

STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY)	
)	
)	Docket No. 02-0864
Filing to increase Unbundled Loop and)	
Nonrecurring Rates. (Tariffs filed)	
December 24, 2002))	

REPLY BRIEF ON EXCEPTIONS OF THE CITIZENS UTILITY BOARD

May 24, 2004

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rates in other states and related industries are irrelevant to a determination of Illinois TELRIC costs.” PO at 17. The Commission must ignore SBC’s state-by-state comparison of UNE rates and instead focus on the facts particular to Illinois.

Contrary to SBC’s insinuation, the Commission cannot invert the TELRIC analysis so that it is driven by the end result; i.e. to first determine that rates are too low, decide on a rate increase, and then justify the increase by backing out the various rate element determinations. Appropriately, the Administrative Law Judges (“ALJs”) gave careful consideration to the hundreds of inputs, assumptions and other aspects of SBC’s loop cost study in their determination of the UNE loop rate, always keeping TELRIC principles in mind. The ALJs’ deliberation resulted in an average recurring rate approximately a couple of dollars above the current monthly loop cost, as SBC points out. SBC BOE at 1. This end was only achieved, however, through evaluation of the arguments and evidence presented on the individual issues of the different cost inputs. The PO properly addresses the various issues in this proceeding separately and independently.

Importantly, SBC’s comment that the amount of the increase “does not even keep up with the cost of inflation” (*Id.*) demonstrates SBC’s misunderstanding of the fundamental underpinnings of TELRIC rate determinations. Inflation is not the proper benchmark for assessing the reasonableness of the loop cost that results from the implementation of the PO’s directives. Instead, the appropriate benchmark is inflation net of productivity. With productivity gains more than offsetting the effects of inflation, one would expect loop costs to *decline*, as the PO has properly concluded.

III. UNE LOOP RECURRING COST STUDIES

B. MAJOR INPUTS TO COST STUDIES

1. FILL FACTORS

CUB agrees with the PO's conclusion that "SBC's actual fills are not forward looking because they fail to account for existing network inefficiencies." PO at 62. However, CUB takes issue with how the PO remedies this failure. The PO accepts Staff's late-breaking proposal, which takes SBC's actual distribution fills and adjusts them upward by 15% (with a 7.5% capacity adjustment to SBC's feeder plant and digital loop carrier capacity). PO at 58. CUB believes Staff's proposal lacks analytical support, though it does represent an improvement over SBC's actual demand fill factors. CUB shares the concerns that CLECs raise that the PO fails to address adequately the important testimony on fill factors of Staff witnesses Hoagg, Green, and Staranczak, concerning the fill factor proposal recommended in Staff's direct testimony, which advocated the use of the target fills. CLEC BOE at 27-28.

The CLECs' remedy differs from that which CUB supports, but the CLECs nonetheless identify similar deficiencies in the use of actual fill as the basis for TELRIC studies as those identified by CUB. Primarily, CLECs and CUB argue that the use of actual fill factors fails to comply with the FCC's requirement that the fill correspond with actual total usage. *Local Competition Order*² at ¶ 682. Actual fill simply recovers costs based on today's demand, not the demand that can be supplied with the theoretical capacity that SBC's loop model "deploys." The

² *Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection between Local Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket Nos. 96-98, 95-185, *First Report and Order*, 11 FCC Rcd 15499 (1996) ("*Local Competition Order*"), *Order on Reconsideration*, 11 FCC Rcd 13042 (1996), *Second Order on Reconsideration*, 11 FCC Rcd 19738 (1996), *Third Order on Reconsideration and Further Notice of Proposed Rulemaking*, 12 FCC Rcd 12460 (1997), further recons. Pending, aff'd in part and vacated in part sub nom. *Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997) and *Iowa Utils. Bd. v. FCC*, 120 F.3d 753 (8th Cir. 1997), aff'd in part and remanded, *AT&T v. Iowa Utils. Bd.*, 525 U.S. 366 (1999), on remand, *Iowa Utils. Bd. v. FCC*, 219 F.3d 744 (8th Cir. 2000), reversed in part subnom. *Verizon Communications Inc. v. FCC*, 535 U.S. 467 (2002).

CLECs aptly stated it thusly: “To calculate fill factors by including sufficient capacity in the forward-looking network to serve long-term demand (and dividing that capacity amount into current actual demand) would be economically unsound, and would not be consistent with the TELRIC requirement that an efficient, forward-looking network be assumed.” CLEC BOE at 32.

Although CUB’s specific recommendation differs from that of the CLECs, the objective is similar, namely to ensure that the fill factor fairly distributes costs over today’s and tomorrow’s ratepayers. Forcing current customers to pay for capacity to be used to serve growth in usage by future customers violates TELRIC principles. The Commission has numerous alternatives to SBC’s proposal, supported by comprehensive evidence, all of which are superior to that advocated by SBC and only slightly improved upon by Staff. The flaws in SBC’s and Staff’s methodologies are apparent and discussed in CUB’s initial and reply briefs and CUB’s brief on exceptions. The Commission must remedy these faults in order to comport with TELRIC principles and requirements. This would be accomplished by adopting the Attorney General’s proposal to use the FCC’s Universal Service Synthesis Model or Staff’s original proposal to use target fills.

2. DEPRECIATION

Despite SBC’s attempts to distort the evidence in this proceeding to its advantage, it remains clear that the PO’s determination with regard to depreciation is proper. The PO concludes that “SBC has failed to demonstrate that either competitive pressures or technological changes have caused the depreciation rate set forth by the FCC to be outdated.” PO at 73. SBC’s assertions that the voice market is “extremely competitive” simply were not demonstrated with evidence in this proceeding. For example, SBC claims that “competition from wireless will soon replace wireline communication completely in 20% of households.” SBC BOE at 25. SBC

similarly argues that the legacy, copper network will be obsolete within five years. PO at 72. Several parties have challenged these claims as significantly exaggerated, but most importantly, the PO considers SBC's demand forecasts for wireless and broadband to be "extreme." PO at 73. CUB agrees and supports the PO's conclusion.

Additionally, SBC seems to insinuate that the FCC's Triennial Review Order directs the use of financial reporting lives, when the truth is quite the contrary. The FCC, after careful consideration of the arguments by ILECs, similar to those made by SBC here, determined that it would not mandate the use of financial depreciation. TRO at ¶ 688. The TRO in fact states that ILECs had "not provided any empirical basis on which [the FCC] could conclude that financial lives always will be more consistent with TELRIC than regulatory lives." *Id.* Further, the FCC declined to mandate a particular depreciation calculation method, and stated only that rates "should be developed using a consistent set of assumptions about competition." *Id.* A careful reading of the *TRO* shows that the FCC continues to have reservations about the use of GAAP lives.

Further, the PO concludes that SBC has not provided sufficient evidence demonstrating that its proposed financial reporting lives are more appropriate than the FCC's prescribed lives. Having considered all the evidence, and appropriately weighing the arguments in the briefs, the ALJs determined that SBC has not met its burden of proof with regard to its depreciation proposal. SBC's arguments in its Brief on Exceptions attempting to boost its position are unpersuasive.

On another note, SBC also does some intriguing maneuvering in an absurd attempt to support its position on depreciation. SBC has the audacity to cite to the **invalid** legislation that was subsequently declared unlawful by the U.S. District Court for the Northern District in

Illinois, to support its proposal for use of financial reporting lives. *Voices for Choices v. Ill. Bell Tel. Co.*, 2003 U.S. Dist. LEXIS 9548 (N.D. Ill. June 9, 2003). The Seventh Circuit Court of Appeals later affirmed the District Court’s ruling that the legislation was unlawful, and instructed the Commission to reinstate the present proceeding and produce a rate that complies with TELRIC. *AT&T Communications of Illinois, Inc., et al., v. Ill. Bell Tel. Co.*, 349 F.3d 402 (7th Cir. 2003). If only one fact is known and understood by every Commissioner as well as every party to this proceeding, it is that the legislation SBC cites to here (220 ILCS 5/13-408) has been declared unlawful. CUB, therefore, finds it astonishing and inappropriate that SBC would cite to this invalid legislation to support the very same position that was rejected by the U.S. District Court and the Seventh Circuit. CUB notes that SBC further cites to the Seventh Circuit opinion that invalidated the legislation to support its proposition regarding fill factors. SBC BOE at 30. This puts the Commission in the awkward position of wondering what other inappropriate or improper support SBC has included in its briefs.

3. COST OF CAPITAL

The Commission should ignore SBC’s criticisms of the PO-adopted approach to cost of capital. In this proceeding, SBC has repeatedly cited to the *Virginia Arbitration Order*³ to support its higher proposed cost of capital. e.g., SBC Init. Br. 47; SBC BOE at 2, 7, 11-12; 15, 17-19. As CUB has demonstrated, the FCC result to which SBC cites is based on stale, and, therefore, irrelevant data. CUB’s witness explained: “[SBC] refers to the 12.95 percent that the FCC adopted in the *Virginia Arbitration Order*. [SBC] fails, however, to point out that the evidence supporting that outcome is extremely dated and therefore the result is entirely irrelevant

³ Memorandum Opinion and Order, Petition of WorldCom, Inc. Pursuant to Section 252(e)(5) of the Communications Act for Preemption of the Jurisdiction of the Virginia State Corporation Commission Regarding Interconnection Disputes with Verizon Virginia Inc., and for Expedited Arbitration, CC Docket No. 00-218, DA 03-2738 (rel. Aug. 29, 2003) (“*Virginia Arbitration Order*”).

to this proceeding. The cost of debt changes over time, as do investors' expectations and perceptions of risk." CUB Ex. 2.0 at 32. Further, the Commission should afford no weight to the 11.25 percent rate of return that the FCC set in 1990, fourteen years ago, because this rate was established when markets and the economy differed significantly from today's capital market and borrowing rates. The rate of return that the FCC established for ILECs' interstate operations in 1990 is irrelevant to a determination of a reasonable rate of return for SBC in 2004, because it was established when markets and the economy differed significantly from today's market and borrowing rates." *Id.* Moreover, in its 2001 *Mag Order*⁴ concerning the appropriate regulation for non-price cap companies (small independent telephone companies), the FCC determined that it lacked the record to make a finding on the rate of return.

SBC also raises the concern that the capital structure that the PO sets "cannot reflect the risk of a competitive market and thus cannot comply with TELRIC." SBC BOE at 13. As the PO concludes, however, SBC has failed to demonstrate that the *overall cost of capital* that the PO establishes would prevent SBC from generating capital in the competitive environment contemplated by TELRIC. PO at 82. The PO adopts the high cost of equity that Staff proposes, a factor that should be considered in tandem with the PO's finding on capital structure. *Id.* at 79. Furthermore, as the CLECs explain, (CLEC BOE at 105-106), the Commission should be wary of modifying one portion of the cost of capital finding in isolation. Rather, should the

⁴ *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, *Order*, FCC Rcd 7507 (1990); and *In the Matter of Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers; Federal-State Joint Board on Universal Service; Access Charge Reform for Incumbent Local Exchange Carriers Subject to Rate-of- Return Regulation; Prescribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket Nos. 00-256, 96-45, 98-77, 98-166, *Second Report and Order and Further Notice of Proposed Rulemaking in CC Docket No. 00-256, Fifteenth Report and Order in CC Docket No. 96-45, and Report and Order in CC Docket Nos. 98-77 and 98-166*, (released November 8, 2001) ("MAG Order"), at ¶¶ 209-210, footnotes omitted.)

Commission make any modifications to the PO (which CUB does not advocate), it should consider the cost of capital components comprehensively.

In summary, contrary to SBC's assertions, the Commission should approve the PO's cost of capital analysis and decisions because they are consistent with the FCC's guidance set forth in the *Local Competition Order* and further clarified in the TRO, and also because they will, as the PO states, allow "SBCI to generate sufficient capital to provide efficient service in a competitive environment." PO at 79.

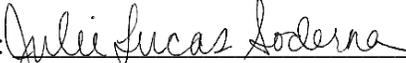
CONCLUSION

WHEREFORE, CUB requests the Commission to adopt the recommendations in this Reply Brief on Exceptions.

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Respectfully Submitted,

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