

Mid-Course Adjustments

AT&T's assumption that some sort of undefined "large variations" between the annual rates of return of local exchange carriers ("LECs") and the Commission's prescribed 11.25% rate of return "show that the LECs' data are unreliable and require correction" (AT&T petition, p. 4) is erroneous and unsupported. During recent years, changing economic and technological conditions in the telecommunications industry have made the prediction of demand for access and other telecommunications services particularly difficult and volatile. Wireless toll plans, as well as the growth of unidentifiable "phantom traffic" for which no one pays access, have rendered demand projections very unstable, with the result that interstate access rates have often not produced the revenues or rates of return that were reasonably expected. Uncertainties regarding the potential growth and regulation of Voice over Internet Protocol ("VoIP") traffic, as well as attempts by some carriers to evade access charges by characterizing their traffic as VoIP traffic, are likely to prolong these instabilities. The point is that changes in marketplace conditions can produce relatively "large" as well as relatively "small" variations in rates of return over certain periods (however such "large" and "small" variations are defined).

Moreover, a "rate of return" for a single calendar year is an inherently unstable, inaccurate and unreliable concept. Just as a rookie is not elected to the Hall of Fame for hitting .300 during his first season in the Major Leagues (or banished to the Minor Leagues forever for hitting .175), the rates of return of telecommunications carriers require longer evaluation periods. The Commission itself has long used a minimal two-year monitoring period for reviewing and evaluating the earnings of rate of return carriers.

On March 29, 2004, Chillicothe filed with the Commission a preliminary Rate of Return Report (FCC Form 492) for calendar year 2003. This report indicated that Chillicothe had

earned only 2.72% on its End Office Switched Access Service during 2003. It also noted that Chillicothe had earned a 25.26% return on its interstate Local Transport service during 2003, and that its aggregate rate of return for the Switched Traffic Sensitive Category for 2003 was 15.91%. Finally, the report indicated that Chillicothe had earned 44.27% for its interstate Special Access services during 2003. In sum, Chillicothe had under-earned in one rate category, and over-earned in two others.

It is important to reiterate that Chillicothe's 2003 Rate of Return Report was merely a preliminary report. Pursuant to Section 65.600(b) of the Commission's Rules, Chillicothe must file a Rate of Return Report for the entire January 1, 2003 to December 31, 2004 monitoring period on or before March 31, 2005, and may make final adjustments to such report until September 30, 2005. It is neither clear nor certain whether Chillicothe's final report for the 2003-2004 monitoring period will reflect under-earnings or over-earnings in the same rate categories, or to the same extent, as its preliminary 2003 report.

More important, Chillicothe has already employed its preliminary 2003 report in a good faith manner to adjust its interstate access rates and earnings to target more closely its authorized rate of return. On January 16, 2004, Chillicothe filed Transmittal 78 to its Tariff F.C.C. No. 1, which became effective January 31, 2004, in order to revise the revenue requirements and demand forecasts, and to adjust the rates, for its End Office, Local Transport and Special Access services. The current Transmittal No. 80 further adjusts many of its End Office, Local Transport and Special Access rates, primarily in a downward direction, in a further attempt to target Chillicothe's authorized rates of return during the remaining six months of the 2003-2004 monitoring period as well as the initial part of the 2005-2006 monitoring period.

Hence, Chillicothe has already used its preliminary Rate of Return Report for 2003 to make mid-course rate adjustments for the 2003-2004 monitoring period. Its effort has been made voluntarily and in good faith, and moots the need for AT&T's requested formal requirement for Chillicothe to file mid-course corrections. Chillicothe will, of course, continue to monitor changing market conditions and its rates and earnings, and make voluntary mid-course corrections when warranted.

Given that AT&T has not alleged that any of the specific rate changes in Transmittal No. 80 are unjust or unlawful, there is no reason or basis for the Commission to adopt AT&T's "second best solution" and suspend Chillicothe's transmittal.

Corporate Operations Expense

AT&T asserts that Chillicothe's projected 2004-2005 corporate operations expenses exceed the average 2002 corporate operations expenses of a group of thirty allegedly "similarly sized carriers" by 105.88% (AT&T petition, p. 8 and Exhibit C-3). It claims that Chillicothe should not be allowed to include corporate overheads beyond some unidentified "reasonable threshold" in its interstate access revenue requirement (Id., p. 8).

Whereas the Commission has adopted Section 36.621(a)(4) of the Rules to expressly limit the amount of corporate operations expense to be used for calculating universal service support payments, it has adopted no rule that specifies a threshold or formula, or that otherwise limits the amount of corporate operations expense to be included in interstate access revenue requirements. Although the Commission has authority to disallow specific expense items in corporate operations expense accounts if it finds they were not incurred in a reasonable or prudent manner, it must conduct a rulemaking before adopting a general threshold or formula for limiting the amount of corporate operations expense included in interstate access revenue

requirements. Here, AT&T has not challenged any specific expenses in Chillicothe's corporate operations expense accounts, and has not developed, proposed or justified any particular "reasonable threshold" for excluding such expenses. Rather, AT&T has asked for some sort of general "disallowances" that the Commission should not employ or implement without an appropriate notice and comment rulemaking in which all interested parties have an opportunity to participate.

AT&T's "analysis" does not suggest, much less prove, that Chillicothe and its other targets have "significantly overstated" their corporate operations expense, or that they operate inefficiently. First, AT&T's attempt to compare the "apples" of Chillicothe's projected 2004-2005 corporate operations expenses against the "oranges" of the average 2002 corporate operations expenses for thirty LECs does not prove or disprove the reasonableness of Chillicothe's 2004-2005 projections. Moreover, AT&T's 30-LEC "sample" is not a fair or accurate yardstick for Chillicothe because it includes five Century affiliates, four ALLTEL affiliates, four FairPoint affiliates, two ACS affiliates and one TXU affiliate – or sixteen affiliates of companies that own and control multiple LECs. Whereas Chillicothe is a one-LEC entity that does not have the ability to share corporate operations expenses with multiple LEC affiliates, the sixteen LEC affiliates comprising the majority of AT&T's 30-LEC "sample" should have significantly lower corporate operations expense than Chillicothe because they can share their executive, planning, accounting, finance, external relations, human resources, information management, legal, procurement, and other general and administrative expenses with multiple LEC affiliates. Third, much of corporate operations expense is overhead expense that is incurred regardless of the size of an entity and that does not vary directly or exclusively with the number of loops served by a LEC. That is, a LEC must incur certain costs for officers,

accountants, lawyers, information systems, human resources and other corporate operations expenses whether it serves 1,000, 10,000, 25,000 or 50,000 loops. Hence, AT&T's per-loop comparisons of corporate operations expense are not generally appropriate or meaningful.

Chillicothe's projected corporate operations expense for 2004-2005 is \$6,814,102, a 6.5% increase from its actual 2003 corporate operations expense. AT&T has submitted nothing to indicate that any of the expenses in Chillicothe's corporate operations expense accounts are imprudent or unreasonable, or that any of Chillicothe's proposed rate changes are unjust or unreasonable. Therefore, there is no reason or basis to disallow any of this projected expense, or to suspend Chillicothe's Transmittal No. 80.

Conclusion

Insofar as it pertains to the proposed rate changes in Transmittal No. 80 to Chillicothe's Tariff F.C.C. No. 1, AT&T's petition should be denied, and Chillicothe's rates should be allowed to become effective on July 1, 2004 without suspension or any of the other conditions sought by AT&T.

Respectfully submitted,
**THE CHILlicothe TELEPHONE
COMPANY**

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CERTIFICATE OF SERVICE

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