by "balancing" the interests of VRS users against those of contributors to the TRS Fund—even though the statute itself says nothing about balancing. We recognize that the Tenth Circuit appeared sympathetic to this argument in its VRS decision, stating that "[t]he FCC has discretion to balance the objectives of § 225 when they conflict."[70] Significantly, however, the Tenth Circuit failed to identify any conflicting provisions within Section 225, and in fact the statute contains no such conflict. To the contrary, Section 225 *differs* from other parts of the ADA on account of the *absence* of limiting language. For example, the ADA's employment discrimination provisions require an employer to make only "reasonable accommodations" and not accommodations that would impose an "undue hardship" on the employer.[71] There is no limitation in Section 225 that is comparable to these limitations, which have been construed to mean that "an accommodation is reasonable only if costs are not *clearly disproportionate* to the benefits it will produce."[72] At the least, therefore, any implicit balancing authority in Section 225 must be no less favorable to the rights of disabled persons than the

70 *Sorenson v. FCC*, 659 F.3d at 1045.

71 *See* 42 U.S.C. § 12.112(b)(5)(A).

72 *Borkowski v. Valley Cent. School Dist.*, 63 F.3d 131, 138 (2d Cir. 1995) (emphasis added) citing *Vande Zande v. Wisconsin Department of Administration*, 44 F.3d 538, 542-43 (7th Cir. 1995).

"clearly disproportionate" standard that has been used to give meaning to the limiting language in the employment section of the ADA.

It also is noteworthy that Section 225 is *more* demanding than Section 254, the general universal service provision. Section 254(b)(1) states that the universal service rules should ensure that telephone service is "affordable," but Section 254(b)(7) gives the FCC broad discretion to adopt universal service principles that advance the "public interest." The FCC reasonably interprets these provisions to give it room to balance the benefit of subsidies to consumers against the burden on contributors to the Universal Service Fund. But, again, the plain language of Section 225 contains no such balancing authority. Moreover, as noted above, Section 225, unlike Section 254, was adopted as part of the ADA, a remedial statute designed to end discrimination against disabled Americans—hence the absence of limiting language.

In short, Section 225 obliges the FCC to ensure the availability of functionally equivalent service without limiting it, for example, to services that do not impose an "undue burden" on contributors to the Fund. Nothing else in Section 225 conflicts with that clear obligation. Moreover, the Tenth Circuit's reliance on two cases involving Section 254 was misplaced—as we have explained, Section 254 is written differently than Section 225, and was not part of the ADA's revolutionary remedial effort.[73] Accordingly, if the Commission claims authority to balance away the right of deaf and hard-of-hearing people to functionally equivalent communications service that is "available . . . to the extent possible," it needs to specify the source and scope of that alleged balancing authority.

[73] *See Vande Zande*, 44 F.3d at 542-43.

We recognize that the Tenth Circuit also stated that "it is folly to suggest that § 225 requires VRS to operate at any cost or entitles VRS providers to unlimited compensation."[74] But that is not our argument here. Although Sorenson does not think the current compensation rate is sufficient to provide service that is both "available . . . to the extent possible" and truly functionally equivalent, Sorenson has not argued that the rate it receives must be increased. Rather, if the Commission orders a further rate cut it must explain why the current TRS contribution rate harms contributors to such an extent that a rate cut is required, notwithstanding its effect on VRS users.

The Tenth Circuit ultimately relied heavily on the interim nature of the 2010 decision in upholding the rate cut; it held expressly that interim decisions are entitled to an extra measure of deference,[75] and it referred to the "interim" nature of the decision 25 times in its opinion. In this proceeding, which will set permanent rather than interim rates, the Commission's decision will not be entitled to an extra measure of deference. In any event, there is nothing in the record that suggests that the interests of contributors to the Fund outweigh the interests of VRS users. Not a single contributor to the Fund has made the case for a further rate cut in the record of this proceeding.

**3. "In the Most Efficient Manner."**

Section 225(b)(1) requires the Commission to ensure that VRS is provided "in the most efficient manner" and the Commission has interpreted that phrase to mean that it should adopt "reasonable compensation rates that do not overcompensate entities that provide TRS." Providers simply are not overcompensated, however, if rates are set at levels that enable them to provide equipment to their customers and borrow money in the capital markets. It follows that

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74 *Sorenson v. FCC*, 659 F.3d at 1044.

75 *See id.* at 1046 & n.6.

the "in the most efficient manner" requirement provides no basis for refusing to consider actual costs of providing VRS—such as the need to provide equipment, pay actual taxes, and borrow money to grow and improve.

If the Commission were to now take its prior statements seriously and establish rates on the basis of a list of allowable costs that does not include equipment costs, interest expenses, and other real-world costs such as actual taxes paid, it would not be regulating VRS "in the most efficient manner." It would instead be operating in a hypothetical universe where deaf Americans can afford costly videophones and companies can operate without borrowing money, earning a profit, or paying taxes. The Commission's vision of this hypothetical universe already has driven all the telecommunications carriers out of the market, and implementing that vision threatens to cripple the remaining providers.

However, it would violate the "in the most efficient manner" requirement for the Commission to continue to use tiered rates because it is plainly less efficient to pay one provider more than another to provide a minute service. Indeed, the Commission is wasting approximately $24 million annually by paying other providers $6.23 or $6.24 to provide a minute of service that Sorenson would be able to provide for $5.14.

**4. The Technology Requirement.**

As noted above, Section 225 also requires the FCC to regulate so as not to discourage the deployment of "improved technology." Although technology issues are discussed in detail in Sections III and IV of these comments, it bears note here that this provision further reinforces Sorenson's position that the Commission cannot reasonably reduce rates substantially below $5.14 at this time. Congress clearly indicated that it expects the FCC not only to ensure the most efficient provision of communications services for the deaf given *today's* technologies, but also to regulate so as not to discourage *tomorrow's* technologies.

As noted above, videophones—and, increasingly, software applications—designed for the deaf are expensive, comparable to the costs of mobile smartphones. The PN's proposed rates—which, of course, reflect the FCC's long-standing but irrational position that the costs of providing videophones and training deaf individuals to use them are not considered in setting VRS rates—plainly undermines the development and provision of more advanced VRS hardware and software. In short, the suggestion that videophone-related costs are not "allowable" for purposes of setting providers' compensation discourages the development of new technology, contrary to Section 225(d)(3).

#### 5. "Rates no Greater than the Rates Paid for Functionally Equivalent Voice Communication Services."

A final statutory requirement that bears emphasis here is Section 225(d)(1)(D)'s mandate that VRS users may be required to "pay rates no greater than the rates paid for functionally equivalent voice communication services." As discussed above, there is simply no way that VRS providers can provide remotely functionally equivalent service at the rates proposed in the PN. It follows that VRS providers must either exit the industry or seek additional revenues to fund VRS elsewhere.

As a practical matter, of course, "elsewhere" necessarily means VRS users, who already bear the substantial burden of paying for the broadband Internet access that VRS requires. But if the Commission reduces rates to $3.40 per minute and—as confirmed by outside auditors—Sorenson's actual total VRS costs are approximately ****BEGIN HIGHLY CONFIDENTIAL****

****END HIGHLY CONFIDENTIAL**** per minute, Sorenson would have no choice but to turn to end users to make up the difference if VRS is to continue to exist. Other VRS providers would, of course, require even larger per-minute contributions by VRS users to continue to provide service.

Under the statute, however, it is simply not permissible for the Commission to impose this kind of burden on VRS users. Hearing users do not pay anything close to this amount per minute for services that are "functionally equivalent" (and, indeed, superior) to VRS. Moreover, end user charges would increase the *inefficiency* of the provision of VRS service, also in violation of the statute. In particular, end user charges would obviously result in additional charges for billing and collection, as well as write-offs for uncollectible bills. As a legal matter, it would be both statutorily impermissible and arbitrary and capricious for the Commission to fail to consider the unintended (but obvious) effects on end users of dramatically underfunding VRS.

In sum, if the Commission substantially cuts the Tier 3 rate at this time, it must, at a minimum: (1) acknowledge that the rate cut will move VRS away from functional equivalence rather than toward the statutory requirement; (2) explain the source of its authority to cut rates despite that predictable adverse effect; (3) set forth the standard it believes applies to its balancing authority—and as explained above, in our view if there is such a standard it must be more favorable to the needs of VRS users than the "clearly disproportionate" standard used under the employment provisions of the ADA; (4) explain why the harm to contributors to the Fund of maintaining something close to $5.14 as the effective per-minute rate is so substantial that it justifies a rate cut and the resulting harm to VRS users; and (5) explain how providers will be able to continue to provide VRS without imposing statutorily excessive charges on end users. The Commission cannot clear these hurdles.

### F. The Commission Should Adopt A Price-Cap Rate Initialized at the Lower of $5.14 Per Minute or the Amount that Would Result from an Auction with At Least Two Winners.

As discussed above, RLSA's proposed rates are economically infeasible, with levels that would destroy the ability of any VRS provider to provide service without levying end user charges that would render the service no longer functionally equivalent. The Commission thus needs to reject RLSA's recommended rates, as well as the outdated rate-of-return methodology on which those recommendations are based, and replace them with rates that reflect what a competitive market would yield for the range of services and equipment that is actually being provided and that remains necessary to fulfill the mandates of the ADA.

In most areas of FCC regulation—and, indeed, government regulation in general—it is common ground among all stakeholders that a fundamental goal of regulation should be to "replicate" the "efficiency incentives found in competitive markets."[76] This was, for example, the reason why the Commission "in the early 1990s . . . began moving away from traditional rate-of-return regulation of the interstate switched and special access rates" in the wireline world and toward "a form of incentive regulation, known as price caps."[77] Here, too, the Commission should reject rate-of-return regulation—especially rate-of-return regulation based on a subset of VRS providers' actual costs and utilizing a return component unsuited to a labor intensive industry—and adopt price caps initialized to mimic the results of a two-winner auction, thereby replicating some of the benefits of competition.

[76] *See, e.g., Connect America Fund, A National Broadband Plan for Our Future, Establishing Just and Reasonable Rates for Local Exchange Carriers, High-Cost Universal Service Support, Developing an Unified Intercarrier Compensation Regime, Federal-State Joint Board on Universal Service, Lifeline and LinkUp*, Notice of Proposed Rulemaking and Further Notice of Proposed Rulemaking, FCC 11-13, 26 FCC Rcd. 4554, 4572 ¶ 49 (2011).

[77] *Id.* at 4572-73 ¶ 49.

### 1. The Most Economically Rational and Viable Way to Initialize Price Caps Would be Via an Auction.

There is no serious disagreement in the record about the desirability of a price-cap system for VRS. The extreme fluctuation in rates over the past decade has plagued providers, making it extremely difficult to plan for the long term and attract investment. It is ironic that the "interim" rates adopted in June 2010 have now been in effect nearly as long as any of the "permanent" rates set by the Commission. Frankly, the long-term instability of rates—which has been at its worst during periods of increased reliance on costs of service in rate setting—reflect badly on the Commission's administration of the VRS program. Rates have changed so frequently, and rate cuts have been threatened so persistently, that long-term planning is nearly impossible and investment is impeded. Indeed, with the recent exit of AT&T and Sprint from the VRS market, *all* telecommunications carriers have now decided to stop providing VRS. The Commission must adopt a reasonable, long-term rate plan with stable rates sufficient to permit VRS providers to obtain the investment necessary to continue to provide improved service to VRS users.

In determining the level at which to initialize the rate before moving to a price-cap system, the most economically rational approach would be for the Commission to use a reverse auction (as opposed to using a cost-of-service approach to calculate the initial rate). Professor Katz addressed the virtues of setting the rate in this manner, which most closely mimics how rates would be set in an unregulated market.[78] As Professor Katz explains, if the Commission were to desire to maintain "N" competitors in the VRS market, the "market rate" should be set equal to the cost of the "N+1" lowest-cost potential service provider.[79] Assuming that the

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[78] *See* Katz FNPRM Declaration ¶¶ 68-70.

[79] *See id.*

Commission would like at least two VRS providers, then rates would properly be initialized based on the costs of the third-lowest-cost provider.

Setting rates based on the levels that could be anticipated to result if the Commission held a two-winner competitive reverse auction provides a much more rational and reasonable methodology for setting rates than a rate-of-return calculation based on a subset of providers' costs with a highly constrained margin. Rather than determining the amount of costs that are "allowed" and a margin that is "appropriate," the Commission would leave it to providers to manage their operations to generate returns—just as any company in an unsubsidized, competitive market would do—taking the price as a given (*i.e.*, with no ability to determine the price). Capital markets would be able to anticipate revenues.

The cost data on the record indicates that the costs of the third-lowest-cost provider are not likely to be substantially below $5.14 per minute, even if all providers achieve substantial scale. At present scale, Sorenson is clearly the industry's lowest-cost provider, with costs only slightly below $5.14 per minute.[80] Purple and ZVRS claim that, given sufficient volume, they could provide service at $4.27 and $4.50 per minute, respectively.[81] Even if one accepts their claims as true—and, as discussed above, there is substantial reason to doubt their validity[82]—and assumes that they reach the scale they claim necessary to achieve those low cost levels, a $5.14 rate would still be only slightly above the costs of the third-lowest-cost provider. Thus, $5.14 per minute is likely to be near the very low end of the range of results that would be anticipated from a two-winner competitive bid.

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80 *See* Sorenson July 11 Letter, Attachment at 10.

81 *See* Purple FNRPM Reply Comments at 9; ZVRS July 10 Letter, Attachment 1 at 8.

82 *See* Section II.B.

Because the Commission seems committed to avoiding a rate increase at all costs, Sorenson believes that it would be reasonable to set rates at the lower of the anticipated results of a two-winner competitive bid or at $5.14. This may result in an initial rate slightly below $5.14, but it would protect the TRS Fund against rate increases, which are not necessary to ensure that consumers can continue to receive functionally equivalent VRS service. But if the Commission rejects Sorenson's proposal to use the lower number of the anticipated result of the two-winner reverse auction or $5.14 as the initial rate, it needs to provide a rational explanation for why the use of a cost-of-service approach is superior. As we have stated, the Commission has all but abandoned the use of rate-of-return regulation in other areas, has embraced the use of auctions, and has provided convincing explanations identifying the flaws of rate-of-return regulation and the virtues of auctions.[83] Accordingly, it would not suffice for the Commission to say that it was rejecting the use of an auction (even though it would provide the rate most comparable to the rate that would exist in a fully competitive market) and choosing to use a cost-of-service approach (despite its documented flaws) simply because the cost-of-service approach resulted in a lower rate.

Of course, after a period of time under a stable rate regime, further rate reductions might be possible. As explained previously and further discussed below, Sorenson's debt costs are in line with those of many other communications companies.[84] Sorenson would be able to reduce its debt costs over time, but only if the Commission were to implement a price-cap regime and maintain it for a period of years without regularly threatening draconian rate cuts. (On the other hand, the cost of borrowing money will only increase—likely to prohibitive levels—if the

[83] *See* Comments of Sorenson Communications, Inc., CG Docket Nos. 10-51, 03-123 (filed May 16, 2011).

[84] *See* Sorenson July 11 Ex Parte, at Attachment 1.

Commission continually threatens to slash rates and periodically does so.) In short, implementation of a stable rate regime could lead to cost reductions that would permit reasonable rate reductions.

### 2. Sorenson's Prior Financing Costs Provide no Justification for Penalizing Sorenson and Every Other Provider by Initializing Rates at a Level that Would Destroy VRS.

Sorenson recognizes that the dividends paid to its private investors and Sorenson's indebtedness are of concern to the Commission. As an initial matter, even though the Commission stated in 2004 that practically no profit is permissible in VRS,[85] the Commission has never actually set rates on that basis. Moreover, the Tenth Circuit explicitly held in its 2009 decision that VRS providers are free to spend the money received from the Fund as they see fit.[86] In other words, there is no basis to suggest that Sorenson violated any rule by issuing dividends or borrowing money. Furthermore, the dividends do not represent an excessive rate of return. The ongoing interest costs arguably associated with the dividend payments represent a margin of only ****BEGIN HIGHLY CONFIDENTIAL**** ****END HIGHLY CONFIDENTIAL**** percent over all other costs, which is hardly an extraordinary profit. Especially in light of the risk of providing VRS as the compensation rate fluctuated wildly and the risk Sorenson took in developing and distributing videophones, the amount of those dividends is by no means unreasonable. ****BEGIN HIGHLY CONFIDENTIAL****

****END HIGHLY CONFIDENTIAL**** In addition, Sorenson has filed information

85 *See Telecommunications Relay Services and Speech-to-Speech Services for Individuals with Hearing and Speech Disabilities*, Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking, FCC 04-137, 19 FCC Rcd. 12,475, 12,541-45 ¶¶ 177-182 (2004).

86 *See Sorenson Communications, Inc. v. FCC*, 567 F.3d 1215, 1222 (10th Cir. 2009).

showing that its debt obligations are comparable to that of many communications companies. As a practical matter, it is appropriate to recognize that debt is typically less expensive than equity, and it is therefore reasonable for a company to use debt as a way to lower costs. In fact, debt financing has allowed Sorenson to keep its "allowable" costs as low as they have been. Sorenson recognizes, however, that the risk associated with debt can also require some level of equity investment.

Against this backdrop, the Commission's apparent concern with Sorenson's *past* dividends provides no basis for a *future* rate cut. Accordingly, if the Commission orders a further rate cut based even in part on Sorenson's financing costs, it must explain why that approach represents rational decisionmaking on the existing record rather than a punitive measure that has nothing to do with a reasonable approach to setting rates.

Purple has suggested that Sorenson's debt would justify the Commission forcing Sorenson into bankruptcy, which (Purple contends) would permit Sorenson to lower its debt obligations without disrupting service.[87] This is a fantasy. As we have explained before and again above, the largest VRS provider cannot go through bankruptcy proceedings without subjecting customers to severe service degradations.[88] Sorenson—which, again, is the lowest-cost VRS provider by a wide margin—simply has no fat to cut in its operations. And it is unrealistic to expect other providers to be able to pick up the slack. First, even in aggregate, the other providers lack the video interpreter capacity to handle a large migration of traffic from Sorenson. Moreover, another round of terminations at Sorenson would be likely to send interpreters away from VRS altogether rather than to another VRS provider. In addition, if tiers

87 *See* Letter, John Goodman, Chief Legal Officer, Purple Communications, Inc., to Marlene Dortch, Secretary, Federal Communications Commission, Attachment 1 at 7, CG Docket Nos. 03-123 & 10-51 (filed May 7, 2012).

88 *See* Sorenson July 11 Letter, Attachment at 2; Section II.B.

have not yet been phased out, moving customers from Sorenson to other providers that are still in Tiers 1 and 2 would have the perverse effect of raising the cost to the Fund.

Moreover, if Sorenson's investors were wiped out and its debt holders saw their interests cut sharply, one clear effect would be to freeze any future investment or lending in support of services for the deaf and hard-of-hearing by any provider, as the vulnerability of such investment to political risks will be acutely apparent. So if the Commission cuts rates on the theory that bankruptcy is an acceptable outcome, it must acknowledge its reliance on that theory and explain how it will be able to ensure that deaf and hard-of-hearing Americans obtain functionally equivalent communications services after it forces the largest and most efficient provider of VRS into bankruptcy. That is not possible.

### G. The Commission's Specific Rate Questions Reveal that RLSA's Proposal Is Fundamentally Misguided.

For the reasons stated above, the five specific questions asked by the Commission on pages 7-9 of the PN are misguided. Nevertheless, for the sake of clarity, Sorenson responds to them as follows, briefly summarizing many of the points already discussed in detail above.

1. *Should the following cost categories, which RLSA has included in its calculation of the proposed rates, be allowable as part of the cost basis for rates: marketing (calculated by RLSA as $0.0504 (2010), $0.0441 (2011), and 0.0466 (2012) per minute); outreach (calculated by RLSA as $0.2741 (2010), $0.2606 (2011), and 0.2594 (2012) per minute); and research and development (calculated by RLSA as $0.0486 (2010), $0.0542 (2011),and $0.0523 (2012) per minute)?*

As detailed above, the Commission should "allow" the specific costs listed in the first question, relating to marketing, outreach, and research and development if it uses a cost-of-service approach. But that list is woefully incomplete and, more fundamentally, the Commission should get out of the business of cost-of-service ratemaking as it has done in virtually every other context. Instead, the Commission should initialize rates at the third-lowest provider's actual total costs (assuming that the Commission wants at least two competing VRS providers), or it should initialize rates at the current blended average of $5.14 compensation.

2. *Should the Commission continue to limit the kinds and amount of capital costs that are allowed to be recovered? Thus, RLSA's proposed rate would allow an 11.25% return on invested capital, an element which has long been used as the basis for calculating TRS rates, as well as other common carrier rates, and which previously has been found to address adequately the recovery of interest and principal payments on debt, income taxes, and profits. RLSA calculates the weighted-average-per-minute return on investment, with allowance for taxes, to be $0.0949 per minute in 2010, $0.0778 per minute in 2011, and $0.0594 per minute (projected) in 2012. We invite commenters to refresh the record on the appropriate treatment of capital costs, rate of return, and related issues. Parties that advocate a particular alternative for treatment of capital costs should specify the type of investment on which they believe providers should be authorized to recover a return, the percentage return that they believe is appropriate in light of current market conditions, an estimate of the dollar amount that their proposed capital cost element would add to proposed VRS rates, and the specific reasons why investment and return should be so defined for purposes of Fund-compensated VRS.*

Because there is absolutely no basis in the record or reality for using the same method for calculating reasonable returns in a labor-intensive industry like VRS as in a capital-intensive industry like wireline telecommunications, let alone a method adopted for that industry in the 1980s, an 11.25-percent rate of return on capital investment makes no sense for VRS, as explained above. The fact that, even under the Commission's flawed calculations, such a methodology produces an estimated return of only six cents per minute in 2012—barely more than ****BEGIN HIGHLY CONFIDENTIAL**** ****END HIGHLY CONFIDENTIAL**** percent of Sorenson's actual costs of providing service—shows that it is not nearly adequate to provide functionally equivalent service for deaf or a reasonable profit. Again, the fact that all telecommunications companies have exited the VRS business is an indicator that the approach is not reasonable.

3. *Should the Commission retain, modify, or eliminate the current tiered VRS rate structure?*

As the Commission itself, Sorenson, and Professor Katz[89] have explained at length, there

[89] *See* Katz PN Declaration ¶ 66.