

Before the
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554

In the matter of)
)
Telecommunications Relay Services and) CG Docket No. 03-123
Speech-to-Speech Services for Individuals)
with Hearing and Speech Disabilities)

To: The Commission

***REPLY TO COMMENTS ON NECA'S PROPOSED PAYMENT FORMULAE
AND FUND SIZE ESTIMATES FOR THE INTERSTATE TRS FUND FOR
THE 2010-11 FUND YEAR***

PURPLE COMMUNICATIONS, INC.

Daniel R. Luis, Chief Executive Officer
Kelby Brick, Vice President, Regulatory
and Strategic Policy

595 Menlo Drive
Rocklin, California 95765
888-600-4780

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TABLE OF CONTENTS

<i>I.</i>	<i>Introduction and summary.....</i>	<i>1</i>
<i>II.</i>	<i>The record supports retention of the multi-tier VRS rate setting methodology.....</i>	<i>2</i>
<i>III.</i>	<i>The Commission should expand Tiers 1 and 2 to reflect the current VRS market size and to promote consumer choice and competition in a dominated marke.....</i>	<i>5</i>
<i>IV.</i>	<i>The tiered rate structure is necessary to address Sorenson’s dominance of the industry arising from its history of market dominance and anticompetitive conduct.....</i>	<i>6</i>
<i>V.</i>	<i>The proposed NECA rates require adjustment to account for costs not considered.....</i>	<i>9</i>
<i>VI.</i>	<i>The Commission should increase the Tier 1 rate to encourage certified entrants and continued innovation.....</i>	<i>11</i>
<i>VII.</i>	<i>The Commission should forthwith institute an open and transparent proceeding to examine and set future VRS rates.....</i>	<i>12</i>
<i>VIII.</i>	<i>Conclusion.....</i>	<i>12</i>

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Purple Communications, Inc. (“Purple”), pursuant to Public Notice, DA 10-761 (CGB April 30, 2010) (“Public Notice”), replies to the comments submitted on or before May 14, 2010 on the National Exchange Carrier Association’s (“NECA”) April 30, 2010 proposed Telecommunications Relay Service (“TRS”) payment formulae and fund size estimates.¹ In support, the following is shown.

I. Introduction and summary.

In its opening comments, Purple explained that: (1) the Commission should avoid use of a single weighted average to set VRS rates because of the existence of a dominant provider in the market whose data obstructs visibility of the true costs for the smaller providers; (2) the Commission should continue to use a multi-tiered rate structure; however, the Commission should expand Tiers 1 and 2 to better foster competition and greater consumer choice in a single provider dominated market; and (3) for this interim rate period, the Commission should use

¹ See Interstate Telecommunications Relay Services Fund Payment Formula and Fund Size Estimate, Docket 03-123 (April 30, 2010) (“Rate Filing”). Purple is responding to the comments submitted by providers and consumer groups. We note in addition that the Commission has received some 10,000 consumer comments expressing concern with respect to the proposed rate levels. The consumer comments show the very real concern of consumers to protect their lifeline VRS service. Absent making the adjustments in the rate requested by Purple and other providers, VRS service and competition will suffer.

historical costs for determining the payment rates for the tiers, with an adjustment to account for costs NECA either miscalculated or did not incorporate into the rates. Review of the various comments by the majority of other providers supports the positions Purple set forth in its opening comments. No party advocates for a single rate based on the weighted average cost approach. All parties who commented -- except for Sorenson Communications, Inc. ("Sorenson") -- support continued use of a multi-tier approach, with most parties proposing to increase the size of Tiers 1 and 2. All parties agree that the historical rates NECA proposes omit or understate material costs necessary for setting reasonable VRS rates. These and related issues will be discussed in detail below.

II. The record supports retention of the multi-tier VRS rate setting methodology.

In its opening comments, Purple endorsed continued use of the multi-tier VRS rate.² The vast majority of the commenters agree that the Commission should continue to employ the multi-tier rate methodology because the tiered rate structure reflects cost savings achieved as providers scale upward.³ The structure also promotes competition, innovation and new entry into the market.⁴

Only the industry's largest provider, Sorenson, disagrees.⁵ Sorenson proposes that the Commission adopt a five-year VRS rate plan, initially setting the VRS rate at \$5.95 per minute and reducing the rate one percent per year.⁶ However, Sorenson's request that the Commission

² Purple Comments at 5-6.

³ AT&T, Inc. ("AT&T") Comments at 2-4; CSDVRS, LLC ("CSDVRS") Comments at 2-4; SNAP Telecommunications, Inc. ("SNAP") Comments at 2-3, 26; Convo Comments at 3.

⁴ CSDVRS Comments at 2-3; PAH!VRS ("PAH") Comments at 8; AT&T Comments at 3.

⁵ Sorenson Comments at 4-5, 27-29.

⁶ Sorenson Comments at 4.

abandon the tiered payment structure should be rejected. First, the tiered rate system fosters competition from smaller providers and new entry into the market. Second, Sorenson offers no justification for its proposed \$5.95 per minute rate beyond what Sorenson needs for its own capital structure. Third, multi-tier payment rates do not create a *Melody Music*⁷ issue because the tiers do not create disparate treatment of similarly-situated providers.

A principal purpose of the tiered structure is to encourage new entrants and competition in the VRS market.⁸ The tiered structure does not, as Sorenson claims, reward inefficient, low volume providers and punish efficient providers. To the contrary, the Commission designed the tiered rate structure to help create a level playing field by increasing competition and more effectively tailoring compensation to costs.⁹ Unfortunately, the tiered structure has not yet fully realized these goals. Sorenson has retained its near-monopolistic hold on the market for more than seven years. Newer providers need time to overcome the barriers that are presented by Sorenson's dominance and control; a tiered rate with a sufficient slope in the payment levels provides the best mechanism for fostering competition and benefiting consumers.

Sorenson cannot support its proposed rate of \$5.95, applied without regard to volume level. In fact, Sorenson provides no data for its arrival at the proposed \$5.95 rate. If there was factual support for Sorenson's proposal it should be available in the financing documents and offering memorandum that Sorenson must have provided to investors in its recent financing. Indeed, Sorenson proposes a single \$5.95 rate for reasons best understood in the context of its interest payments owed in connection with its financing activities.

⁷ *Melody Music, Inc. v. FCC*, 345 F.2d 730 (D.C. Cir. 1965).

⁸ *Telecommunications Relay Services*, 22 FCC Rcd 20140, 20163 (2007) ("2007 Rate Order").

⁹ *Id.*

Any potential insolvency issues Sorenson might encounter in connection with the NECA proposed Tier 3 rate are directly related to its interest payment obligations, and not, as Sorenson suggests, exclusively to its costs of service to deaf consumers. According to recent news reports, Sorenson has outstanding financial obligations in excess of one billion dollars. This large amount is a result of Sorenson's recent choice to incur new financial obligations of \$735 million through a recent financing, underwritten by Goldman Sachs and Morgan Stanley.¹⁰ The financing reportedly enabled Sorenson (1) to refinance its existing financial obligations and (2) to siphon profits away from its VRS operations and into the pockets of its private equity shareholders through the payment of a substantial dividend. It is no coincidence that Sorenson now proposes a five-year rate plan that runs concurrently with the due date for repayment of this newly-incurred \$735 million financial obligation. Based on the foregoing, it is clear that Sorenson's bankruptcy predictions are based not on the company's inability to provide service to deaf consumers should the FCC adopt NECA's proposed Tier 3 rate, but on the difficulties the company would reportedly face in making interest payments while maintaining a profitability level that would not result in defaulting on financial obligations. NECA's proposed Tier 3 rate, as properly adjusted as discussed herein, would not drive Sorenson from the marketplace and into liquidation. Instead, Sorenson simply would have to face the consequences of its decisions regarding its financing choices and the likelihood that the company would have to restructure its financial capital structure.

Finally, a multi-tier payment structure presents no *Melody Music* issue. *Melody Music* essentially requires similarly-situated parties to be treated similarly, or for the Commission to explain the disparate treatment. The tiered rate system does not treat parties disparately. All

¹⁰ See <http://www.reuters.com/article/idUSN1115548520100114>.

parties serving X number of minutes are paid the same. Sorenson would be paid the rate for Tier 1 for its Tier 1 minutes and the rate for Tier 2 for its Tier 2 minutes. Sorenson and all other providers who provide Tier 3 minutes would be paid the Tier 3 rate. Accordingly, a tiered rate structure does not amount to unequal treatment. Furthermore, it must be noted that Sorenson is not similarly situated to smaller providers. NECA data has repeatedly shown that Sorenson -- with an 80 percent market share -- has a lower cost structure than the rest of the VRS industry, and the Commission is well within its discretion to recognize this fact.¹¹

For each of these reasons, use of the multi-tier VRS rate should be continued and Sorenson's proposal that the FCC establish a single VRS rate of \$5.95 should be rejected. The Commission's continued application of a multi-tiered rate structure is necessary for adequate competition, beneficial for consumers and critical for the long-term health and stability of the TRS industry and the Interstate TRS Fund.

III. The Commission should expand Tiers 1 and 2 to reflect the current VRS market size and to promote consumer choice and competition in a dominated market.

Purple continues to support an expansion of Tiers 1 and 2, to ensure adequate compensation for providers. In its opening comments, Purple advocated expanding Tier 1 to 100,000 minutes a month and Tier 2 to 1,500,000 minutes a month.¹² NECA's proposal to apply the proposed Tier 3 rate of \$3.8963 for minutes beyond 500,000 highly concerns Purple. Providers do not achieve sufficient scaling and cost reduction to make the proposed Tier 3 rate economically feasible until they are offering a much higher quantity of minutes than 500,000 minutes per month.

¹¹ See, e.g., <https://www.neca.org/cms400min/WorkArea/linkit.aspx?LinkIdentifier=id&ItemID=1393>.

¹² Purple Comments at 8-11.

Given the actual cost to providers of processing calls at a volume above 500,000 minutes per month, small and medium-size providers would be disincentivized from growing their businesses beyond the 500,000 minute mark. Accordingly, several providers share Purple's proposal to widen the tiers. Convo advocates increasing Tier 1 to 100,000 and adding two additional tiers, with the fifth tier operative at more than 1,000,000 minutes a month.¹³ CSDVRS and PAH likewise advocate expanding Tier 1 to 100,000 minutes, and suggest expanding Tier 2 to 1,000,000 minutes per month.¹⁴ SNAP also supports widening the tiers.¹⁵

Purple continues to maintain that Tier 2 should be expanded to 1,500,000 minutes a month, in light of the substantial reduction proposed by NECA for Tier 3 compensation. Purple has serious concerns that no provider could hit the "break even" mark at a Tier 3 rate of \$3.8963 at less than 1,500,000 minutes of use per month. Providers must be adequately compensated for their minutes above 500,000 or NECA's proposed Tier 3 rate would have the anomalous effect of disincentivizing providers from expanding their market share beyond the cap for Tier 2 minutes.¹⁶

IV. The tiered rate structure is necessary to address Sorenson's dominance of the industry arising from its history of market dominance and anticompetitive conduct.

As the Commission determines the VRS rates for this interim period, it is important to recall that Sorenson did not achieve its market dominance from mere efficiency. Much of Sorenson's market dominance occurred through aggressive and anticompetitive activity. For example, Sorenson entered the VRS market in the Spring of 2003 and immediately and

¹³ Convo Comments at 4.

¹⁴ CSDVRS Comments at 2-3; PAH Comments at 8-9.

¹⁵ SNAP Comments at 25, 26.

¹⁶ Should Sorenson's threat of bankruptcy come to fruition, numerous providers would need to enter the Tier 3 to service Sorenson's vast customer base.

systematically engaged in an anticompetitive tie-in arrangement. Sorenson licensed its videophone device to consumers and contractually required them to use only Sorenson's VRS service. Moreover, it electronically locked the devices from accessing the VRS services of competing providers. This anticompetitive arrangement was inconsistent with long-standing FCC policies on open network architecture, equipment interoperability and consumer choice in service.¹⁷ In May of 2006,¹⁸ the Commission issued a declaratory ruling that prohibited such practices. However, in just three short years, Sorenson succeeded in leveraging its free videophone device with the tie-in arrangement to amass a dominant market share of more than 70 percent.

Even after the FCC declared Sorenson's aforementioned practices in violation of the Communications Act, Sorenson persisted in anti-competitive acts. After announcing the removal of the block on its videophones, Purple discovered that Sorenson was placing an intercept announcement on its videophones when a consumer sought to use a provider other than Sorenson. It was also reported to Purple by consumers that Sorenson had monitored their usage and threatened to take back consumers' equipment, or deny an upgrade, if the consumer used a VRS providers other than Sorenson or did not engage in adequate use of Sorenson's services.

The Commission has previously made clear that those practices -- deemed improper -- would subject a VRS provider to denial of compensation from the TRS Fund.¹⁹ Unfortunately,

¹⁷ See, e.g., *Hush-A-Phone Corporation v. U.S.*, 238 F.2d 268 (D.C.Cir.1956); *Carterphone Device*, 13 F.C.C.2d 420 (1968); *Time Warner, Inc. and America Online, Inc.*, 16 FCC Rcd 6547 (2001); *Competition in the Interstate Interexchange Marketplace*, 7 FCC Rcd 2677 (1992).

¹⁸ *Telecommunications Relay Services*, 21 FCC Rcd 5442 (2006).

¹⁹ See *Public Notice, Federal Communications Commission Clarifies that Certain Telecommunications Relay Services (TRS) Marketing and Call Handling Practices are Improper and Reminds that Video Relay Service (VRS) May Not be Used as a Video Remote Interpreting Service*, 20 FCC Rcd 1471 (2005) ("2005 Declaratory Ruling).

Purple believes that Sorenson continues to demonstrate anticompetitive practices. On December 27, 2007, Purple's predecessor Hands On Video Relay Services, Inc. submitted a Petition for Institution of Enforcement Action. That petition documented repeated instances of Sorenson's anticompetitive misconduct, including threatening to repossess a consumer's videophone for failure to use Sorenson's services, removing other providers from Sorenson videophone directories without the consumer's consent, telling consumers they may only use Sorenson's services, and removing, without a consumer's permission, videophones supplied by other VRS providers. To date, it is not apparent that the Commission has taken any action in response to the Hands On petition.

Moreover, since the filing of the Hands On petition, Purple has received numerous complaints that similar anticompetitive conduct continues. Purple has learned from consumers that Sorenson representatives have arrived at private premises unannounced, telling consumers they are there to "fix" the videophones. The consumers discovered that at least part of the "fix" included removing other providers from their speed dials. In addition, consumers report that although their Sorenson equipment was working perfectly, Sorenson installers removed routers provided by other providers – disabling other providers' video equipment. Purple has also discovered instances where Sorenson erroneously told consumers that they are limited to one 10 digit number from one provider, and if they did not choose Sorenson, they could lose their Sorenson provided videophone. While Sorenson touts its efficiency, Purple believes Sorenson has gained and retained its market dominance, in part, through prohibited practices.²⁰

²⁰ We also note that Sorenson entered into an exclusive agreement with Gallaudet University which prohibits other providers from marketing their services on Gallaudet's campus. Given the substantial contributions Sorenson has made to Gallaudet and its contract for VRS interpreting services with the Gallaudet Interpreting Services it would appear the exclusive agreement constitutes a prohibited financial incentive under the 2005 Declaratory Ruling, 20 FCC Rcd 1471, and the discussion of permissible marketing practices contained in the 2007 Rate Order, 22 FCC Rcd at 20173-76.

V. *The proposed NECA rates require adjustment to account for costs not considered.*

In its opening comments, Purple expressed concern that the historical rate calculation methodology used by NECA does not fully account for several costs which increase year-to-year. Most notably, providers must bear the continuing increase in interpreter costs and related labor overhead, such as health insurance expenses. These costs are rising well above of the 3.2 percent inflation factor utilized by NECA.²¹ In addition, NECA has proposed an inadequate 1.6 percent working capital allowance, which is based on a 30-day payment cycle, rather than the 65-day payment cycle actually in effect. Moreover, NECA's proposed allowance of \$0.0083 per minute for numbering costs appears to be extremely low; Purple's numbering and E911 costs are approximately \$0.02 per minute.²² In its opening comments, Purple also questioned whether NECA factored in the cost of normal internal business use of VRS in fashioning the historical rate proposals. Accordingly, while Purple endorses the use of the historical cost figures, the proposed rate levels need to be increased to correct for these deficiencies.²³

The comments of several other providers raise similar cost-related issues.²⁴ To better account for year-to-year inflation, AT&T proposes utilizing projected costs in setting the VRS

²¹ See Purple Comments at 7 & n.5. Purple explained that NECA's use of the 3.2 inflation rate appears to be based on nationwide salary increase data. However, due to the shortage of video interpreters, the VRS industry has experienced substantially higher wage inflation. In this vein, it is important to note that the majority of costs associated with the delivery of VRS rise substantially each year (e.g., wages, health care expenditures, rental expense). As such, if the FCC adopts historical costs as the basis for the 2010-11 interim rate, it should consider whether the multipliers NECA proposed are sufficient to cover the expected cost increases in the areas noted.

²² Purple urged NECA to submit reply comments addressing these apparent issues with its historical cost calculation methodology. Purple Comments at 8 n.7.

²³ Purple Comments at 6-8.

²⁴ AT&T Comments at 5; SNAP Comments at 10-16; CSDVRS Comments at 4-13; Sorenson Comments at 16-17 & n.35.

rates.²⁵ PAH also supports the use of projected rates.²⁶ Purple is sympathetic to these arguments, but notes that use of projected rates for the interim 2010-2011 rate year would require use of the problematic data for Tier 3 that NECA highlighted in its Rate Filing.²⁷ For this reason, Purple recommends adoption of the historical rate multi-tier option with adjustments to account for missing or underestimated costs.

The Commission should consider several critical factors which demonstrate the necessity to adjust the multi-tier rates. For example, CSDVRS's comments set forth an extended discussion of the failings of the current process for determining rate of return and other costs omitted from the NECA proposed rates. The discussion principally focuses on the failure of the present methodology to consider providers' capital structures.²⁸ Capital structures are a standard component of rate of return methodology, rendering its omission significant.²⁹

Additionally, CSDVRS and Purple both stress the problems with the working capital adjustment NECA proposes. Specifically, NECA's proposal will not sufficiently compensate providers, given that the lag in payment to VRS providers is approximately 65-days and not the 30-days NECA contemplates.³⁰ According to CSDVRS's analysis, fixing the working capital analysis would add \$.11 to the various VRS rates. Purple agrees.

²⁵ AT&T Comments at 5.

²⁶ PAH Comments at 1-8.

²⁷ Rate Filing at 18.

²⁸ CSDVRS Comments at 4-9.

²⁹ See *American Telephone and Telegraph Co.*, 38 F.C.C.2d 213 (1972); *American Telephone and Telegraph Co.*, 9 F.C.C.2d 30 (1967). See also Jamison, "Rate of Return Regulation," at 15-16 (available at http://warrington.ufl.edu/purc/purcdocs/papers/0528_Jamison_Rate_of_Return.pdf).

³⁰ CSDVRS Comments at 10.

CSDVRS further suggests adjustments to the rates based on videophone and research and development costs.³¹ CSDVRS rightly advocates adjusting the rates by \$.31 per minute for videophone costs and \$.05 per minute for research and development costs.³² CSDVRS also proposes an adjustment of some \$.09 for numbering and 911 costs, while SNAP indicates its costs are approximately \$.19.³³ As indicated in its opening comments, Purple's cost are approximately \$.02 per minute, some two and ½ times NECA's estimate.³⁴ Accordingly, NECA's calculation of numbering costs does not reflect the actual costs of providers and requires adjustment.

VI. The Commission should increase the Tier 1 rate to encourage certified entrants and continued innovation.

In its opening comments, Purple noted a logical disconnect between the NECA rate proposals for Tiers 1 and 2, and suggested that the Tier 1 rate should be set five percent above the Tier 2 rate.³⁵ Likewise, Convo suggests that the Tier 1 rate should be higher than the Tier 2 rate.³⁶ As Convo explains, a lower rate for Tier 1 does not account for the high start-up costs of small providers who operate their own networks.³⁷ Convo, for example, points out that providing 24/7 service is particularly costly for small providers given the paucity of calls received

³¹ *Id.* at 10-11. Additionally, the Consumer Groups correctly point out that research and development is necessary in such areas as IP captioned telephone service. Consumer Comments at 5.

³² *Id.*

³³ CSDVRS Comments at 11-12; SNAP Comments at 8.

³⁴ Purple Comments at 8.

³⁵ Purple Comments at 12.

³⁶ Convo Comments at 4-5.

³⁷ This same fact may not be true of "resellers" who are in Tier-1 who may have lower costs than their reselling partner.

overnight.³⁸ For these reasons and for the reasons stated in Purple's opening comments, Purple reiterates that the Tier 1 rate should be set above the ultimately determined Tier 2 rate.

VII. The Commission should forthwith institute an open and transparent proceeding to examine and set future VRS rates.

Purple supports action by the Commission to institute a Notice of Inquiry to obtain information relative to the ADA's goals to guide its future rate decisions. Thereafter, Purple believes the Commission should issue a Notice of Proposed Rulemaking to consider future TRS rate methodologies. This proceeding should be transparent and all data relied upon by the Commission or the TRS Fund administrator should be made available for public review and comment. Purple, SNAP and the consumer groups have openly advocated for transparent proceedings to establish future TRS rates.³⁹ Without full data as to how VRS and other TRS services are operating to achieve the ADA's goals, the Commission is forced to set future TRS rates in a vacuum. Likewise, the Commission should not set rates without public participation, and should allow full public access to information concerning the costs of providing functionally equivalent services.

VIII. Conclusion.

In sum, the comments of record filed in this proceeding support the positions Purple put forth in its opening comments. The record supports the continued use of the tiered rate setting methodology and does not support the use of a single proxy for establishing the VRS rate. Because the NECA historical rate calculations omit several substantial costs associated with providing VRS, the record supports the Commission adjusting the proposed historical rates to

³⁸ *Id.*

³⁹ See Purple Comments on Public Notice and Notice of Proposed Rulemaking at 17 (June 18, 2009); SNAP Comments at 22-23; 2009 Comments of Consumer Groups at 14 (June 26, 2009).

compensate for these omissions. The record further supports expanding Tiers 1 and 2 to cover approximately one percent (100,000) and 18 percent (1,500,000), respectively of the projected monthly VRS market. Moreover, adding a differential to the Tier 1 rate which would make that rate equal to the Tier 2 rate plus five percent is necessary to properly compensate small and start-up providers and thus to promote competition and consumer choice. Finally, the record supports the FCC issuing a Notice of Inquiry to examine progress in meeting the ADA's goals, and in light of the findings of that proceeding, establishing TRS rates and rate methodologies to ensure that the ADA's goals are fully realized.

Respectfully submitted,

PURPLE COMMUNICATIONS, INC.

By: _____/s/_____
Daniel R. Luis, Chief Executive Officer
Kelby Brick, Vice President, Regulatory
and Strategic Policy

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