

I.C.C. Docket No. 04-0461
Staff Ex. 1.0 (PUBLIC)

PUBLIC DIRECT TESTIMONY

OF

ROBERT F. KOCH

RATES DEPARTMENT

TELECOMMUNICATIONS DIVISION

ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY

PETITION REGARDING COMPLIANCE WITH THE REQUIREMENTS OF

SECTION 13-505.1 OF THE PUBLIC UTILITIES ACT

DOCKET NO. 04-0461

September 29, 2004

Table of Contents

<i>Table of Contents</i>	<i>0</i>
<i>I. Introduction</i>	<i>1</i>
A. Witness Identification and Qualifications	<i>1</i>
B. The Imputation Requirement.....	<i>4</i>
<i>II. Network Access Line Imputation Tests</i>	<i>11</i>
<i>III. SBCI's Proposed Imputation Tests</i>	<i>20</i>
A. SBCI Scenario 1.....	<i>22</i>
B. Scenario 2	<i>25</i>
C. Scenario 3	<i>26</i>
<i>V. Possible Alternative Solutions To Bring SBCI's Test Into Compliance</i>	<i>28</i>
<i>VI. Summary</i>	<i>30</i>

1 **I. Introduction**

2

3 **A. *Witness Identification and Qualifications***

4

5 **Q. Please state your name and business address.**

6 A. My name is Robert F. Koch and my business address is 527 East Capitol
7 Avenue, Springfield, Illinois 62701.

8

9 **Q. By whom are you employed and in what capacity?**

10 A. I am employed by the Illinois Commerce Commission (“Commission”) as a
11 Rate Analyst in the Telecommunications Division of the Public Utilities
12 Division.

13

14 **Q. Please describe your educational and occupational background.**

15 A. I received a Bachelor of Science degree in Mathematics and Economics
16 from Illinois State University in 1992. In May of 1997 I received a Master
17 of Science degree in Economics from Illinois State University. During the
18 Summer of 1996, I worked as an intern in the Telecommunications Rates
19 Section of the Public Utilities Division with the Commission. Upon
20 graduation, I accepted a position with the Commission as an Economic
21 Analyst in the Rates Section of the Telecommunications Division.

22

23 **Q. Please briefly describe your duties with the Illinois Commerce**
24 **Commission.**

25 A. My responsibilities include providing expert testimony in docketed
26 proceedings that have cost of service and rate implications for
27 telecommunications services. In the course of my duties, I also review the
28 wholesale and retail tariff filings of telecommunications carriers. Further, I
29 am also responsible for reviewing the managerial, technical, and financial
30 capabilities of companies seeking approval to do business in Illinois as
31 competitive local exchange carriers ("CLECs").

32

33 **Q. Please describe your experience at the ICC as it relates specifically**
34 **to the administration of imputation tests.**

35 A. As mentioned previously, I routinely review tariff filings that have cost of
36 service implications. This review includes (1) the determination of whether
37 an imputation test applies in a particular filing, (2) an analysis of the proper
38 form of the test, and (3) an analysis of whether the service at issue in the
39 filing passes the test. I have also provided testimony in several
40 proceedings regarding imputation, including Docket No. 99-0536, which
41 examined revisions to Code Part 792; Docket No. 98-0200, which
42 examined imputation of extended area service for GTE; as well as in
43 Docket No. 02-0864 for the services in question in this proceeding.

44

45 **Q. What is the purpose of your Direct Testimony in this proceeding?**

46 A. My Direct Testimony addresses the appropriate structure of an imputation
47 test as required by the Illinois Public Utilities Act and Illinois Administrative
48 Code Part 792 as they pertain to UNE loop tariffs that SBC Illinois (“SBCI”)
49 filed pursuant to the Commission’s June 9, 2004 Order in Docket 02-
50 0864.¹ In summary, I address:

- 51 • The appropriate form of the imputation tests required by Illinois Law
52 and Administrative Rule as a result of SBCI’s UNE loop tariff filing;
- 53 • The deficiencies in the imputation tests provided by SBCI;
- 54 • The results of the amended imputation tests that show SBCI’s current
55 UNE loop rates cause retail business access line rates to fail the
56 imputation test in certain instances.
- 57 • In the event the Commission accepts Staff’s recommendation and
58 decides to give SBCI guidance regarding a future imputation filing, I
59 provide five possible alternatives for SBCI’s consideration, the
60 implementation of which would bring all retail services into compliance
61 with Illinois’ imputation requirements.
- 62 • In the event the Commission accepts Staff’s recommendation, I also
63 provide a fifth alternative for the Commission’s consideration that
64 would require SBCI to file tariffs that would bring SBCI’s retail business
65 NAL rates into compliance with Section 13-505.1 and Code Part 792.

66

¹ Order, Illinois Bell Telephone Company: Filing to increase Unbundled Loop and Nonrecurring Rates, ICC Docket No. 02-0864, 2002 Ill. PUC Lexis© 564 (June 9, 2004)

67 **B. The Imputation Requirement**
68

69 **Q. What is the statutory source of Illinois' Imputation requirement?**

70 A. Imputation is required by Section 13-505.1 of the Public Utilities Act
71 ("PUA"), which states as follows:

72 *Sec. 13-505.1. Imputation.*
73

74 (a) *This Section applies only to a telecommunications*
75 *carrier that provides both competitive and noncompetitive services.*
76 *If a carrier provides noncompetitive services or noncompetitive*
77 *service elements to other telecommunications carriers for the*
78 *provision by the other carriers of competitive services, switched*
79 *interexchange services, or interexchange private line services or to*
80 *other persons with which the telecommunications carrier also*
81 *competes for the provision by those other persons of information or*
82 *enhanced telecommunications services, as defined by the Federal*
83 *Communications Commission, then the telecommunications carrier*
84 *shall satisfy an imputation test for each of its own competitive*
85 *services, switched interexchange services, or interexchange private*
86 *line services, that utilize the same or functionally equivalent*
87 *noncompetitive services or noncompetitive service elements. The*
88 *purpose of the imputation test is to determine whether the*
89 *aggregate revenue for each service exceeds the costs, as defined*
90 *in this Section, to be imputed for each service based on the*
91 *telecommunications carrier's own routing arrangements. The*
92 *portion of a service consisting of residence untimed calls shall be*
93 *excluded from the imputation test. The imputed costs of a service*
94 *for purposes of this test shall be defined as the sum of:*

95
96 (1) *specifically tariffed premium rates for the*
97 *noncompetitive services or noncompetitive service elements, or*
98 *their functional equivalent, that are utilized to provide the service;*
99

100 (2) *the long-run service incremental costs of facilities and*
101 *functionalities that are utilized but not specifically tariffed; and*
102

103 (3) *any other identifiable, long-run service incremental*
104 *costs associated with the provision of the service.*
105

106 (b) *Notwithstanding the provisions of subsection (a), if a*
107 *telecommunications carrier permits other telecommunications*
108 *carriers to purchase interexchange private line services, except*

109 *those provided under contract or other form of agreement pursuant*
110 *to the provisions of Section 13-509, under the same tariffed rates,*
111 *terms, and conditions as any other customer, then such*
112 *interexchange private line services provided by the*
113 *telecommunications carrier shall not be subject to the imputation*
114 *test required in this Section.*

115
116 *220 ILCS 5/13-505.1*
117

118
119 **Q. Has the Commission developed rules to implement this statutory**
120 **requirement?**

121 A. Yes. The Illinois Commerce Commission adopted Code Part 792 to
122 implement Section 13-505.1 of the Public Utilities Act and amended
123 thereafter, with the modified rule effective December 15, 2002. This code
124 part specifies certain requirements for filing imputation tests and is
125 attached as Schedule 1.01 to this testimony. Carriers must satisfy an
126 imputation test for all competitive services that rely on noncompetitive
127 services (or noncompetitive service elements) for the provision of the
128 competitive service.

129
130 **Q. What prompted the opening of this proceeding?**

131 A. In Docket No. 02-0864, (hereafter referred to as “the *SBCI UNE Loop*
132 *Proceeding*”), the Commission adopted revised inputs used to develop
133 SBCI’s TELRIC UNE loop rates and directed SBCI to file new tariffs
134 reflecting these changes.² SBCI filed revised tariffs raising the rates for its

² Order in the SBCI UNE Loop Proceeding at 299.

135 UNE loop services on June 18, 2004, to be effective on June 25, 2004.³
136 Without making a determination that imputation tests were necessary as a
137 result of the UNE rate increases, the Commission required SBCI to file a
138 petition and for a separate investigation to be opened in order to verify
139 whether or not retail business access line rates are now compliant with the
140 imputation requirements of Section 13-505.1 and Code Part 792.⁴

141

142 **Q. When are imputation tests required?**

143 A. Code Part 792.30(c) lists three instances in which imputation tests are
144 required. Of particular interest in this proceeding is Code Part
145 792.30(c)(3), which states that an imputation test be filed:

146

147 3) *When any tariff is filed that increases rates for a*
148 *noncompetitive service or a noncompetitive service element,*
149 *or its functional equivalent, which is utilized in providing a*
150 *service subject to imputation.*
151

152 **Q. Have the conditions under Code Part 792.30(c)(3) for requiring the**
153 **filing of imputation tests for SBCI's retail business network access**
154 **lines in this proceeding been met?**

155 A. Yes. In determining whether imputation tests for retail business network
156 access lines must be filed under Code Part 792.30(c)(3), two conditions
157 must be met. First, it is necessary to determine whether SBCI's retail
158 network access lines are services subject to imputation. Section 13-

³ See Illinois Bell Telephone Company tariff ILL. C.C. No. 20, Part 19, Section 2, Sixth Revised Sheet No. 31.

159 505.1(a) of the PUA indicates that the statute applies to the competitive
160 offerings of telecommunications carriers offering both competitive and
161 noncompetitive services. SBCI offers both competitive and
162 noncompetitive services, and the Company classifies retail business
163 network access lines as competitive services. Additionally, SBCI witness
164 Eric Panfil concurs that its retail business network access lines are
165 services subject to imputation in his direct testimony.⁵ Therefore, the first
166 condition has been met.

167

168 Second, it is necessary to determine whether a rate increase has occurred
169 for a noncompetitive service or noncompetitive service element that is
170 utilized in the provision of retail business network access lines. The UNE
171 loop rates that were increased as a result of the *SBCI UNE Loop*
172 *Proceeding* are classified as noncompetitive telecommunications services
173 in SBCI's tariff.⁶ Also, as SBCI acknowledges, UNE loops are utilized in
174 the provision of retail business network access lines.⁷ Therefore, the
175 second condition has been met.

176

⁴ Id.

⁵ See SBCI Exhibit 1.0 at 3.

⁶ Attached as Exhibit 1.02 to this testimony is a photocopy of SBCI's noncompetitive tariff III. C.C. No. 20, Part 19, Section 2, 10th Revised Sheet No. 1, which specifically states that UNE loops are telecommunications services.

⁷ See SBCI's response to Staff Data Request RFK 1.11.

177 Based on these two conditions being met, it is my opinion that Code Part
178 792.30(c)(3) requires that imputation tests be performed for retail business
179 network access lines.

180

181 **Q. Where does SBCI diverge from your view regarding the applicability**
182 **of Code Part 792.30(c)(3) to this proceeding?**

183 A. Mr. Panfil does not offer an opinion in his direct testimony as to whether
184 Code Part 792.30(c)(3) or Section 13-505.1 of the PUA require that
185 imputation tests be performed as a result of the recent UNE loop rate
186 increases. Rather, he indicates that this is primarily a legal issue that
187 SBCI will discuss in its Initial Brief.⁸

188

189 Mr. Panfil also diverges from my viewpoint in that he does not consider
190 UNEs services or service elements.⁹ Mr. Panfil merely indicates that SBCI
191 has always interpreted the term “service element” to refer to rate elements
192 within a “service” that are separately priced.¹⁰ However, nothing in
193 Section 13-505.1 or Code Part 792 would suggest that UNEs are not to be
194 considered as services or service elements. In fact, Code Part 792.20
195 specifically references the term “service” as including “telecommunications
196 service”, as defined in Section 13-203 of the PUA provided that “it meets
197 the description of subject services in Section 13—505.1 of the Act.” 83 Ill.

⁸ See SBCI Exhibit 1.0 at 4.

⁹ Id.

¹⁰ Id.

198 Adm. Code §792.20. As I discussed previously, SBCI's tariffs specifically
199 identify UNE loops as being telecommunication services.

200

201 SBCI should therefore do the following in its rebuttal testimony in this
202 proceeding:

- 203 • Specifically indicate why UNE loops should not be considered
204 "services" for purposes of developing imputation tests while, at the
205 same time, classifying them as noncompetitive telecommunications
206 services in its tariff, as shown in Schedule 1.02 to Staff Exhibit 1.0;
207 and
- 208 • Explicitly state whether Code Part 792.30(c)(3) requires that
209 imputation tests be performed for retail business network access
210 lines.

211

212

213

214 **Q. What is the purpose of an imputation test?**

215 A. The purpose of this test is to foster competition in the telecommunications
216 market in Illinois. Imputation accomplishes this by guarding against
217 anticompetitive pricing in the form of what is called a "price squeeze."
218 Two prominent commentators have stated that: "a price squeeze occurs
219 when a supplier of an essential facility reduces the margin between the
220 price for an essential facility and the price that it charges for a retail

221 product in the competitive downstream market”.¹¹ The margin can be
222 reduced by either lowering the price of the competitive service(s) or by
223 increasing the rate(s) that the supplier (SBCI in this case) charges its
224 competitors (the CLECs) for the essential element. The imputation test
225 establishes a minimal margin for each competitive service subject to
226 imputation.

227

228 **Q. How does the imputation test prohibit price squeezes?**

229 A. When a competitor cannot provide a competitive service without the use of
230 a noncompetitive service (or service element), the incumbent local
231 exchange carrier that provides the noncompetitive service has a potential
232 advantage over other carriers. Although the market for the *retail* service in
233 question is classified as competitive, the incumbent carrier controls the
234 market for *noncompetitive elements* necessary to provision the
235 competitive service. The imputed cost, in essence, is a proxy for the cost
236 that the competitive carriers incur in order to provide the same service at
237 retail. If the incumbent carrier prices the competitive services below its
238 imputed cost, it is assumed that competitive carriers will not be able to
239 operate in the market. If the incumbent carrier is permitted to engage in
240 this type of pricing, the market for the competitive service will become
241 decreasingly competitive over time. In order to prevent such practices and

¹¹ J. Hausman and T. Tardiff, (1995) “Efficient local exchange competition”, 40 The Antitrust Bulletin, 529-556 at p.536.

242 insure a level playing field for provision of the competitive service, Section
243 13-505.1 of the PUA places restrictions on the amount that the incumbent
244 local exchange carrier can charge for the competitive service in the form
245 of a price floor on the incumbent's retail provision of the service. That
246 price floor is equal to the imputed cost (to the competitor) of providing the
247 service.

248

249 **II. Network Access Line Imputation Tests**

250

251 **Q. Please describe the general form of the imputation tests.**

252 A. As I noted previously, the imputation test establishes a statutorily required
253 price floor that ensures that the cost incurred by a competitor to provide a
254 service is at or below the rate charged by the incumbent carrier for the
255 same retail service. The imputation test compares the retail revenue
256 realized by the incumbent carrier for a particular service, to the imputed
257 cost that reflects the costs that its competitors would face in offering the
258 identical service. To satisfy the test and thereby protect against a price
259 squeeze, the imputed cost must be less than or equal to the retail
260 revenue. As a formula, this test could be expressed in its simplest form
261 as:

$$\text{Imputed Cost} \leq \text{Retail Revenue}$$

262

263 **Q. How are the components of the imputation test developed in**
264 **practice?**

265 A. Once the exact service subject to imputation is defined, determining the
266 retail revenue for the test is fairly straightforward. It usually is as simple as
267 identifying the appropriate rate for the service from a tariff page. For
268 certain services, however, it may be necessary to make assumptions
269 regarding other factors that affect the rate level, such as minutes of use or
270 mileage distances. Mathematically, retail revenue for the test can usually
271 be expressed as follows:

272

$$\text{Retail Revenue} = \text{Tariff Rate for Service Subject to Imputation}$$

273

274 The imputed cost is defined in Section 13-505.1 and Code Part
275 792.40(a)(3) as the sum of the tariffed rates for the noncompetitive
276 services or services elements utilized to provide the service; plus the long
277 run service incremental costs (“LRSICs”) of facilities and functions that are
278 utilized but not specifically tariffed; plus any other identifiable LRSICs
279 associated with the provision of the service. In practice, the task of
280 developing imputed costs is a two-step process. First, it is necessary to
281 identify all of the LRSIC values for the various components needed to
282 provision the service that is subject to imputation. Second, the LRSIC for
283 all noncompetitive services or service elements that are included as
284 components above must be replaced by their tariffed rates.
285 Mathematically, this can be expressed as follows:

$$\text{Imputed Cost} = \text{LRSICs for all components of service} \quad \textit{Step 1: Identify all cost components.}$$

– LRSICs for components that are considered noncompetitive services
+ Tariffed rates for those components that are considered noncompetitive services

Step 2: Where applicable, replace all LRSIC costs with tariffed rates.

286

287

288

The formula for the imputation test then becomes:

$$\begin{aligned} & \text{LRSICs for all components of service} \\ & \quad - \text{LRSICs for components that are considered noncompetitive services} \\ & \quad + \text{Tariffed rates for those components that are considered noncompetitive services} \end{aligned} \leq \text{Tariff Rate for Service Subject to Imputation}$$

289

290

291 **Q. Please describe the form of the test for retail business network**
292 **access line rates.**

293 A. The foundation for these imputation tests is the relationship between the
294 UNE Loop rate and the retail network access line charge. When the other
295 relevant cost and revenue elements are included, the imputation test in its
296 most basic form is expressed as:

297

$$\text{Imputed Cost} = \text{UNE Loop Rate} + \text{UNE Port Rate} + \text{Cross Connect Rate} + \text{SCF} \leq \text{Retail Revenue} = \text{NAL}^{12} + \text{EUCL}$$

298

299

300 **Q. Please explain why SBCI's End User Common Line ("EUCL") charge**
301 **is included in the revenue side of the imputation tests?**

302 A. The EUCL has been established to recover a portion of the cost for
303 access lines, namely the interstate non-traffic sensitive costs of the NAL.
304 SBCI charges a EUCL to all retail access line customers for which an
305 imputation test is performed. The same interstate costs that are
306 recovered by the EUCL on the retail side are also included in the TELRIC
307 costs of the UNE loop and port developed by SBCI. As such, it is only
308 proper to include SBCI's EUCL rate on the revenue side of the equation.
309 The tests provided by SBCI in this proceeding include the EUCL on the
310 revenue side as well.

311

312 **Q. Which specific retail business network access lines are subject to**
313 **the imputation requirement?**

314 A. An imputation test must be performed on all competitive retail services
315 that are subject to imputation and are affected by the increase in UNE
316 loop rates. Section 13-502.5(b) of the PUA provides that all retail
317 telecommunications services provided to business end users by a
318 telecommunications carrier subject to alternative regulation (such as

¹² NAL stands for "Network Access Line."

319 SBCI) are competitive.¹³ Accordingly, in this instance, the services
320 impacted are retail business access lines, ISDN lines, COPTS coin lines,
321 COPTS basic lines, and STF lines and must therefore pass imputation.¹⁴
322 Furthermore, any and all competitive service packages that include, or
323 “bundle” one or more of the types of lines described above with other
324 telecommunications services must also pass imputation. Staff lacks
325 sufficient information to perform its own test for bundled services at this
326 time, however, and requests that SBCI provide such tests with its rebuttal
327 filing in this proceeding. Staff believes that if the test is passed under the
328 most basic of conditions (i.e. for a business customer that has no local or
329 toll usage, does not subscribe to any central office features, and
330 generates no switched access revenue for the company) then it follows
331 that SBCI’s more complex service offerings would likely meet the
332 imputation criteria as well.

333

334 **Q. Why must the imputation test for retail business access lines be**
335 **performed on a stand-alone basis?**

336 A. Staff strongly believes that the statute requires an imputation test for every
337 competitively tariffed service that can function on a stand-alone basis, and

¹³ 220 ILCS 5/13-502.5. I note that, on September 22, 2004, Judge Philip J. Kardis, sitting in the Circuit Court for the Third Illinois Judicial Circuit, entered an order declaring Section 13-502.5 to be unconstitutional. *Order at 7-9, Big Sky Excavating, Inc., and others similarly situated v. Illinois Bell*, Case No. 03 L 175 (Madison Cty. Cir.Ct., September 22, 2004). However, I am advised by counsel that it is not clear what, if any, effect this decision may have on this proceeding.

¹⁴ ISDN stands for Integrated Service Digital Network; COPTS stands for Customer Owned Pay Telephone Service; and STF stands for Service Transport Facilities.

338 for every unique rate offered for that service in the tariff. Specifically, Staff
339 looks to the following portion of Section 13-505.1 as providing guidance on
340 this issue:

341 *“...the telecommunications carrier shall satisfy an imputation*
342 *test for each of its own competitive services, switched*
343 *interexchange services, or interexchange private line services, that*
344 *utilize the same or functionally equivalent noncompetitive services*
345 *or noncompetitive service elements.”*

346 *220 ILCS 5/13-505.1(a). emphasis added*
347
348

349 Code Part 792 also provides some guidance in that it consistently uses
350 the phrase “for each service” when describing when an imputation test
351 must be filed. Further, SBCI’s tariffs include separate and distinct
352 definitions for services such as business NAL’s, local usage, and the
353 various central office features. To argue that these separately rated
354 functionalities can only be considered as part of one service, it would
355 follow that SBCI’s entire competitive tariff has incorrectly defined these
356 functionalities in error.

357

358 **Q. If this basic test is passed, will this protect against price squeezes?**

359 A. Yes. To include revenue for services other than the retail network access
360 line in the test for the retail network access line would necessarily weaken
361 the ability of the test to protect against price squeezes in the marketplace
362 for that specific service. As additional revenue for services other than the
363 network access line are added to the imputation test, the effectiveness of
364 the test becomes increasingly compromised precisely because these

365 revenues from additional services *do not make up or are not part* of the
366 network access line. Furthermore, the revenue for services such as local
367 usage and central office features normally have a significant level of
368 margin (i.e., the revenue realized from them greatly exceeds the cost of
369 production).

370

371 The danger of including additional levels of usage and features in the test
372 for the business NAL is that, as the level of usage assumed in the test
373 increases, the percentage of customers that achieve the level of usage in
374 the test decreases. Consequently, the percentage of customers receiving
375 any protection against price squeezes decreases at the same time.

376

377 **Q. Is there any level of usage and features that would be appropriate to**
378 **include in the imputation test?**

379 A. No. For each bundled service package that includes usage and features
380 as part of the basic rate for the service, I would agree that the revenue
381 and costs for such services should be included in the tests specific to that
382 bundled service package. However, the tests that I provide in this
383 proceeding are for services that do not include any usage or features as
384 part of the base rate. Therefore, there is no acceptable level of usage or
385 features to include in these tests.

386

387 **Q. Is it conceivable that a business customer may purchase solely the**
388 **network access line from SBCI or a CLEC?**

389 A. Yes. For the basic access line services, though, it is quite likely that some
390 customers purchase the service for the sole purpose of having dial tone
391 and have no intention of making outgoing telephone calls. An example of
392 this type of customer is a small business such as a restaurant that offers
393 take-out or delivery service. Use of a phone to make outgoing calls may
394 cause a potential customer to not be able to reach the business to make a
395 purchase, and therefore the manager of such an operation would have an
396 incentive to prohibit such use of the phone. Another business may have
397 the phone strictly as a means to have reliable access to emergency
398 services. To include any level of retail usage revenue in the test would
399 render the test ineffective to protect the marketplace for such customers.

400

401 Regardless, telephone customers have a wide range of demand for usage
402 and features. To assume any particular level of demand for usage and
403 features as being “appropriate” for the test necessarily weakens the test
404 so that it cannot insure against price squeezes in markets for customers
405 with lower call volumes than that assumed in the test. Conversely, the
406 only way to ensure that the market for all types of customers is protected
407 against a price squeeze is to require that the test be passed under the
408 most basic conditions.

409

410 **Q. Why are there no LRSIC costs included in the retail business NAL**
411 **imputation test formula?**

412 A. As the formula above illustrates, all of the LRSIC cost components
413 included on the imputed cost side have been replaced by rates for
414 noncompetitive services. It is Staff's interpretation of Section 13-505.1
415 that whenever a noncompetitive rate exists for an imputed cost item, it
416 must be included in the test. Naturally, the UNE loop rate corresponds
417 directly to the type of retail business network access line rate for which the
418 test is being performed. The UNE port rate, cross connect rate, and
419 service connection fee are all essential items in retail access line
420 provisioning, as well, and each has its own corresponding noncompetitive
421 tariff rate.

422

423 **Q. Please describe the differences between the tests that you provide in**
424 **this proceeding as compared to the tests you provided in the *SBCI***
425 ***UNE Loop Proceeding*.**

426 A. The tests that I propose here are in large part identical to those that I
427 proposed in the *SBCI UNE Loop Proceeding*. The following items reflect
428 the differences between the tests that I propose here and the tests that I
429 had proposed in the *SBCI UNE Loop Proceeding*:

430 • I update my tests to reflect the UNE loop rates in the revised tariffs that
431 SBCI filed on June 18, 2004.

- 432 • I update my COPTS tests to reflect revised retail rates for both coin
433 and basic COPTS lines that went into effect since the filing of my
434 imputation tests in the *SBCI UNE Loop Proceeding*.¹⁵
- 435 • I update my ISDN tests to reflect revenues and costs for services that
436 are essential for the provisioning of ISDN, but that were left out of the
437 tests that both SBCI and Staff sponsored in the *SBCI UNE Loop*
438 *Proceeding*. Specifically, revenue and costs for Central Office
439 Termination and Circuit Switched Capability for B Channels are now
440 included. Mr. Panfil indicates that SBCI has made these modifications
441 to its tests as well.¹⁶
- 442

443 **III. SBCI's Proposed Imputation Tests**

444

445 **Q. Please describe the imputation tests provided by SBC Illinois in this**
446 **proceeding.**

447 A. SBCI provided a set of twelve tests filed under three scenarios in this
448 proceeding. I define these scenarios as follows

- 449 • Scenario (1), which includes revenue for network access lines,
450 usage, and features;
- 451 • Scenario (2), which includes only revenue for the stand-alone
452 network access line service; and

¹⁵ See Illinois Bell Telephone Company Tariff 19, Part 4, Section 2, 6th Revised Sheet 2.3 (Effective June 1, 2004).

¹⁶ See SBC Illinois Exhibit 1.0 at 12.

- 453 • Scenario (3), which has identical revenue to the first scenario
454 but develops its imputed costs via the UNE-Platform.¹⁷

455 The results of the first two scenarios are included in Schedule ELP-D1 to
456 SBC Illinois Exhibit 1.0, while the results of the third scenario are included
457 in Schedule ELP-D2. The imputation tests were filed as work papers
458 supporting the testimony of Mr. Panfil. The twelve tests in each scenario
459 are basically a set of tests for four separate retail services in each of the
460 three access areas in SBCI's service territory: business NAL, ISDN direct,
461 COPTS coin line, and COPTS basic line.

462

463 **Q. Has SBCI provided all of the necessary imputation tests and**
464 **supporting information in its filing?**

465 A. No. First, SBCI did not provide any imputation tests for STF access lines.
466 SBCI provided tests for this service in the *SBCI UNE Loop Proceeding*,
467 but has not yet provided such tests in this proceeding. Second, SBCI did
468 not provide any imputation tests for bundled service offerings that include
469 retail business NALs as part of the package. Third, for the tests that SBCI
470 did provide in its filing, it did not provide all the information required for an
471 imputation test. Specifically, SBCI did not provide, as required in Code
472 Part 792.40(a)(2), "an illustration or diagram ... specifically identifying the
473 noncompetitive services and noncompetitive service elements, or their

¹⁷ Mr. Panfil discusses the difference between his first 2 scenarios on pages 13 and 14 of his direct testimony, SBCI Exhibit 1.0. Mr. Panfil goes on to describe his 3rd scenario as the alternative form of the broad test that is based on UNE-P rates on pages 18 and 19 of his direct testimony.

474 functional equivalent, and the competitive services and competitive
475 service elements that are utilized to provide the service.” Staff
476 recommends that the all of the above items be provided at the time that
477 SBCI files its rebuttal testimony in this proceeding.

478

479 **Q. Do SBCI’s imputation tests satisfy the requirements of Section 13-**
480 **505.1 and Code Part 792?**

481 A. No. A description of the deficiencies in each approach follows.

482 **A. *SBCI Scenario 1***

483

484 **Q. Please describe how SBCI Scenario 1 does not comport with the**
485 **requirements of Section 13-505.1 and Code Part 792.**

486 A. In addition to the revenue for the retail NAL and the EUCL provided in my
487 tests, this scenario also includes revenues for average local usage, toll,
488 and central office features on the retail side of the business NAL and ISDN
489 direct imputation tests. Scenario 1 does not provide a test for any one
490 specific service that is offered in the company’s retail tariffs. Rather, it
491 combines revenues from several separately tariffed services. As I
492 discussed previously, such tests do not comply with the requirements of
493 Section 13-505.1.

494

495 **Q. What is the impact of the various revenue assumptions made in**
496 **SBCI’s Scenario 1?**

497 A. The revenue assumptions included in SBCI's Scenario 1 would render the
 498 test completely ineffective. These imputation tests would no longer be
 499 useful to protect CLECs from price squeezes for business NALs – in other
 500 words, the tests would no longer serve the purpose for which imputation
 501 was established. Since the test includes revenues from several
 502 individually tariffed services, it does not constitute a useful or valid
 503 imputation test for any one of those services. This is clearly illustrated in
 504 the table below, which lists the margin by which the rates in each access
 505 area pass SBCI's test along side the corresponding retail rates for
 506 business network access lines.
 507

	<u>Access Area A</u>		<u>Access Area B</u>		<u>Access Area C</u>	
	\$		\$		\$	
Panfil Revenue Surplus	XX.XX		XX0.XX		XX.XX	
SBCI Bus. NAL Rates	\$	5.00	\$	8.21	\$	11.87

*Source: SBCI Exhibit 1.1, Schedule ELP-R1

508
 509 Because the margin exceeds the access line rates in each access area,
 510 each of these access line rates could be reduced to *zero* and still pass
 511 SBCI's imputation test.¹⁸
 512

¹⁸ Staff acknowledges that reducing retail rates to zero is a hypothetical situation that is prohibited by the Commission's cost of service rules. This hypothetical situation was chosen as an example because it best illustrates that there are no reductions to retail business NAL rates that would cause SBCI's imputation tests to fail.

513 **Q. Even if the margins by which SBCI's proposed test passed**
514 **imputation were relatively small, would the use of average revenue**
515 **and costs for usage and central office features be appropriate?**

516 A. No. As I stated previously, Section 13-505.1 requires that each service
517 must pass, and it can only do so on a stand-alone basis. Any level of
518 usage and feature revenue would necessarily weaken the ability of the
519 test to provide against a price squeeze.

520

521 **Q. What impact does the use of these averages have on the purpose of**
522 **the imputation requirement?**

523 A. As a result of using such averages, only the market for the highest volume
524 customers would be protected against a price squeeze. In response to
525 Staff Data Request RFK 1.05, SBCI indicates that XX% of its business
526 NAL customers have less than average usage revenue and that XX% of
527 its business NAL customers have less than average revenue for central
528 office features.¹⁹ It is important to note that, by including these additional
529 service revenues on the revenue side of the test, it follows that the
530 imputed cost side of the test will necessarily also inappropriately have
531 values for these services. Just as using average revenue for usage and
532 features is inappropriate, so is including average costs for these services.
533 They simply do not belong in the test.

534

535 **Q. Is SBCI's characterization of its revenue projections as**
536 **"conservative" relevant?**

537 A. SBCI claims that, because CLECs typically target high volume customers,
538 the figures used in the SBCI tests are probably underestimated.²⁰ This is
539 so far unsubstantiated. Section 13-505.1 and Code Part 792 do not
540 address whether a typical CLEC currently operating in the market is doing
541 so at a profit. Rather, the statute and the Code Part require that the test
542 be passed for the specific retail services in *all* cases, and not just under
543 the most favorable of conditions for the ILEC.

544

545 **B. Scenario 2**

546

547 **Q. Please describe how Scenario 2 does not comport with the**
548 **requirements of Section 13-505.1 and Code Part 792.**

549 A. The "narrow" revenue per NAL as developed in this scenario is
550 acceptable. However, the imputed cost per NAL is developed using the
551 long run service incremental cost ("LRSIC") of the port, rather than tariffed
552 noncompetitive UNE rate.

553

¹⁹ SBCI indicates that it has not performed specific analysis on each service subject to imputation, and that the figures provided in response to Staff Data Request RFK 1.05 are based on business customer accounts with ten or fewer lines.

²⁰ SBCI Ex. 1.0 at 9.

554 **Q. Please explain why the UNE port rate should be used rather than the**
555 **port LRSIC as a part of the imputed cost of retail business access**
556 **line rates?**

557 A. The port is a noncompetitive element of the retail business access line.
558 Because there is a tariff rate for the UNE port, it is Staff's reading of
559 Section 13-505.1 and Code Part 792.40(c) that the tariff rate must be
560 imputed in the test. Further, CLECs are not charged the LRSIC when they
561 order the port functionality; rather, they are charged the UNE port rate.
562 Imputation is intended to prevent a price squeeze, and this is only
563 accomplished by choosing the costs that are most reflective of those faced
564 by the CLECs. Because the LRSIC of the port is lower than the UNE port
565 rate, the imputed cost presented in this scenario by SBCI is
566 underestimated.

567 **C. Scenario 3**

568

569 **Q. Please describe how Scenario 3 does not comport with the**
570 **requirements of Section 13-505.1 and Code Part 792.**

571 A. This scenario is essentially the same as the first scenario, except that the
572 UNE port is included in the imputed cost side of the test as opposed to the
573 UNE LRSIC. The revenue side of the tests in this scenario is identical to
574 the revenue side in the Scenario 1 tests and, thus, leads to an ineffective
575 test as in Scenario 1-- due to the inappropriate inclusion of revenue for
576 usage and features. The imputed cost side of the test is improved

577 because it includes the UNE port rate. However, just as the revenue side
 578 of test inappropriately includes the usage and features revenue, the
 579 imputed cost side of the test in this scenario includes the same
 580 inappropriate assumptions regarding the average level of usage and
 581 features. Therefore, the tests provided under this scenario are also
 582 deficient.

583

584 III. STAFF'S IMPUTATION TEST RESULTS

585 **Q. What are the results of your proposed business NAL imputation**
 586 **tests?**

587 A. Schedule 1.03 to this testimony contains the statutorily required imputation
 588 tests for this proceeding. The table below summarizes the results.
 589 Business NALs in Access Area B and C, as well as all of the COPTS Coin
 590 and COPTS Basic fail the imputation test as required by Illinois law (as
 591 indicated by the negative values in parenthesis in the Margin column).

<u>Service</u>	<u>Access Area</u>	<u>Revenue</u>	<u>Imputed Cost</u>	<u>Margin</u>
Business NAL	A	\$ x.xx	\$ x.xx	\$ x.xx
	B	\$ xx.xx	\$ xx.xx	\$ (x.xx)
	C	\$ xx.xx	\$ xx.xx	\$ (x.xx)
ISDN	A	\$ xx.xx	\$ xx.xx	\$ xx.xx
	B	\$ xx.xx	\$ xx.xx	\$ x.xx
	C	\$ xx.xx	\$ xx.xx	\$ x.xx
COPTS- Coin	A	\$ x.xx	\$ x.xx	\$ (x.xx)
	B	\$ xx.xx	\$ xx.xx	\$ (x.xx)
	C	\$ xx.xx	\$ xx.xx	\$ (x.xx)
COPTS- Basic	A	\$ x.xx	\$ x.xx	\$ (x.xx)
	B	\$ x.xx	\$ xx.xx	\$ (x.xx)
	C	\$ xx.xx	\$ xx.xx	\$ (x.xx)

STF	A	\$ x.xx	\$ x.xx	\$ x.xx
	B	\$ xx.xx	\$ xx.xx	\$ x.xx
	C	\$ xx.xx	\$ xx.xx	\$ x.xx

592

593

594 **V. Possible Alternative Solutions To Bring SBCI's Test Into**
595 **Compliance**

596

597 **Q. What alternatives exist to bring SBCI's retail business NAL rates into**
598 **compliance with imputation standards?**

599 A. Following are five possible alternatives:

- 600 • Alternative 1: Restructure retail business NAL rates by creating a kind of
601 base rate "package" for business POTS and ISDN NALs. The base rate
602 for the NAL would increase to the point where these services pass
603 imputation and to offset the increase, local usage and/or some central
604 office features would be provided to customers as part of the base rates.
605 This new "base rate package" should be developed in such a way that
606 retail customers receive the combined services for a price equal to or
607 lower than the rates that would be possible currently. In addition, SBCI
608 would have to stop providing business NALs on a stand-alone basis.
- 609 • Alternative 2: Reduce UNE loop rates in Access Area B and C.
- 610 • Alternative 3: Increase business NAL rates as in Remedy 1 but, in order
611 to ensure that business customers "remain whole," also reduce rates for
612 other services so that the combined impact is revenue neutral. SBCI

613 offers a similar proposal in this proceeding as a remedy to imputation.

614 See SBC Illinois Exhibit 1.0 at 22-29.

615 • Alternative 4: Increase business NAL rates in Access Area B and C. (See
616 Schedule 1.03 of this testimony for the calculation).

617 • Alternative 5: Without providing specific direction on how to do so, require
618 SBCI to file tariffs that would bring SBCI's retail business NAL rates into
619 compliance with Section 13-505.1 and Code Part 792. .

620

621 **Q. Are there any other issues which should be considered with respect**
622 **to the above alternatives?**

623 A. Section 13-502.5(b) of the Public Utilities Act caps retail business services
624 for customers with 1-4 lines until July 1, 2005 for all carriers under an
625 alternative regulation plan.²¹ It is difficult to conceive how retail network
626 access lines for these customers could be increased in light of this
627 statutory cap, especially since these small business customers are the
628 ones most likely to use the most basic service offering. The potential
629 conflict between Sections 13-505.1 and 13-502.5(b) is clearly a legal issue
630 that should be addressed in briefs. It is noted here for the sake of
631 completeness.

632

633 **Q. How should SBCI remedy the failure of COPTS coin and COPTS**
634 **basic lines to pass imputation?**

²¹ 220 ILCS 5/ 13-502.5(b)

635 A. I do not have a recommendation at this time. Retail COPTS rates are set
636 by a formula adopted by the Commission in its SBC/Verizon Payphone
637 Proceeding²² in order to pass the federal New Services Test (required by
638 Section 276 of the federal Telecommunications Act of 1996), and are
639 based primarily on the LRSIC for the services. When the UNE loop for
640 COPTS services were increased in the *SBCI UNE Loop Order*, the LRSIC
641 for retail COPTS services were not simultaneously updated. The result is
642 that COPTS services fail imputation by a considerable margin.
643 Additionally, there does not seem to be a manner of resolving the
644 imputation concerns without either violating the Payphone Order or the
645 *SBCI UNE Loop Order*. Any recommendation that I may have will be
646 presented in response to CLEC witnesses in Staff's Initial Brief in this
647 proceeding.

648

649 **VI. Summary**

650

651 **Q. Please summarize your testimony in this proceeding.**

652 A. First, it is necessary to determine whether imputation tests are required as
653 a result of the recent increase in UNE loop rates. Section 13-505.1 and
654 Illinois Administrative Code Part 792.30(c)(3) requires such a test, as UNE
655 loops are classified as noncompetitive telecommunications services.
656 Second, it is necessary to determine the correct form of the imputation test

²² The formula, adopted in the November 12, 2003 Interim Order in the proceeding at page

657 to be applied. The statute requires a basic imputation test wherein only
658 the cost and revenue elements directly associated with the specifically
659 tariffed service in question are included. The imputation tests submitted
660 by SBC Illinois in this proceeding do not comport with these requirements.
661 The tests provided by Staff in this proceeding do comport with these
662 requirements.

663

664 **Q. What recommendations do you have at this time?**

665 A. I recommend that SBCI's rebuttal testimony should:

- 666 • Address the various deficiencies I have identified in this testimony;
- 667 • Revise its imputation tests to reflect the aspects of a proper imputation
668 test that I described in Part II;
- 669 • Develop tests for STF loops and provide all diagrams and descriptions
670 as required in Code Part 792 for each test; and
- 671 • Address the alternative solutions that I have outlined in Part V of this
672 testimony .

673

674 **Q. Does this conclude your testimony?**

675 A. Yes.

46, is as follows: Rate = LRSIC + (LRSIC x Overhead %) – EUCL – NoPICC.