

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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Illinois Bell Telephone Company	)	
	)	
	)	<b>04-0461</b>
Petition Regarding Compliance with	)	
the Requirements Docket No. of	)	
Section 13-505.1 of the Public	)	
Utilities Act	)	

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**REPLY TO BRIEFS ON EXCEPTIONS OF THE STAFF  
OF THE ILLINOIS COMMERCE COMMISSION'S**

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**REPLY TO BRIEFS ON EXCEPTIONS OF THE STAFF  
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Now comes the Staff of the Illinois Commerce Commission ("Staff"), by its undersigned attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice (83 Ill. Adm. Code 200.830) respectfully submits this Reply to Briefs on Exceptions to the Administrative Law Judge's Proposed Order issued on January 24, 2005 ("Proposed Order").

**I. WHETHER UNES ARE "SERVICES" OR "SERVICE ELEMENTS" FOR PURPOSES OF THE IMPUTATION REQUIREMENT**

**Reply to SBC**

SBC takes exception to the Proposed Order's finding that SBC's "UNEs should be imputed at all to SBC Illinois' retail rates." SBC BOE at 1. SBC primarily bases its exception on the supposition that the Illinois General Assembly did not intend to include unbundled network elements ("UNEs") within the meaning of "services" or "service elements" in Section 13-505.1 because

UNEs did not exist in 1992. *Id.* at 3-7. The implication is that because UNEs were essentially created by the Telecommunications Act of 1996 (“TA 96”) and Section 13-505.1 was enacted in 1992, it would have been impossible for the General Assembly to contemplate UNEs prior to TA 96 and, thus, could not have intended UNEs to be covered by the imputation requirements found in Section 13-505.1. SBC BOE at 5 (“There is no question that UNEs were not contemplated by the General Assembly when Section 13-505.1 was enacted and could not have been within the ‘purpose or object’ of that provision.”). The mere fact, however, that UNEs did not exist in the exact shape and form that UNEs currently are known is not a reason for concluding that the General Assembly *intended* UNEs to be outside of the coverage of Section 13-505.1.

As Staff noted in its BOE, SBC’s (and to a more limited extent the Proposed Order’s) theory “is belied by the fact that this Commission, as well as the FCC and other state PUCs, had addressed the problems of opening markets to competition by unbundling elements of an ILEC’s bottleneck facilities prior to 1996 and, in this Commission’s case, even 1992.” First, as Staff pointed out in its Reply Brief (at 35-36) and BOE (at 8-10), this Commission had entertained the notion of unbundling critical network elements or network services such as local loops since before Section 13-505.1 was enacted. See *In re: Investigation concerning access charges, the administration of the High Cost Fund, administration of the Illinois Small Carrier Association and other telecommunications issues*, ICC Docket No. 90-0425, 1992 Ill. PUC LEXIS 111, at \*31-33 (Order entered Feb 5, 1992) (“What are the additional interconnections

which are necessary and/or appropriate for the development of broad and effective local exchange services competition, *such as unbundling of local loops from other network services*, number portability, central office inter-connection, and attendant financial and administrative inter-relationship as a result of such interconnections.”) (Emphasis added). See Staff BOE at 9-10.

Further, as Staff also previously noted (Staff BOE at 8), the FCC in its *Local Competition First Report and Order*,<sup>1</sup> issued on August 8, 1996, pointed out that a “number of states already employ, or have plans to utilize, some form of LRIC or TSLRIC methodology in their approach to setting prices for unbundled network elements, with several states choosing LRIC or TSLRIC as a price floor.” *Local Competition First Report and Order*, ¶ 631. The FCC continued on in this vein to note that: “Unbundled element prices also exist in several states pursuant to negotiated interconnection agreements that have either already been approved by state commissions or are under consideration.” *Id.*, at n. 1516. Although the FCC’s *Local Competition First Report and Order* followed the enactment of the federal Telecommunications Act of 1996 (“TA 96”), signed into law on Feb. 8, 1996, by 7 months, the discussion in paragraph 631 makes it clear that states were already addressing the problems of opening markets to competition by unbundling essential bottleneck facilities and determining what cost methodology to use to price these network elements long before the enactment of TA 96. Staff BOE at 8.

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<sup>1</sup> *First Report and Order*, In the Matter of 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, 95-181 (Rel. August 8 1996) (“*Local Competition First Report and Order*”).

Moreover, the idea of unbundling critical bottleneck facilities or network elements is hardly novel to the telecommunications industry. In fact, the idea of unbundling bottleneck facilities to open up formerly closed markets for competition has a very long established precedent in antitrust law, which is the “essential facilities doctrine.” See e.g., *United States v. Terminal R.R. Ass’n*, 224 U.S. 383 (1912) (a group of railroads controlling all railway bridges and switching yards into and out of St. Louis prevented competing railroad services from offering transportation to and through that destination was found to be an illegal restraint of trade.). This is a variant of the “refusal to deal” line of antitrust case law. The essential facilities doctrine:

[I]mposes liability when one firm, which controls an essential facility, denies a second firm reasonable access to a product or service that the second firm must obtain in order to compete with the first.

*Alaska Airlines v. United Airlines*, 948 F.2d 536, 542 (9<sup>th</sup> Cir. 1991); see also *Byars v. Bluff City News Co.*, 609 F.2d 843, 846, 856 & n. 34 (6<sup>th</sup> Cir. 1980) (“a business or group of businesses which controls a scarce facility has an obligation to give competitors reasonable access to it.”), citing *Associated Press v. United States*, 326 U.S. 1 (1945); *Hecht v. Pro-Football*, 570 F.2d 982, 992 (D.C. Cir. 1977) (“where facilities cannot practicably be duplicated by would-be competitors, those in possession of them must allow them to be shared on fair terms. It is illegal restraint of trade to foreclose the scarce facility.”) (internal citations omitted).

Since *Terminal R.R. Ass’n* in 1912, courts have often employed the essential facilities doctrine in those circumstances where one company uses its

control of bottleneck facilities to eliminate potential competitors. See e.g., *MCI Communications v. American Tel. & Tel.*, 708 F.2d 1081, 1132-33 (7<sup>th</sup> Cir. 1983) (essential facilities doctrine applied to require AT&T to provide access to its local service network to long-distance competitors). Thus, SBC's theory that the General Assembly could not have possibly contemplated unbundling of SBC's essential bottleneck facilities when it enacted Section 13-505.1, despite the fact that the essential facilities doctrine had been around since 1912, is simply wrong.

Moreover, as Staff has also pointed out on numerous occasions, the Illinois Supreme Court has long rejected the theory that the scope of a statutory provision is shackled to only those circumstances present at the time when the statute became law. See Staff Reply Brief at 36, *citing McDaniel v. Bullard*, 34 Ill. 2d 487, 491 (Ill. 1966). Put differently, the fact that unbundled loops and ports were not labeled as "network elements" or "unbundled network elements" in 1992, or were not even then in existence, is immaterial to the issue of whether they qualify as "service elements" under Section 13-505.1 today. Staff Reply Brief at 36; Staff BOE at 10.

Further, Staff is unaware of any better indicia of whether the General Assembly intended UNEs to be imputed than the General Assembly's *own* clear demonstration of its intent that UNEs are to be covered by the imputation requirements of Section 13-505.1. As Staff noted in its BOE (at 25-26) and Staff's Response to the ALJ's Notice of January 11, 2005, at 2-3, the words the General Assembly chose to use in Section 13-408(d) words are *clear* and *completely unambiguous* -- the UNEs addressed by Section 13-408 are

exempted from the imputation requirements of Section 13-505.1.2 Section 13-408(d), moreover, contains no additional purpose or meaning other than to exempt the UNEs that are the subject of Section 13-408 from the imputation requirements contained in Section 13-505.1. No party disputes this interpretation. As Staff also pointed out, the UNEs that were the subject of Section 13-408 are also precisely the same UNEs that are the subject of this proceeding. *Id.*

The General Assembly's express UNE exemption found in Section 13-408(d) from imputation requirements clearly represents the best indication of the General Assembly's intent that the phrase "service elements" contained in Section 13-505.1 includes or covers the very same UNEs at issue in this proceeding. Thus, if any doubt should remain, the language of Section 13-408 is *conclusive* evidence that the General Assembly determined that UNEs are "services" or "service elements" under Section 13-505.1 and Staff recommends that the Commission interprets the language of Section 13-505.1 in this manner.

To reach a conclusion other than the conclusion that the General Assembly intended that the UNEs at issue in this proceeding be covered by the imputation requirements of Section 13-505.1 would necessitate ignoring *all* of the language of subsection (d) of 13-408. The Illinois Supreme court has long followed the canon of statutory construction that requires that "[e]ach word, if possible, must be given reasonable meaning and not rendered superfluous."

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<sup>2</sup> Section 13-408(d) provides, in full, that: "Notwithstanding anything to the contrary contained in Section 13-505.1, unbundled network element rates established in accordance with the provisions of this Section shall not require any increase in any rates for any telecommunication service." 220 ILCS 5/13-408(d) (emphasis added).

Staff's Response to the ALJ's Notice of January 11, 2005, at 3, *citing Illinois Secretary of State v. Mikusch*, 138 Ill. 2d 242, 247-48 (1980).

Moreover, to read Section 13-408 in a manner that renders all of the language of subsection (d) superfluous presumes that the General Assembly acted irrationally. Again, the Staff provided the ALJ with canons of statutory construction that requires a presumption that the General Assembly acts in a rational manner, which does not include drafting statutory provisions containing language that is meaningless. *Id.*

Finally, as demonstrated above the "essential facilities doctrine" has been applied by the United States Supreme Court in numerous industries since 1912 and has been applied in the landmark telecommunications case *MCI Communications v. American Tel. & Tel.*, 708 F.2d 1081, 1132-33 (7<sup>th</sup> Cir. 1983), wherein the Seventh Circuit applied the essential facilities doctrine to require AT&T to provide access to its local service network to long-distance competitors. Consequently, SBC's statement that, "[t]here is no question that UNEs were not contemplated by the General Assembly," is misleading at minimum as the courts, the General Assembly, the FCC, and this Commission had long grappled with the problem of opening up essential bottleneck facilities to competition in order to open up formerly closed markets and to protect competitive markets.

## **II. HOW TO DEFINE THE "SERVICE" THAT IS SUBJECT TO IMPUTATION IN THIS PROCEEDING**

SBC takes exception to the Proposed Order's conclusion to "to take a middle-ground position on how to define the 'service' which is subject to

imputation.” SBC RBOE at 9-11. SBC essentially argues that the Commission should adopt an even “broader” test than the broad test that the proposed Order adopts. SBC wants Band C usage, vertical features, and intraMSA toll call revenues to also be included amongst the various revenue streams already included in the imputation test. *Id.* SBC’s proposal to further reduce the marketplace protected by the imputation test by including *additional* revenue streams from vertical features (like call waiting and caller ID), Band C usage and intraMSA toll calling ignores the purpose of the imputation tests, which purpose would be utterly abandoned by this Commission if the additional revenue streams are to be added to the imputation test.

The Proposed Order appears to have correctly concluded that the purpose of the PUA’s imputation requirement is to foster competition in the telecommunication markets by guarding against anti-competitive pricing in the form of what is termed as a “price squeeze.” Proposed Order at 41, *citing* Staff Ex. 1.0 at 9. As Staff noted in its Initial Brief, the Commission has long rejected a “broad” definition of “service” for purposes of performing an imputation test that protects against anticompetitive behavior. *See MCI Telecommunications Corp. and LDDS Communications, Inc. v. Illinois Bell Telephone Company: Complaint under Articles IX and XIII of the Illinois Public Utilities Act*, Docket No. 93-0044, 1994 Ill. PUC LEXIS 417, (Order entered Oct. 5, 1994) (“*MCI Complaint Order*”). In the *MCI Complaint Order*, the Commission addressed the very same issue that is currently before it. In rejecting Ameritech’s broad definition of service, the Commission stated:

Allowing a broad definition of the term “service,” as Ameritech proposes, may not achieve the purpose of safeguarding against anticompetitive practices, particularly if the carriers determine how tariffed offerings should be aggregated for imputation purposes.

\* \* \*

By performing an aggregated imputation test, a local telephone company may be able to anticompetitively price its more competitive offerings by allowing the less competitive offerings to make up the difference for the imputation test.

\* \* \*

The Commission finds that the criteria advanced by Ameritech focus on the functionality of an offering, but neglect the potential for anticompetitive pricing and behavior. The Commission concludes that it must examine offerings on a case-by case basis utilizing all relevant criteria, with the main goal being to prevent and discourage anticompetitive pricing and behavior.

MCI Complaint Order at \*29-32.

In its BOE, like in the *MCI Complaint Order*, SBC is focused on the “functionality of an offering” but utterly “neglect[s] the potential for anticompetitive pricing and behavior.” *Id.* Moreover, Staff witness Mr. Koch provided the Commission with an analysis of SBC’s proposed business NAL imputation, which concluded that: “Any level of usage and feature revenue would necessarily weaken the ability of the test to provide against a price squeeze.” Staff Ex. 1.0 (Koch) at 24. In fact, including the level of usage and feature revenue, proposed by SBCI, and accepted in the *Proposed Order*, necessarily weakens the imputation requirement of the PUA to such a degree that Section 13-505.1 would no longer be able to perform its central function in the future, which is to foster competition in the telecommunication markets by guarding against anticompetitive pricing in the form of what is termed as a “price squeeze.”

In making their argument that the “service” which is subject to imputation is “unduly narrow”, SBC urges the ALJ to focus on the “customer.” For instance, the following quotes are representative of SBC’s focus on the customer.

Features provide convenience and add value to customers’ use of the network, or they would not subscribe to them. As the Proposed Order recognizes, features are “quite popular.” *Id.* at 68-69. Similarly, it is common for business customers to make Band C and intraMSA toll calls. In fact, the CLECs typically compete most actively for customers who make intensive use of all of these capabilities.

\* \* \*

What is important is to base the test on the conduct of the *average* customer, which is precisely what SBC Illinois’ methodology does. Moreover, these variations in customer behavior are fully reflected in SBC Illinois’ studies, which are based on *average* feature and usage revenues across SBC Illinois’ entire business customer base.

SBC BOE at 9-10 (emphasis in original).

The Propose Order, however, correctly concludes that an analysis focused on the customer is “immaterial.” Proposed Order at 68. In fact, the Proposed Order states that:

The hypothetical customer put forth by Staff in support of its ‘narrow’ analysis speaks to only that, a single customer. Single customers of this type may indeed exist, but they are not the norm nor are they are [sic] material for purposes of Section 13-505.1. Nowhere in the language of the statute is there any reference to customers. Service is the subject of the statue, and not each individual customer who take the service.

*Id.*

Staff agrees with the ALJ’s conclusion that the focus of an analysis intended to determine how to define the “service” that is subject to imputation should not be on a customer or a set of customers but, rather, it should be on the

*market* that the imputation requirement is designed to protect. Obviously, the purpose of imputation is for the protection of competitive *markets* and not individual customers. It would be illogical to assume that customers would need to be protected against anticompetitive pricing. To the contrary, anticompetitive pricing actually provides a benefit to customers in the short run because they are receiving services at prices below what could be sustained in a competitive market.

However, that is not to say that an examination of the customers that constitute the demand side of the market is not a necessary part of an appropriate price squeeze analysis. A close reading of the Proposed Order in the very same section containing the above-quoted passage shows that the ALJ found it necessary to rely upon a conception of the customer base to make its determination as to the appropriate service subject to imputation. In Staff's analysis, the purpose of examining the customer base was to define the relevant *market for the service* for which the imputation test is to protect against a price squeeze. To say that Staff's analysis was inappropriate for its focus on the customer base is an indication that the Proposed Order has failed to recognize the need for such identification in Staff's analysis. Further, as Staff noted in the its BOE, by faulting Staff for examining customers and then proceeding to employ a similar examination, the Proposed Order suffers from a lack of logical consistency that makes it ripe for appeal. To be clear, it would be difficult (if not impossible) to define the appropriate market in a price squeeze analysis without also describing a range of customers that make up the demand for the service.

Staff's position is that all of the market place needs to be protected from anticompetitive pricing, not just segments of the market. Staff Ex. 1.0 (Koch) at 24. By adopting a broad imputation test in this proceeding, through aggregating revenue streams from various services, the Proposed Order erroneously accepts SBC's proposed methodology that only protects a fraction of the market for retail business access lines. *Id.* Such a finding is not insignificant, and could not be otherwise deduced without an examination of customers within the market. Staff thus urges the Commission to ignore the imputation tests adopted in the Proposed Order as well as the proposal in SBC's BOE to further reduce the percentage of the marketplace protected by the test by including *additional* revenue streams from vertical features (like call waiting and caller ID), Band C usage and intraMSA toll calling.

### **Reply to CUB**

Like SBC, CUB takes exception to the Proposed Order's determination to exclude Band C usage revenues from Band C, local toll, and vertical services revenues. Staff has addressed these same arguments above in reply to SBC and will not articulate those points again.

### **III. PAYPHONE ISSUES**

#### Response to IPTA

It appears from IPTA's *Brief on Exceptions* that its position is as follows: (1) changes in UNE rates do not affect COPTS rates; (2) adoption of a cost model, and cost inputs, that generate increases (or other changes) in TELRICs do not necessarily result in changes in LRSICs; and (3) that any attempt in this

proceeding to suggest that COPTS rates might be subject to change as a result of increases in TELRICs constitutes a collateral attack on the Commission's *Payphone Order*. IPTA BOE at 10-13. None of these assertions will bear any scrutiny.

IPTA is correct in asserting that COPTS lines are not UNES, when sold to COPTS providers, for the excellent reason that COPTS providers are considered to be retail end users. However, it is incorrect to assert that COPTS rates are not related to UNE rates in a significant way. First, it is important to remember that, in its *UNE Loop Order*, the Commission approved a number of changes to SBC's cost structure, including the use of the LoopCAT model, revised depreciation inputs, and revised cost of capital inputs. UNE Loop Order at 29, 76-77, 85-87. Implicit in approving this model for use in developing UNE loops is that LoopCAT is the most appropriate means of developing SBCI's entire set of network related costs, including LRSICs. In fact, Commission Cost of Service Rules direct that LRSIC studies be based upon the most recently approved depreciation rates and cost of equity, 83 Ill. Admin. Code §791(a)(1); (b)(1), which is to say the ones approved in the *UNE Loop Order*. Accordingly, IPTA's argument that LRSIC and TELRIC are completely unrelated should be dismissed out of hand.

Likewise, IPTA cannot contend that any change in COPTS rates is somehow a collateral attack on the *Payphone Order*. As Staff demonstrated in its several Briefs in this proceeding, see, e.g., Staff IB at 62, Staff RB at 58, the Commission adopted a rate setting methodology in its Payphone Order, rather than setting rates that were to endure forever afterwards. This methodology fully

complies with the FCC's Order, In the Matter of Wisconsin Public Service Commission: Order Directing Filings, FCC No. 02-25; CPD 00-01 (January 31, 2002) (hereafter "WPSC Order"), providing that only certain overhead loading methodologies were proper. WPSC Order, ¶158. Accordingly, provided that rates comply with the Commission's approved methodology, they also comply with the FCC's requirements, IPTA's protests notwithstanding.

#### Response to SBC

SBC has, in the course of this proceeding, raised arguments regarding COPTS rates in which the Staff concurs to a significant degree, regarding the manner in which SBC can file rates that comply with both imputation, and with the law and rules governing COPTS rates. However, as SBC notes, Staff's and SBC's "approaches may differ". SBC BOE at 12. In its BOE, SBC argues that, in light of the fact that the Commission's Payphone Order is currently before the Appellate Court, reopening it is, in general terms, not an option. Id.

SBC's recommendation is as follows:

The better approach would be to require SBC Illinois to file revised tariffs for its payphone services that comply with both the FCC's New Services Test and Section 13-505.1 or show cause why such tariffs cannot be filed. [fn] It would be understood that the Commission will suspend and investigate this tariff filing, so that a complete record can be developed and alternative approaches can be explored. Under Section 10-113 of the Act, the Commission always has the authority to change a prior order in a separate proceeding as long as notice and an opportunity to be heard are provided to the "public utility affected." Given the amount of time that has passed since the cost studies in Docket No. 98-0195 were prepared, SBC Illinois requests a reasonable opportunity to review and update those studies, as appropriate. Therefore, the Company proposes that it be directed to file revised tariffs within 90 days of the date of the final order in this proceeding.

SBC BOE at 12.

While this approach has, on its face, a certain amount to recommend it, the Staff cannot, without further information, endorse SBC's proposal. Specifically, SBC proposes to "file revised tariffs for its payphone services that comply with both the FCC's New Services Test and Section 13-505.1 or show cause why such tariffs cannot be filed." *Id.* Conspicuously absent from this proposal is any mention of SBC filing rates that comply with the Commission's *Payphone Order*. As Staff has noted elsewhere, *see, e.g., supra*; Staff IB at 62; Staff RB at 58; the Commission's methodology for setting COPTS rates is in full compliance with the FCC's *WPSC Order*, and, moreover, the Commission has specifically directed SBC to use the Commission-approved formula, and no other. *See Payphone Order* at 37 (Commission adopts ratemaking formula for COPTS); *Id.* at 46-47 (Commission requires SBC to file rates compliance tariffs using the Commission-approved formula). Accordingly, to the extent that SBC proposes to file rates that rely upon some methodology other than the one that the Commission ordered it to use in the *Payphone Order*, the Staff must object to this proposal.

In so doing, the Staff recognizes that the FCC did not suggest that there is only one way to skin a cat. As the FCC noted in its *WPSC Order*:

States may continue to use UNE loading factors to evaluate BOCs' overhead allocation for payphone services, but we do not require that UNE overhead allocations must serve as a ceiling on payphone service overhead loading. To evaluate such a ceiling, states should use the methodology from either the Commission's *Physical Collocation Tariff Order* or *ONA Tariff Order*. Consistent with Commission precedent, the BOCs bear the burden of justifying their

overhead allocations for payphone services and demonstrating compliance with our standards.

WPSC Order, ¶58.

Accordingly, to the extent that SBC takes the view that one of the other FCC-approved methodologies is more properly applicable to overhead loadings of COPTS rates, the Staff agrees with the proposition that, all things being equal, SBC is free to attempt to show that the use of the overhead loadings established in the *Physical Collocation Tariff Order* or *ONA Tariff Order* result in just and reasonable loadings and rates. However, since this was precisely the issue that the Commission resolved in the *Payphone Order*, it appears to the Staff that, to the extent that SBC wishes to do this, the proper – and indeed, the only – way to properly do it is to seek reopening of the *Payphone Order*. SBC's proposal, which appears to dismiss this as a possibility, would, to the extent SBC does not use the Commission approved formula, constitute a collateral attack on the *Payphone Order*.

WHEREFORE, for all the reasons set forth herein, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in this proceeding.

Respectfully submitted,

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