STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Alhambra-Grantfork Telephone Company	:	
	:	**04-0354**
Petition for Universal Service Support	:	

PROPOSED ORDER

DATED: August 4, 2005

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By the Commission:

I. PROCEDURAL HISTORY

In its petition filed with the Illinois Commerce Commission ("Commission") in this proceeding, Alhambra-Grantfork Telephone Company ("AGTC," "Alhambra" or "Company") requests, among other things, that the Commission "enter an order directing the administrator of the Illinois Universal Service Fund ("IUSF") to collect additional funds to pay Alhambra . . . universal service support effective January 1, 2003, and thereafter in an amount commensurate with the qualifications established in the Second Interim Order on Rehearing in docket 02-0233 and 00-0335."

Petitions for leave to intervene filed by Illinois Bell Telephone Company ("SBC Illinois" or "SBC"), Verizon North Inc. and Verizon South Inc. ("Verizon"), and AT&T Communications of Illinois, Inc. ("AT&T") were granted.

Pursuant to due notice, hearings were held at the offices of the Commission at Springfield, Illinois. Appearances were entered by Alhambra, the Commission Staff ("Staff"), SBC, AT&T and Verizon through their respective attorneys. Alhambra presented the testimony and exhibits of Robert C. Schoonmaker and Alvin Wilkening. Staff presented the testimony and exhibits of Dr. Genio Staranczak and Bill L. Voss. SBC Illinois presented the testimony and exhibits of James E. Stidham, Jr. There being no objections to doing so, the above-referenced testimony and exhibits were presented by affidavit. At the conclusion of the hearings, the record was marked "Heard and Taken."

Post-hearing initial briefs ("briefs") were filed by AGTC, Staff, SBC and Verizon. Reply briefs were filed by AGTC, Staff and SBC.

II. STATUTORY AUTHORITY

AGTC seeks IUSF funding under **Section 13-301(d)** of the Illinois Public Utilities Act, 220 ILCS 5/13-301(d). Section 13-301(d) provides in part:

> Consistent with the findings and policy established in paragraph (a) of Section 13-102 and paragraph (a) of Section 13-103, and in order to assure the attainment of such policies, the Commission shall:
> …
>
> (d) investigate the necessity of and, if appropriate, establish a universal service support fund from which local exchange telecommunications carriers who pursuant to the Twenty-Seventh Interim Order of the Commission in Docket No. 83-0142 or the orders of the Commission in Docket No. 97-0621 and Docket No. 98-0679 received funding and whose *economic costs* of providing services for which universal service support may be made available exceed the *affordable rate* established by the Commission for such services may be eligible to receive support, less any *federal universal service support* received for the same or similar costs of providing the supported services; provided, however, that if a universal service support fund is established, the Commission shall require that all costs of the fund be recovered from all local exchange and interexchange telecommunications carriers certificated in Illinois on a competitively neutral and nondiscriminatory basis. In establishing any such universal service support fund, the Commission shall, in addition to the determination of costs for supported services, consider and make findings pursuant to paragraphs (1), (2), and (4) of item (e) of this Section. Proxy cost, as determined by the Commission, may be used for this purpose. In determining cost recovery for any universal service support fund, the Commission shall not permit recovery of such costs from another certificated carrier for any service purchased and used solely as an input to a service provided to such certificated carrier's retail customers[.]
>
> 220 ILCS 5/13-301(d) (emphasis added)

Paragraphs 1, 2 and 4 of Section 13-301(e), in turn, provide in part:

> In any order creating a fund pursuant to this item, the Commission, after notice and hearing, shall:
>
> (1) Define the group of services to be declared "supported telecommunications services" that constitute "universal service". This group of services shall, at a minimum, include those services as defined by the Federal Communications Commission and as from time to time amended. In addition, the Commission shall consider the range of services currently offered by telecommunications carriers offering local exchange telecommunications service, the existing rate structures for the supported telecommunications services, and the telecommunications needs of Illinois consumers in determining the supported telecommunications services. The Commission shall, from time to time or upon request, review and, if appropriate, revise the group of Illinois

> supported telecommunications services and the terms of the fund to reflect changes or enhancements in telecommunications needs, technologies, and available services.
>
> (2) Identify all implicit subsidies contained in rates or charges of incumbent local exchange carriers, including all subsidies in interexchange access charges, and determine how such subsidies can be made explicit by the creation of the fund.
>
> …
>
> (4) Establish an affordable price for the supported telecommunications services for the respective incumbent local exchange carrier. The affordable price shall be no less than the rates in effect at the time the Commission creates a fund pursuant to this item. The Commission may establish and utilize indices or models for updating the affordable price for supported telecommunications services.
>
> ….

AGTC, Staff and SBC also cite **Section 13-517** of the Act. Section 13-517 provides in part:

> (a) Every Incumbent Local Exchange Carrier (telecommunications carrier that offers or provides a noncompetitive telecommunications service) shall offer or provide advanced telecommunications services to not less than 80% of its customers by January 1, 2005.
>
> (b) The Commission is authorized to grant a full or partial waiver of the requirements of this Section upon verified petition of any Incumbent Local Exchange Carrier ("ILEC") which demonstrates that full compliance with the requirements of this Section would be unduly economically burdensome or technically infeasible or otherwise impractical in exchanges with low population density . . . .
>
> ….

III. PRIOR ORDERS

In its **Second Interim Order** in Dockets 00-0233 and 00-0335 (Cons.), entered September 18, 2001 (“Second Interim Order” or “2d Interim Order”), the Commission established the Illinois Universal Service Fund pursuant to Section 13-301(d) of the Act.

Regarding costing methodologies, the Commission observed that Section 13-301(d) contemplates the establishment of a Universal Service Fund for the small companies if their economic costs of providing services for which universal service funds may be made available exceed the affordable rate established by the

Commission for such services less any federal universal service support received for the costs of providing such services. The statute specifically authorizes the use of cost proxies found by the Commission to be appropriate. (2nd Interim Order at 5)

The Commission concluded on page 13 that the use of a forward-looking cost model is appropriate in setting the legislatively permitted proxy cost for services eligible for USF support. The term “economic cost” is undefined in the statute but its use is pervasive in Commission proceedings dealing with telephony where it has generally been recognized as involving forward-looking costs, as opposed to embedded costs.

On page 17, the Commission observed that the Illinois Independent Telephone Association (“IITA”) and each of the small companies were requesting support based on the rate-of-return (“ROR”) showing, not the qualifying economic costs formula results which produced substantially higher amounts than the ROR analysis. That amount under the ROR analysis, for all small companies seeking support, was $12,799,298, later revised on remand. Under the forward looking “HAI” cost models, the qualifying amount at the default input levels, the IITA's input levels, or the Staff's input levels all exceed the level of support sought. As a result, the Commission concluded that the small companies qualify at all proxy cost levels.

On page 20, the Commission noted that once the economic cost of providing the supported services has been established, the statute requires the Commission to determine whether that cost exceeds the “affordable rate” which is to be established in the first instance by the Commission. On page 31, the Commission found that for purposes of Section 13-301(d), Verizon’s affordable rate of $22.23 per month, excluding taxes and surcharges, is the affordable rate to be adopted for the State of Illinois. On rehearing, the affordable rate was reduced to $20.39.

In Section III.F, on page 36-37, the Commission noted the obligation to ascertain each funded company’s actual need for support. The Commission observed that both the HAI economic model and the rate of return approach are problematic in determining IUSF funding levels, and neither should be used as the sole criterion. Among other things, the HAI model tends to significantly overstate relevant costs. Rate of return analyses have many limitations. One such limitation is that “ROR results, by their very nature, do not reveal information specific to the costs and revenues of the set of services that we determine to be potentially eligible for IUSF support. Rather, ROR results apply to the entire company on an overall basis.”

Next, in Section III.G of the 2nd Interim Order, ”Accounting Issues,” the Commission explained that it requested and received, from each small company, a truncated rate of return showing. That rate of return review was intended, in the first instance, to allow the Commission to consider, based upon the limited review necessitated by the short time frame associated with these dockets, whether any of the small companies were in an over-earnings situation. The Commission then adopted the ROR analyses as the benchmark against which to measure the potential size of the fund. To that end, Staff reviewed the submission and suggested adjustments to the proposals similar to those that would have been made had the various companies come in for rate cases. (2nd Interim Order at 52) The Commission then considered the actual adjustments proposed by Staff.

With respect to services deemed eligible for support, The Commission concluded that the list of Illinois-supported services should be the same as the list of FCC-supported services. (2nd Interim Order at 5)

With respect to the element of the "voice grade access to the network," the Commission found that it should be limited to a primary residence line and a single business line. This finding was reversed on appeal in *Harrisonville vs. Illinois Commerce Commission*, 212 Ill. 2d 237, 250 (2004) ("*Harrisonville*"). A Second Interim Order on Remand was entered December 21, 2004. Among other things, it found on pages 5-6 that the "qualifying line limitation" shall be removed, and ordered that "the services defined by the Federal Communications Commission as supported services shall be the state supported Universal Services for the purposes of the Fund with the Fund being based upon support for all access lines." The final fund size was specified in the First Ordering Paragraph.

In its **Fourth Interim Order** in Dockets 00-0233/00-0335 (Cons.), entered April 7, 2004, the Commission denied, without prejudice, AGTC's motion for additional IUSF filed December 17, 2003. The Commission stated, in part, on pages 7-8:

> As an initial matter, the Commission must consider whether it is even appropriate for a recipient LEC to request an increase in USF support. The Appendix to the Second Interim Order on Rehearing identifies the amount of USF support that each recipient LEC is to receive each year of the first five years following the effective date of the USF. Nothing in the Act or the Commission's prior orders in this matter, however, prohibit a LEC from seeking a change in the level of USF support it receives if its costs of providing the services eligible for support change during the first five years or sometime thereafter. Moreover, it is easily conceivable that a recipient LECs' costs could change. Therefore, if AGTC's costs of providing the services for which universal service support is available have increased, it is free to ask for an increase in USF support.
>
> A review of all recipient LECs' respective funding levels is not necessary at this time, as some of the parties have suggested. While at some point such a review may be prudent, absent evidence of over-earning or broad requests for additional support, the Commission believes it is more prudent to wait until the phase-in period is complete before reevaluating all LECs' funding. Until such time, the Commission will rely on Staff and other interested parties to inform it of when adjustments to the USF may be necessary.
>
> ….

> Because it is clear from the responses and replies to AGTC's motion that there is some dispute as to exactly what must be shown to warrant a change in the level of USF support that a LEC receives, the Commission also takes this opportunity to provide some guidance on this issue. Nothing requires the Commission to use the same generic criteria used in establishing the USF and eligibility for USF support when evaluating a[n] individual LEC's request for additional subsidization. As noted in the Second Interim Order, only a limited review of LECs' situations was possible in light of the time available. The general parameters used in the earlier phases of this proceeding assisted the Commission in addressing the needs of the many different LECs seeking funding in the limited timeframe. Beyond the use of the affordable rate established in the Second Interim Order on Rehearing, the Commission is free to examine an individual carrier's cost of service associated with providing the telecommunications services supported by universal service funding. Accordingly, AGTC should be prepared to provide information on its cost of service as well as demonstrate why such costs are reasonable. Moreover, nothing in the Act or the Commission's prior orders entitles each recipient LEC seeking additional USF support to a specified rate of return. Finally, it must be said that AGTC bears the burden of establishing that additional USF support is appropriate.

IV. AGTC'S PROPOSAL

AGTC is a local exchange carrier ("LEC") with 1,202 access lines in two exchanges in Bond and Madison Counties. Using the 11.21% ROR set forth in the Second Interim Order to determine eligibility for USF support and the affordable rate of $20.39 per access line per month established in the Second Interim Order on Rehearing, AGTC initially calculated that it was eligible for $213,781 of IUSF support for 2003 and thereafter. (AGTC Ex. 1.0 at 57) AGTC subsequently reduced that request to $101,322.

AGTC requests that the Commission direct the USF administrator, the Illinois Small Exchange Carrier Association, to collect additional funds from the contributing local exchange carriers ("LECs") and interexchange carriers and pay the requested amount to AGTC. AGTC claims that additional funding is necessary because it has experienced a substantial change in financial circumstances since entry of the Second Interim Order on Rehearing. Based on a "2003 test year," AGTC asserts that its current ROR is 8.15%.

AGTC states that in 2003 it began a two-year construction project, involving 18 miles of copper and new fiber cable between the central offices and the two exchanges, "to upgrade its outside plant to improve voice-grade access to the network for local calls and to improve access to the toll network by installing an additional toll line to serve the Grantfork exchange." (AGTC brief at 10, citing AGTC Ex. 2 at 3) These improvements also allow for the provision of advanced services within the meaning of Section 13-517 of the Act. AGTC says that at a cost of $1,350,191, this network improvement provided a substantial change in its financial circumstances that forms the basis of its petition for IUSF support in this docket.

As noted above, under the formula in Section 13-301(d), IUSF funding is contemplated when "economic costs" exceed the "affordable rate" less any federal universal fund support. In the Second Interim Order, the Commission analyzed economic costs within the meaning of 13-301(d) using a forward-looking cost model. However, USF funding amounts were established using an ROR approach which produced lower costs per line than the forward-looking model and has been described as providing a limit or cap on the amount of funding to be approved.

In the instant case, AGTC says it followed the same approach, first calculating economic costs using the forward-looking "HAI" model employed in 00-0233, and then seeking a funding level of $101,322 "using the identical ROR analysis employed in the 00-0233 docket . . ." rather than the higher funding amount produced by the HAI model. (AGTC brief at 13) AGTC says it used a 2003 test year for this purpose. AGTC claims its funding eligibility under the HAI "economic cost" test based on its proposed assumptions would be $918,776 and under the default assumptions of the HAI model proposed by AT&T in 00-0233, AGTC would be eligible for IUSF funding in the amount of $409,897. (AGTC brief at 13, citing AGTC Ex. 1 at 41, Att. 5; AGTC Ex. 5 at 5)

With respect to the "affordable rate" within the meaning of Section 13-301(d), AGTC used the same "affordable rate" established in 00-0233.

AGTC made adjustments for federal support within the meaning of the formula in Section 13-301(d). As discussed below, Staff and SBC contend that AGTC's calculation of federal support is incomplete and understated.

V. POSITIONS OF PARTIES

The statements contained in this section of the order appear in the parties' briefs and testimony. They do not constitute Commission findings unless otherwise indicated.

A. Summary of Positions

According to **AGTC**, It is manifestly in the public interest to provide IUSF support to AGTC and not wait until 2006.

The ROR operates as a limit on support, not as a guarantee. Staff's and SBC's allegations disregard the very methodology the Commission used to determine individual LEC qualifying amounts in the Second Interim Order. The "Compelling Rationale Test" recommended by Staff is unjustified, and in any event, AGTC passes the test.

AGTC's improvements qualify as supported services despite the advanced services requirement. Staff's argument for a disguised increase in the affordable rate is illegal. SBC's argument for delayed construction is contrary to the policy of 13-103(a) of the Act.

AGTC has reduced its ROR funding request to reflect future federal USF support through 2005 under the known and measurable accounting standards. Staff and SBC erroneously overstate future USF support, which cannot be substantiated beyond 2005.

AGTC has made a proper allocation of costs and has demonstrated a revenue shortfall of $101,322 for IUSF support. Alhambra's IUSF funding support should be retroactive to December 17, 2003.

According to **Staff,** the Commission should deny AGTC's request for IUSF funding. Considerations of sound public policy, administrative economy, and treating similarly situated carriers the same require this outcome. Further, the IUSF is not intended to guarantee a rate of return.

Further, AGTC has shown no compelling rationale or credible basis for an award of IUSF support. The evidence supports the proposition that AGTC's allegedly changed financial circumstances are entirely due to the company's decision to upgrade its network so that it can provision advanced services, which are not supported by the IUSF. Its assertion that the upgrade was intended to improve voice grade service and provide redundant toll capability to part of its service territory is contrary to the evidence. AGTC also fails to apprise the Commission of significant increases in federal high cost support and interstate access revenue that it will enjoy.

Finally, should the Commission reach the merits of AGTC's assertions, it should nonetheless deny the Petition. The evidence indicates that, when costs are properly allocated to its unregulated affiliates, and when federal funds it will realize from its plant upgrade are taken into account, AGTC has not shown it is in fact earning less than the target rate of return. (Staff reply brief at 27-28)

The position of **SBC** is that the Commission should deny Alhambra's petition for additional support from the Section 13-301(d) fund. Alhambra's "need" for additional funds appears to be the avoidable result of its own business decisions. Despite the rhetoric in Alhambra's brief about the principles of universal service, neither those principles nor the Commission's earlier orders dictate the result that Alhambra be granted additional support, thereby increasing the size of the fund and requiring ratepayers of other carriers throughout the state to pay for that increase.

Furthermore, Alhambra's Petition appears to be predicated upon network upgrades that were made at least in part to satisfy its obligations to offer advanced services under Section 13-517 of the Act by January 1, 2005. Article 13 of the Act contains specific provisions for waivers and grants for carriers that are having difficulty meeting that requirement. Finally, Alhambra has underestimated the support that it will be getting from the federal USF. For all of these reasons, SBC Illinois submits that Alhambra's petition should be denied or, alternatively, deferred until the fund established in Docket Nos. 00-0233/00-0335 is scheduled to expire in 2006. (SBC reply brief at 1-2)

It is **Verizon's** position that the Commission Staff has raised numerous valid concerns with regard to Alhambra's request, demonstrating that the request fails to comport with Section 13-301(d) of the Act.

Absent any reasonable evidence demonstrating that Alhambra's request comports with the requirements of Section 13-301(d), the Commission must deny Alhambra's request for additional subsidies. Otherwise, all telecommunications customers throughout the State will be required to subsidize Alhambra beyond what is required under the Act. Accordingly, it is Verizon's opinion that the Commission should deny Alhambra's request.

B. Policy/Public Interest; Method to Determine USF Support; USF and ROR

1. Staff Position

Staff contends that "it is not in the public interest to authorize IUSF for AGTC in this docket." (Staff brief at 13)

In Part I of its "public interest" argument, Staff claims "administrative economy and the principle of equal treatment of similarly situated carriers require that AGTC's Petition be denied." (Staff brief at 14) Staff says it is clear that the Commission has already decided upon the appropriate level of funding for IUSF eligible companies, determining that the fund size should be $11,992,215. (Id., citing Second Interim Order on Remand at 4) Accordingly, Staff reasons, "the Commission would be ill advised to commence a piecemeal revision of IUSF funding levels or funding eligibility before the fund size is reviewed generally, because such a non-methodical, piecemeal review could lead to funding inequities among companies." (Staff brief at 14-15, citing Staff Ex. 1.0 at 11)

In particular, if the Commission entertains AGTC's request, a precedent will be established that permits eligible companies to "pick and choose" a subsidy level. Some eligible companies will opt for subsidy levels established in the IUSF proceeding, while other companies will opt for subsidy levels established in proceedings they themselves bring to obtain new or additional IUSF subsidies. (Staff brief at 15, citing Staff Ex. 3.0 at 5) The ultimate result will be that the fund size will invariably increase over time, since carriers that are earning in excess of the target rate of return will "hold their cards" and opt to continue receiving subsidies at the levels set in the IUSF Proceeding, while others, in a position to credibly assert that they are earning less than the target rate, will opt for a funding level set in an individual proceeding. (Staff brief at 15)

As a result, subscribers who pay for subsidies through surcharges on their bill will face higher surcharges. Accordingly, increasing the fund size amounts to imposing additional burdens on the ratepayers of non-IUSF companies. (Staff brief at 15-16)

In Part 2 if its “public interest” argument in Section V.B. of its brief, Staff contends that “the IUSF is not intended to guarantee eligible carriers a specific **rate of return**.” (Staff brief at 16-22) The IUSF fund is not a “make whole” fund, intended to guarantee that eligible companies will earn a specified rate of return. As the Commission noted in its Fourth Interim Order, “nothing in the Act or the Commission’s prior orders entitles each recipient LEC seeking additional USF support to a specified rate of return.” (Staff brief at 16, citing Fourth Interim Order at 8)

Under Section 13-504 of the Act, small companies such as AGTC can raise rates virtually at will, without Commission review, unless 10% of affected ratepayers object. (Staff brief at 18) If the Commission cannot suspend and review a small carrier’s tariffs pursuant to the standard rate of return methodology, it is in no position to establish a revenue requirement for such a company, which is, of course, the manner in which a rate of return is achieved under such circumstances. Thus, Section 13-504, while freeing eligible carriers such as AGTC from certain perceived onerous aspects of rate of return regulation, such as filing requirements and the possibility of suspension of tariffs and their investigation by the Commission on its own motion, nonetheless also freed eligible carriers such as AGTC from the legal right to potentially earn a specific, Commission-approved rate of return. AGTC is attempting here to avoid the burdens of Section 13-504 without forgoing the benefits. (Staff brief at 18-19)

Further, the clear language of Section 13-301(d) demonstrates that the General Assembly did not intend the IUSF to guarantee eligible carriers a specific rate of return. As noted above, Section 13-301(d) provides in relevant part that:

> [Eligible carriers shall receive IUSF support to the extent that their] economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services[.]

As further noted above, the Commission has determined that “economic cost” means “forward-looking,” or incremental cost. (Staff brief at 19-20, citing Second Interim Order at 14) Since rate of return proceedings are based upon embedded, or “book” costs, the forward-looking cost basis of the IUSF is incompatible with guaranteeing eligible companies a specific target rate of return.

Staff does not intend to call into question the Commission’s determination in the IUSF Proceeding that, since economic costs as developed by the HAI model exceeded book costs, the use of book costs was acceptable in the context of that proceeding. (Staff brief at 20, citing Second Interim Order at 17-18)

Staff "agree[s] that the economic costs proxied by the HAI model using default input assumptions or input assumptions provided by IITA suggest that the 'economic cost' per line is greater than revenue per line." (Staff Ex. 1.0 at 21-22) Staff also "concur[s] with AGTC that once 'economic costs' are shown to be greater than revenues, actual IUSF support should be calculated as the difference between historical cost and revenue and not economic cost and revenue." (Id.)

According to Staff, "This is not what AGTC seeks, however, what it seeks is a rate of return guaranteed through IUSF funding." Permitting AGTC to obtain funding in this proceeding would effectively turn the IUSF fund into a "make whole" fund, to which eligible companies could apply whenever their rate of return fell below a certain level. (Staff brief at 20-21)

In the view of Staff, the Commission should not guarantee small companies a specific rate of return by increasing IUSF surcharges placed on other subscribers in the state every time a small company falls short financially. Instead, the eligible companies should take the steps that firms in competitive industries take to achieve desired financial targets, such as raising prices, stimulating demand, or cutting costs. Nothing prevents AGTC from raising rates above the affordable rate established in the IUSF Proceeding. Subscribers of some small companies, such as Leaf River and Yates City currently pay more than $20.39 for basic local service. The "affordable rate" is not, as AGTC might suggest, a figure above which eligible company rates cannot or should not rise; rather, as the plain language of Section 13-301(d) makes clear, the affordable rate is a tool to establish the amount of support a small company receives, regardless of its rates. (Staff brief at 21-22)

Staff concludes this section of its brief with the argument that the Commission should deny the petition "without addressing the merits." (Staff brief at 22)

2. SBC Position

According to SBC, the universal service fund established the 11.21% rate of return only for purposes of determining the "eligibility" for high cost fund support. Nowhere in its Orders in the 00-0233/0335 proceeding did the Commission suggest that a company was entitled to a guaranteed rate of return of 11.21%. In its Fourth Interim Order, page 8, the Commission reiterated that nothing in the Commission's prior Orders entitled any LEC seeking additional USF support to a specified rate of return. (SBC brief at 4)

SBC says Alhambra should be required to look to its own customers before seeking money from the high cost fund. (SBC brief at 11) While the issue of whether $20.39 is an appropriate affordable rate will presumably be revisited when the current USF fund expires in 2006, nothing precludes Alhambra from increasing its rates to its end users now.

3. Alhambra Position

According to Alhambra, nowhere do either SBC or Staff ground their arguments in statutory policy language in 13-103(a), nor do they point to any language in the Act to justify the discriminatory treatment that they seek to impose upon AGTC. The reason that neither SBC nor Staff cite any case law or legislative support for their proposals, AGTC argues, is because the proposals are unlawful and hostile to the goals of both 13-103(a) and 13-301(d). The size of the fund is not locked in at one fixed number and should be adjusted in the face of changing circumstances.

AGTC points to the Fourth Interim Order where the Commission declined to revisit the funding level for all companies at that time, but explicitly allowed AGTC to file its petition and have it considered. AGTC maintains that there is no reason why its subscribers should be denied IUSF support until all companies' funding levels are reviewed simultaneously.

With regard to the methodology, AGTC argues that Staff's and SBC's allegations disregard the very methodology that the Commission used to determine individual LEC qualifying amounts in the Second Interim Order and Second Interim Order on Rehearing. Affording AGTC the same treatment that was afforded other LECs in the USF case does not lead to funding inequities, and the Fourth Interim Order recognized that a change in the cost of service is a reason to consider a new funding request.

The fact that granting IUSF support to AGTC may impact the size of the IUSF is no basis for denying that support as urged by Staff. AGTC argues that it makes more sense to grant AGTC support at the present time and have its funding levels reviewed along with other companies whenever the review process takes place.

AGTC maintains that its request is not a guaranteed ROR. Rather, its funding request is based upon new construction, and that using the rate-of-return methodology as a limit upon forward-looking costs is not a guaranteed ROR, but, rather, is a limit upon earnings. AGTC maintains that it should not be required to raise prices beyond the affordable rate, and that it provides service in a high-cost area where the market is not capable of additional demand for its services. AGTC asserts that it has already cut costs.

State policy in Section 13-103 does not require AGTC to raise its rates above the affordable rate. Instead, state policy in 13-301 requires the Commission to make services available at the affordable rate. Raising prices above the affordable rate is incompatible with this state policy. AGTC argues that the affordable rate of $20.39 should be the rate used in calculating its ROR IUSF support. AGTC maintains that in the Second Interim Order on Rehearing, the same argument was made, and the Commission did not require other companies to raise their rates above the affordable rate.

C. Compelling Rationale Test; AGTC Business Decisions; Advanced Services

1. Staff Position

In its brief, Staff next argues that if the Commission determines that it should even consider IUSF funding for AGTC, it should establish a threshold “compelling rationale” test that small companies such as AGTC must satisfy before becoming eligible for increased IUSF funding. (Staff brief at 23, citing Staff Ex. 3.0 at 2)

As proposed by the Staff on rebuttal, the compelling rationale test should consist of two elements. First, a small company must demonstrate that its rate of return is 3% below the target established in the IUSF Proceeding to ensure that companies can only apply for more IUSF monies when there is a significant, as opposed to a trivial, deterioration in their finances.

Second, a company would have to demonstrate that the reduced rate of return is due to circumstances beyond the company’s control. Circumstances beyond a company’s control would include, but not necessarily be limited to, such events as: (a) a sudden increase or decrease in the number of lines served (5% since the Second Interim Order on Rehearing); (b) a sudden increase or decrease in total access minutes (20% since the Second Interim Order on Rehearing); (c) a sudden increase or decrease in input prices (interest rates and equipment prices but not wages); or (d) legislative requirements that impose additional costs. (Staff brief at 23-24)

Without a compelling rationale test, Staff argues, small companies “will try to eliminate perceived financial shortfalls through regulatory pleading (i.e., obtaining larger subsidies from the IUSF), rather than through more efficient management of their operations.” In Staff’s view, it makes no sense to return to the “burdensome pre-1986 method” of exercising rate of return regulation on small companies. (Staff brief at 24-25)

Using the guidelines articulated above, Staff claims the Commission should declare that AGTC’s application fails to satisfy the “compelling rationale” test, since AGTC has failed to allege that its purported ROR deficiency is any way attributable to factors beyond its control. Rather, the record in this proceeding shows that AGTC’s current financial “shortfall” is directly attributable to the company’s own discretionary actions and business decisions. (Staff brief at 25-26, citing Staff Ex. 3.0 at 4)

Staff avers that the “shortfall” in question results primarily from an affirmative decision by AGTC to significantly upgrade the company’s outside plant. The purpose of this upgrade, according to AGTC, was essentially threefold: first, to make high-speed data service available to 80% of its customers, in compliance with Section 13-517; second, to ameliorate alleged deficiencies in service quality; and third, to make redundant toll and 911 services available to its Grantfork territory. Staff asserts that no law or regulation required AGTC to make this upgrade, and AGTC has advanced no evidence in this proceeding in support of its contention that the upgrade was necessary to adequately provision IUSF-supported voice grade services. (Staff brief at 25-26)

Staff urges the Commission to dismiss any argument by AGTC that it was required by Section 13-517 of the PUA to make an upgrade to outside plant. Staff observes that the Commission is authorized to grant a full or partial exemption to a carrier that can demonstrate that this requirement is likely to cause adverse economic impact, technical infeasibility, or impracticality, and that the grant of an exemption in otherwise in the public interest. Staff notes that AGTC did not seek an exemption, although Verizon was granted such an exemption.

Staff further asserts out that the IUSF fund does not support advanced service in any case. The Commission has determined that the IUSF should only support voice-grade services, specifically, voice grade access to the local network, local usage, signaling, single-party service (as opposed to party lines); access to 911 service, access to operator services, access to interexchange carriers' networks, access to directory assistance, and toll limitation for qualifying low-income customers. (Staff brief at 27, citing Second Interim Order at 5) AGTC cannot contend that it upgraded its plant to provision high-speed data service – a service not supported by the IUSF – and then obtain IUSF support based on the upgrade.

Staff further recommends rejection of AGTC's arguments that its outside plant upgrade was necessary to support voice grade services; specifically, that the upgrade in question was necessary, first, because of increased trouble reports; and, second because of a lack of toll (or in this case, apparently, out-of-exchange) redundancy, such that, if some catastrophe were to befall the trunk running from Grantfork to the company's switch in Alhambra, the former would be isolated, at least in terms of the landline network, from the outside world. (Staff brief at 28)

With respect to trouble reports, Staff asserts that AGTC has produced no evidence to show that this minor increase in such reports was attributable to deteriorating outside plant, rather than to weather conditions or other factors. AGTC presented no statistically significant evidence of a trend towards more trouble reports attributable to deteriorating outside plant. During the worst of the alleged trouble report "crisis" at AGTC, the level of trouble reports per hundred access lines never reached even half of the maximum permitted by Commission service quality rules. Over the period for which AGTC provided data, its average level of trouble reports was slightly more than one-third of the permissible level – 2.16 reports per month. Staff believes this shows AGTC did not experience any service quality deterioration such as would warrant significant plant investment, and its attempt to attribute to service quality concerns its decision to upgrade its plant simply does not survive any sort of scrutiny. (Staff brief at 28-29)

As to the question of toll redundancy, Staff first states that access to toll services, much less redundant access to such services, is not an IUSF supported service. According to Staff, AGTC argues that its Grantfork subscribers must utilize toll service to call 911, and, in consequence, redundant toll capacity is necessary, but has produced no evidence that toll service to Grantfork has ever been interrupted. Likewise, Staff argues, AGTC has presented no evidence that redundant trunking of this nature is required by any engineering standards in common use in the telecommunications industry. (Staff brief at 29-30)

In response to certain AGTC arguments citing the decision of the Illinois Supreme Court in *Harrisonville vs. Illinois Commerce Commission*, 212 Ill. 2d 237, 250 (2004) ("*Harrisonville*") decision as noted below, Staff claims the decision does not support the proposition that the IUSF should support advanced services. It stands for nothing more than the proposition that Section 13-301(d) requires that all eligible lines receive support for all eligible (i.e., voice grade) services. (Staff reply brief at 6-7, citing *Harrisonville*, 212 Ill. 2d at 251; 817 N.E.2d at 488) Beyond that holding, Staff argues, the *Harrisonville* decision does not reach. Staff adds, "No party to this proceeding suggests that AGTC should not get whatever support to which it might prove to be entitled for the purpose of supporting voice grade access to all access lines." (Staff reply brief at 7)

2. SBC Position

SBC does not speak to the compelling rationale test specifically, but does address certain issues discussed in that section of Staff's brief.

Alhambra's alleged need for additional funding is largely based on Alhambra's own business decisions. (SBC brief at 5) Mr. Wilkening testified how Alhambra commenced its two-year project in 2003 to upgrade Alhambra's outside plant. This involved installing over 18 miles of copper and fiber cable and installing four new nodes and copper loops from the nodes to customer premises. (Alhambra Ex. 2.0 at 3) The project, which was scheduled to be completed in two years, could have taken place over a greater number of years, which would have significantly reduced the short-term impact on Alhambra's earnings. (SBC brief at 5, citing SBC Ex. 1.0 at 13-14)

Alhambra has had a lack of total redundancy since at least 1993. (SBC brief at 6) Yet it was only relatively recently that Alhambra decided to upgrade its services to the Grantfork central office by adding not only a second fiber optic line between its Alhambra and Grantfork central offices, but by adding two new fiber lines between the two central offices using diverse routes. Further, Alhambra has presented no factual evidence supporting the broad claim that it experienced problems with either its service quality or its network capacity.

Alhambra should not receive support for advanced services. It is appropriate that Alhambra not seek advanced services to be designated as supported services. In the Second Interim Order in Docket No. 00-0233/0335, the Commission designated the same services as those identified by the FCC to be supported services, and advanced services were excluded from the list. (SBC brief at 9-10)

It appears likely that the decisions on both the scope and the duration of the network upgrade project were driven by Alhambra's desire to upgrade its network to make advanced services widely available by January 1, 2005 pursuant to Section 13-517 of the Act. (SBC brief at 10)

In choosing to invest in a massive network upgrade within a short two-year period, Alhambra made the business decision not to pursue other options available to it, such as a Section 13-517 waiver process whereby the Commission has authority to grant a full or partial waiver from the advanced services requirements. (SBC brief at 10-11)

In response to arguments by AGTC relying on the *Harrisonville* decision as discussed below, SBC argues, in part, "To the extent that Alhambra appears to be suggesting that denying its request for additional universal service support funding would be inconsistent with the federal universal service support fund, its argument is fundamentally flawed." Alhambra fails to demonstrate how denying its request for additional funding is inconsistent with any portion of the FCC's universal service orders. (SBC reply brief at 4)

3. AGTC Position

AGTC contends that the compelling rationale test proposed by Staff should not be adopted. (AGTC brief at 16-18 and reply brief at 13-16). Clearly, AGTC argues, financial circumstances of LECs change over time, and no public interest is served by arbitrarily denying a company support until the entire fund is reviewed. AGTC points to the Fourth Interim Order stating that nothing in the Act or prior Commission orders prohibits a LEC from seeking a change in the level of USF support it receives if its costs of providing service have changed. AGTC argues that it would be punitive to limit IUSF support to qualified LECs to only extreme emergency circumstances.

Nevertheless, AGTC maintains that it passes Staff's test. AGTC has demonstrated that its ROR is 8.15%, which is approximately 3% below the IUSF rate of 11.21%. AGTC argues that its decision to improve its outside plant, which also allowed it to meet the legislative requirement for advanced services, qualifies under the compelling rationale test, because 13-517 explicitly required AGTC to make advanced services available to 80% of its customers by January 1, 2005.

AGTC's plant upgrades provide both voice-grade improvement and toll services, and are not inconsistent with advanced services. (AGTC brief at 18-22) The fact that these improvements also provide AGTC with the capability of providing advanced services does not disqualify it from IUSF support. The legislature in 13-517 mandated the provisioning of advanced services to not less than 80% of each local exchange carrier's customers by January 1, 2005. AGTC cannot be criticized for complying with the legislature's clear directives in a timely manner. (AGTC brief at 22-23)

AGTC cites the FCC's Fourteenth Report and Order, Twenty-Second Order on Reconsideration in Docket No 96-45, par. 200, released on May 21, 2001, where the FCC stated:

> The public switched telephone network is not a single-use network. Modern network infrastructure can provide access not only to voice services, but also to data, graphics, video and other services. High-cost loop support is available to rural carriers to maintain existing facilities and make prudent facility upgrade. Thus, although the high-cost loop support mechanism does not support the provision of advanced services, our policies do not impede the deployment of modern plant capable of providing access to advanced services. Rural carriers may consider both their present and future needs in determining what plant to deploy, knowing that prudent investment will be eligible for support. The measures that we adopt in this Order will increase incentives for carriers to modernize their plant by increasing the total amount of high-cost loop support available under the cap.

Clearly the FCC supports upgrades to the network that improve voice-grade service and allows for the provisioning of advanced services. Contrary to the arguments of the other parties, the FCC has made it clear that these goals are not mutually exclusive. (AGTC brief at 20-21)

AGTC cites the Supreme Court decision in *Harrisonville* for the proposition that under 13-301(e), the Commission is required to support the same services that the FCC supports. In the Second Interim Order on Rehearing in 00-0233, the Commission reduced funding for all companies by their percentage of non-primary lines even though the FCC provided funding for all access lines.

In reversing the Commission's order, the Supreme Court held that the Commission's non-primary line limitation was inconsistent with the legislature's intent in 13-103 and in violation of 13-301(d) and (e) when imposing support limitations the FCC does not impose. Under 13-301(e), the Commission is required to support the same services that the FCC supports, and it would be incongruous to follow the FCC's words but not its deeds. (AGTC brief at 21-22) Moreover, the fact that universal service requires customers in other areas of the state to contribute to the cost of services in rural high-cost areas was not a reason to deny support for non-primary lines, since the FCC and the legislature have determined that universal service support is a worthy public goal. The court stated that "universal service means universal service."

In the instant case, no party alleges that AGTC's network improvements will not qualify for federal universal service funding. In fact, the parties emphatically maintain that it will qualify for federal funding in future years. AGTC's network improvements qualify as supported services under the ROR test.

Further, the argument that the costs of advanced services should not be considered in the ROR test would be a major departure from what the Commission established in 00-0233. Staff argues that AGTC is not entitled to fund advanced services through IUSF and that AGTC must exclude its revenues and costs attributable to advanced services from the ROR calculation. (Staff Ex. 1 at 13-14) However, this argument is wrong because the ROR includes all regulated revenue and costs of the LEC from all sources. The ROR test does not parcel out the nine supported services of universal service because the ROR operates as a cap on the recovery of economic costs of supported services. (AGTC brief at 21)

D. Allocation Issue

1. Staff Position

According to Staff, if the Commission finds that an examination of AGTC's IUSF funding levels is warranted over Staff's arguments to the contrary, AGTC's funding requirement should be based on a consolidated income statement for AGTC, and its long-distance internet-DSL affiliate A-G Long Distance, Inc. (Staff brief at 31-32, citing Staff Ex. 1.0 at 4) Staff asserts that the affiliate, A-G Long Distance, uses the plant, administrative and other services of AGTC but does not appear to compensate its parent for these services in a proper fashion.

Staff says this concern is best shown by the fact that A-G Long Distance, a reseller of long distance service, earned a return of 600%, based on its issued common stock value of $10,000. (Staff brief at 32, citing Staff Ex. 3.0 at 8) Such profits are unusual, since resale of telecommunications is very competitive and is characterized by low profit margins. The fact that A-G Long Distance is able to earn such a high rate of return suggests that many of its costs have been improperly allocated to AGTC, and Staff asserts that it found this to be the case. A-G Long Distance apparently requires neither property, nor plant, nor equipment to run its profitable resale business, since it has no recorded assets under these accounting classifications.

Staff indicated in its direct testimony that AGTC subsidized A-G Long Distance by not charging A-G Long Distance for billing services that AGTC provides for A-G Long Distances internet customers. (Staff brief at 34, citing Staff Ex. 1.0 at 4-5 and 2.0 at 13-16) Only then, in rebuttal testimony, did AGTC made an adjustment to correct it. (Staff brief at 34, citing AGTC Ex. 4.0 at 2–3)

Further, AGTC subsidized A-G Long Distance and Alhambra-Grantfork Cellular by paying the full costs of the companies' joint Board of Directors and executive time, even though the Board of Directors and the executive are involved in the operations and decisions of these two subsidiaries. (Staff brief at 34-35, citing Staff Ex. 1.0 at 4-5) After Staff demonstrated the existence of this subsidy, AGTC allocated a 5% portion of its Board of Directors and executive time costs to A-G Long Distance. (AGTC Ex. 4.0 at 3-4) However, AGTC refused to allocate any Board of Directors or executive time costs to Alhambra-Grantfork Cellular, until it became clear -- as a result of questions from Staff --

that AGTC incurred expenses on behalf of Alhambra-Grantfork Cellular, whereupon AGTC has assigned some of these costs to its subsidiary. (Id.; AGTC Ex. 5.0 at 16–17)

In direct testimony, a Staff witness also testified that A-G Long distance uses AGTC's loops since DSL is provisioned over the high-frequency portion of the copper loop facilities used to provision voice services, but does not appear to make any payments to AGTC for use of these loops. (Staff Ex. 1.0 at 5) As noted in Staff rebuttal, AGTC witness Mr. Schoonmaker responded in rebuttal testimony that A-G Long Distance does in fact provide fair compensation to AGTC because it buys DSL service from Alhambra at interstate tariffed rates available to all customers. (AGTC Ex. 3 at 7-8; Staff Ex. 3.0 at 6-7)

According to Staff, there is no question that, in the past, Alhambra has subsidized its competitive affiliates, and the fact that such practices took place at all points to the likely existence of other similar subsidies. (Staff brief at 35)

In view of these problems, Staff's position is that instead of trying to determine what proportion of AGTC's costs should be allocated to A-G Long Distance, the Commission should simply consolidate the income statements of AGTC and A-G Long Distance for IUSF determination purposes. (Staff Ex. 3.0 at 8-9; Staff brief at 32) The Commission notes that according to Staff's schedules, adoption of the consolidation adjustment alone would eliminate all but $1,397 of AGTC's final IUSF funding request of $101,322. (Staff brief at 39; Staff Ex. 4.0C at 14)

Staff also recommends that the Commission authorize no IUSF funding until AGTC conducts a thorough review of its expenses to insure that all direct and indirect costs are properly assigned to Alhambra's non-regulated subsidiaries. The review should use the cost allocation methodologies of 83 Ill. Adm. Code 712. (Staff brief at 33-34, citing Staff Ex. 2.0 at 16 and 4.0 at 8-10)

In the absence of such a review, and also assuming that AGTC's IUSF need is not based consolidated financial data, Staff witness Voss proposed to allocate 5% of the expenses for executive functions, other general and administrative functions, accounting and finance and legal services to A-G Long Distance and 5% of the expenses to Alhambra-Grantfork Cellular. (Staff Ex. 4.0 at 7-8) The amounts are shown in Schedule 4.03 of Staff Exhibit 4.0. This adjustment, which Alhambra opposes, totals $20,111. (Staff Ex. 4.0 at 9-10 and Schedule 4.03)

2. AGTC Position

AGTC's position is summarized in its initial brief, pages 38-40, and reply brief, pages 21-23, citing AGTC Exhibits 3, 4 and 5.

AGTC argues against a consolidation of the income statements of AGTC and AG Long Distance, also known as "AGLD," because AGLD pays AGTC for services it receives. Staff propounded 14 data requests and conducted a thorough review of the audit and audit work papers, maps and other documents of AGTC and AGLD. That investigation did not find any additional subsidies, and AGTC maintains that Staff's subsidization argument is unsupported by the evidence.

During the discovery phase of this case, AGTC found that it failed to allocate costs for executives and members of its Board of Directors, and AGTC made that adjustment in the amount of $3,424, which Staff accepted. In another instances, AGLD failed to pay AGTC for internet-only billing expenses which resulted in an AGTC adjustment of $1,449. Finally, on another occasion, travel and meal expenses should have been charged to A.G. Cellular, and that adjustment was made in the amount of $1,818. These three adjustments total $6,691. AGTC argues that it is unreasonable to consolidate the income statements of AGTC and AGLD based upon these "minor discrepancies".

Further, AGTC says its office personnel keep time records on non-regulated activities and that non-regulated activities for outside costs are billed separately to each company. AGLD does not require any plant to run its business because it is a reseller of long distance services, and that is the reason it has no recorded assets. In addition, there is no basis for making an adjustment for general administrative costs for AG Cellular, because it is a passive company in a limited cellular partnership. All of the functions in the cellular partnership are paid for by the general partner. AGTC concludes that Staff's arguments are exaggerated and that all costs have been properly accounted for.

E. Federal Support Offset

Under Section 13-301(d), IUSF support is contemplated when economic costs exceed the affordable rate "less any **federal universal service support** received for the same or similar costs of providing the supported services." (Staff brief at 37, quoting 220 ILCS 5/13-301)

As noted above, the basis of Alhambra's petition for IUSF support is a purported substantial change in its financial circumstances attributable to expenditures of $1,350,191 in network improvements pursuant to a two-year construction project commencing in 2003.

Throughout the case, SBC and Staff have contended that Alhambra has not properly reflected the federal support it will receive as a result of this investment.

On rebuttal, AGTC reduced its funding request by $62,365 to reflect an increase in 2005 federal high cost loop ("HCL") USF funds over 2004 levels. (AGTC Ex. 3 at 21-22 and Att. 2, Sch. 1.05) The effects of that reduction, and other adjustments, are reflected in the Company's final IUSF funding request of $101,322.

1. SBC Position

SBC argues that Alhambra will see significant increases in federal universal service fund support related to its 2003-2004 plant investments, starting in January, 2005 and increasing again in January of 2006. (SBC brief at 8, citing SBC Ex. 1.0 at 18) Alhambra attempts to justify its position that the embedded cost analysis should not include projected increases in Federal USF support in 2006 and beyond, on the basis that those increases are not "known and measurable." (SBC reply brief at 12, citing AGTC brief at 40-41) However, SBC argues, Alhambra's application of the "known and measurable" concept is illogical and self-serving.

SBC witness Mr. Stidham testified that the financial data used to calculate FUSF HCL is two years removed, and Alhambra's 2005 FUSF HCL support is based on the 2003 financial data of Alhambra. Therefore, the inclusion of the 2004 financial data use by Mr. Schoonmaker to calculate future IUSF support should include the 2006 FUSF HCL support in 2006 that will be calculated based on adjusted 2004 data. (SBC Ex. 1.1 at 4)

SBC says Alhambra does not deny that, under existing FCC rules, it will receive increased Federal USF support payments in 2006, due to the increased plant investment resulting from the 2004 portion of its network build-out. Rather, Alhambra contends that since the FCC may not continue the current USF rules and that Alhambra might be impacted by a change in the level of support payments, the Commission should assume that Alhambra will receive no increase at all in federal USF payments in 2006.

According to SBC, this is not a reasonable application of the "known and measurable" concept. A more reasonable application of this concept would be to assume that the FCC's rules, as they exist today, will continue to be in effect until such time as the FCC actually changes them, at which time the actual impact of such changes, should they ever actually occur, could be taken into account. Alhambra's refusal to acknowledge that it will receive increased federal USF support in 2006 makes its embedded cost analysis inappropriate even for use as a starting point in attempting to determine any possible need for IUSF support. (SBC reply brief at 12-13)

2. Staff Position

Staff contends that "AGTC has failed to fully address the significantly increased interstate revenues that it will enjoy as a result of its plant additions." (Staff brief at 36)

Attachment A to Mr. Voss' rebuttal testimony, Staff Exhibit 4.0, is a copy of the minutes of the March 10, 2003 meeting of the AGTC Board of Directors. Attachment B to that exhibit is a 5-page abridgment of AGTC's response to Staff data request BV-8.04 containing a copy of a presentation made by Mr. Becker, a representative of GVNV Consulting, Inc., at that meeting. These attachments were admitted into the evidentiary record along with Mr. Voss' rebuttal testimony. According to Mr. Voss, these attachments suggest that AGTC may fully recover its investment from additional interstate access revenues over a period of five or six years. (Staff Ex. 4.0C at 11)

Specifically, Mr. Becker's presentation projects that AGTC will receive significantly increased Carrier Common Line revenues and High Cost Loop Support revenues as a result of its investment in the upgrade. (Staff brief at 36, citing Staff Ex. 4.0C, Att. B at 3) Both Carrier Common Line and High Cost Loop Support are federal programs, relying upon interstate funding sources. (Staff brief at 36, citing SBC Ex. 1.0 at 15-16) AGTC's attempt to recover costs associated with the same investment from the IUSF, when it is certain to recover them from interstate and federal sources, must therefore be rejected as "double dipping." (Staff brief at 33-37, citing SBC Ex. 1.0 at 17-18) At the very least, Staff argues, AGTC is certain to enjoy revenues well in excess of those it has reported to the Commission in this proceeding.

In its surrebuttal testimony, AGTC did not respond to this Staff rebuttal evidence. Accordingly, Staff argues, it is unrebutted that AGTC will realize substantial new interstate revenues as a result of its plant upgrade, and it is further unrebutted that a substantial portion of these revenues will take the form of federal high cost support. This is significant, Staff argues, since AGTC has the burden of proof in this proceeding. Accordingly, AGTC must prove, by a preponderance of evidence all elements of its case for IUSF support.

Significantly, one of these proof elements is the amount of federal high cost support to which the company is entitled. Under 220 ILCS 5/13-301(d), IUSF support is based upon the difference between economic cost and affordable rate, "less any federal universal service support received for the same or similar costs of providing the supported services." (Staff brief at 37)

Thus, Staff argues, AGTC has failed to make an important element of its case and is attempting to attempt to "game" the IUSF support system. Staff finds it curious that AGTC is, in essence asserting that the Commission cannot and should not consider revenues projections that were presented to AGTC's Board of Directors for their consideration in deciding whether to embark on the plant upgrade. (Staff brief at 42-43)

Schedule 2 attached to Staff's Initial Brief purports to show "the calculation of increased interstate revenues based upon the presentation made by GVNW Consulting, Inc., to AGTC's Board of Directors at its March 10, 2003 meeting. " (Staff brief at 38) According to Staff, if these additional revenues are considered, AGTC's rate of return is above the 11.21% target. Table 2 on page 40 of Staff's brief quantifies the adjustment of interstate revenue recoveries and resulting negative funding requirement as calculated by Staff. The Commission observes that Schedule 2 and Table 2 of Staff's brief and the "adjustment to interstate revenues" calculated therein were not offered into the evidentiary record, and Alhambra disputes these calculations in its reply brief. The Commission's conclusions on this issue are not based on that calculation.

3. AGTC Position

AGTC's position on what characterizes as this "miscellaneous accounting issue" is set forth in its brief, pages 41-42, and reply brief, pages 23-29. AGTC contends that it has reduced its ROR funding request to reflect future federal USF support through 2005 under the known and measurable accounting standards. AGTC maintains that Staff and SBC erroneously overstate future USF support, which cannot be substantiated beyond 2005, especially because federal rules for USF support expire on July 1, 2006 and are undergoing a review at this time. No one can project with any reasonable assurance the amount of support that AGTC will receive in the years to come.

AGTC maintains that Staff's projection of future USF support is not how USF support is calculated, and it is therefore unreliable. Moreover, 13-301(d) allows the reduction of state USF support by the amount of federal USF support "received" for the same services. AGTC maintains that any projection years into the future beyond 2005 does not allow for an accurate projection of the amount of support that will be received.

AGTC discounts the presentation by Mr. Becker to the AGTC Board of Directors because that information, like Schedule 2 of Staff's brief, was based upon financial information that is out of date and irrelevant. Staff relied on assumptions and estimates based on 2001 data, whereas AGTC presented its case on 2003 data. Mr. Becker's presentation was specifically limited to an estimate that assumed no other changes, and that the investment would be used for CWF subscriber OSP. AGTC's plant additions included not only subscriber outside plant, but the replacement of and building of plant to carry toll traffic, which is not included in plant or federal high-cost loop support. Therefore, Staff's extrapolation would overstate the revenue impacts that would actually occur. Mr. Becker's estimates also did not take into account the changes in the national average loop cost for 2005 or factors of depreciation.

AGTC argues that Staff's projection is further inaccurate because some of the revenues Mr. Becker forecasted were already included in the 2003 test period. Staff and AGTC agreed to several adjustments to the test period revenues, and Mr. Becker's estimates, which were incorrect and out of date, on top of the revenue that was reflected in the 2003 test year, would be double-counting. AGTC concludes that it is not earning in excess of the 11.21% ROR and that the adjustments recommended by Staff and SBC are improper and unfounded and should be rejected.

F. Retroactive Funding

In its petition, AGTC requests that any funding ordered in this proceeding be made effective as of December 17, 2003, that being the date it filed its original request for additional IUSF support in Docket 02-0233/02-0335 (cons). (AGTC brief at 43) AGTC says the Supreme Court in *Harrisonville* upheld the Appellate Court's decision to provide funding for secondary lines retroactive to the date the Commission ceased funding secondary lines, holding that as a matter of equity, retroactive funding was necessary to prevent a gap in funding. (AGTC brief at 43, citing *Harrisonville* at 252-253)

In its direct testimony, SBC took issue with the retroactive funding request, but it did not address the issue after that.

The position of the Staff is that AGTC should not be penalized financially for administrative delays beyond its control. Staff asserts that "if AGTC's financial statements justify subsidies starting the day AGTC filed for such subsidies then, subsidies should commence on that date." (Staff brief at 44 citing Staff Ex. 3.0 at 14)

On this issue, based on the record, the Commission finds that if Alhambra were entitled to IUSF funding, such funding should be retroactive to December 17, 2003 if AGTC's financial statements are deemed to justify funding starting that day.

VI. COMMISSION ANALYSIS AND CONCLUSIONS

In its Second Interim Order in Dockets 00-0233 and 00-0335 (cons.), entered September 18, 2001, the Commission established the Illinois Universal Service Fund pursuant to Section 13-301(d) of the Act. The Commission observed that Section 13-301(d) contemplates the establishment of a Universal Service Fund for the small companies if their *economic costs* of providing services for which universal service funds may be made available exceed the *affordable rate* established by the Commission for such services less any *federal universal service support* received for the costs of providing such services. (2nd Interim Order at 5; emphasis added)

In Docket 00-0233/00-0335, Alhambra filed a motion for additional IUSF on December 17, 2003. In it Fourth Interim Order entered April 7, 2004, the Commission denied the motion, without prejudice. The Commission observed, however, that nothing in the Act or the Commission's prior orders prohibit a LEC from seeking a change in the level of USF support it receives if its costs of providing the services eligible for support change during the first five years or sometime thereafter. The Commission further stated that if AGTC's costs of providing the services for which universal service support is available have increased, it is free to ask for an increase in USF support. The Commission provided some additional guidance on the issue, noting, among other things, that nothing in the Act or prior orders entitles a LEC seeking support to a specified rate of return.

In its final proposal in the present case, Alhambra, a local exchange carrier with 1,202 access lines in two exchanges in Bond and Madison Counties, seeks annual IUSF support of $101,322 for 2003 and annually thereafter pursuant to Section 13-301(d) of the Act. The Company had originally requested support of $213,781.

The basis of its petition for IUSF support is a purported "substantial change" in Alhambra's financial circumstances attributable to expenditures of $1,350,191 in network improvements. AGTC says it began a two-year construction project in 2003, involving 18 miles of copper cable and new fiber between the central offices and the two exchanges, "to upgrade its outside plant to improve voice-grade access to the network for local calls and to improve access to the toll network by installing an additional toll line to serve the Grantfork exchange." (AGTC brief at 10) These improvements will also allow for the provision of advanced services within the meaning of Section 13-517 of the Act, and in the opinions of SBC and Staff, were made primarily for that purpose.

As summarized above, Staff and SBC made a number of **policy arguments** in support of their position that the petition should be denied without being considered on the merits. For example, Staff says "administrative economy and the principle of equal treatment of similarly situated carriers require that AGTC's Petition be denied." Staff says the Commission has already decided upon the appropriate level of funding for IUSF eligible companies, and a "non-methodical, piecemeal review could lead to funding inequities among companies." (Staff brief at 14-15)

In the Commission's opinion, while these policy arguments do have some appeal, they do not appear to be in keeping with the findings in the Fourth Interim Order cited above. As such, these arguments do not provide a sufficient basis for rejecting the petition.

Regarding **costing methodologies**, the Commission observed in the Second Interim Order that Section 13-301(d) contemplates the establishment of a Universal Service Fund for the small companies if their economic costs of providing services for which universal service funds may be made available exceed the affordable rate established by the Commission for such services less any federal universal service support received for the costs of providing such services. (2nd Interim Order at 5)

As described more fully above, the Commission concluded that the use of a forward-looking cost model is appropriate in setting the legislatively permitted proxy cost for services eligible for USF support, and noted that HAI cost models were employed for that purpose. Truncated rate of return analyses were also performed for each LEC. USF funding requests were actually based on the ROR analyses, which produced substantially smaller amounts than did the forward-looking HAI cost models. (2nd Interim Order at 5, 13, 17, 36-37)

The Commission observed that both the HAI economic models and the ROR approach had serious limitations in terms of calculating USF support. Among other things, the HAI model tends to significantly overstate relevant costs. Rate of return analyses also have many shortcomings, one being that "ROR results, by their very nature, do not reveal information specific to the costs and revenues of the set of services that we determine to be potentially eligible for IUSF support. Rather, ROR results apply to the entire company on an overall basis." (2^{nd} Interim Order at 36-37)

After determining that qualifying amounts produced by the HAI models were well in excess of the purported revenue deficiency calculated using an ROR analyses, the cost element used in determining each LEC's Commission-approved IUSF support was based on the ROR analysis after certain adjustments were made thereto. As such, the ROR result is sometimes described as a limit or cap on the amount of funding to be allowed. Use of an ROR test also helps ensure that support is not being granted to a LEC that is overearning.

In this proceeding, Alhambra says it has basically used the same approach employed in 00-0233/00-0335, first calculating economic costs using the forward-looking HAI model employed in 00-0233, but then limiting or capping its funding request to $101,322 "using the identical ROR analysis employed in the 00-0233 docket . . . ." According to Alhambra's calculations, its request is well below the funding amount that would result from use of the HAI model. (AGTC brief at 13)

As described above, Staff and SBC take issue with Alhambra's approach, complaining that what Alhambra seeks "is a rate of return guaranteed through IUSF funding." They cite language in the Fourth Interim Order stating that "nothing in the Act or the Commission's prior orders entitles each recipient LEC seeking additional USF support to a specified rate of return", and that "[n]othing requires the Commission to use the same generic criteria used in establishing the USF and eligibility for USF support when evaluating a[n] individual LEC's request for additional subsidization." (Staff brief at 16, 21, citing 4th Interim Order at 7-8)

Having reviewed the arguments, the Commission agrees that is not required to use the same approach as was employed in 00-0233/00-0335. The Commission observes, however, that Staff and SBC do not appear to dispute Alhambra's assertions that it used the same approach employed in 00-0233/00-0335; that the economic costs estimated using the HAI model are greater than its revenues per line; or that HAI-based IUSF funding would exceed the ROR-based funding request. In fact, there is Staff testimony concurring "that once 'economic costs' are shown to be greater than revenues, actual IUSF support should be calculated as the difference between historical cost and not economic cost and revenue." (Staff Ex. 1.0 at 21)

Furthermore, Staff and SBC do not appear to propose an alternative to the costing approach employed in the earlier docket.

All things considered, the Commission concludes that an approach patterned after the one followed in 00-0233/00-0335, while hardly ideal, remains a reasonable proxy and may appropriately be used in this proceeding, except as otherwise noted below. It is difficult to reject the use of that approach out of hand, or the consequences of using it, despite its shortcomings, absent an alternative methodology. If other alternatives are proposed in the future, they will be duly considered.

As explained above, another argument made by Staff is that the Commission should require Alhambra and other LECs to satisfy a threshold "**compelling rationale**" test before becoming eligible for IUSF funding. Under the first element of the test, a LEC could only apply for funding upon demonstrating its rate of return is at least 3% below the target established in the IUSF proceeding. Second, the LEC would have to demonstrate that the reduced ROR is due to circumstances beyond its control. Without such a test, Staff avers, applications such as Alhambra's would "throw back the clock" to pre-1986 ROR regulation. (Staff brief at 23-24)

Having reviewed the arguments, the Commission does not believe the compelling rationale proposed by Staff in its rebuttal case should be applied in this proceeding. While Staff's underlying policy concerns are not without merit, the test appears to be considerably more restrictive than the guidance provided in the Second Interim Order, especially if applied on other than a prospective basis.

As indicated above, one of Alhambra's reasons for the plant upgrades was to make high-speed or **advanced services** available to 80% of its customers by January 1, 2005 pursuant to Section 13-517 of the Act. Alhambra says the upgrades were primarily needed "to improve voice-grade access to the network for local calls and to improve access to the toll network by installing an additional toll line to serve the Grantfork exchange." The Company is also apparently requesting that the Commission declare advanced service to be a supported service for Illinois universal service support.

It is noted that since Staff addressed this issue as part of its "compelling rationale" test, the parties arguments' are summarized in that portion of this order above.

Staff and SBC claim the reason and timing of the upgrades were primarily for advanced services, which is not an IUSF "supported service". They also contend that AGTC could have sought a waiver under Section 13-517, thereby avoiding the cost of improvements needed to provide advanced services. For these and other reasons, they contend that the petition should be denied.

First, regarding the waiver issue raised by Staff and SBC, the Commission views this argument as somewhat problematic from a public policy standpoint. The basic objective in Section 13-517 is to make advanced services available to subscribers, not to encourage waivers.

With regard to other advanced services-related arguments, the Commission declines, based on the record in this proceeding, to add advanced services to the list of USF supported services. According to the record, these services have not been designated as supported services by the FCC and the record does not dictate it here. However, Alhambra also contends that the FCC does in fact support those upgrades to the network that both improve voice-grade service and allow for the provisioning of advanced services. The Company also notes that Staff and SBC claim federal support associated with the upgrades will be received by Alhambra, and should be considered in the calculation of IUSF support as discussed below. (AGTC brief at 20-21)

With respect to the purpose and use of the Alhambra upgrades, they do appear to support both voice grade and advanced services. Whether some portion of the cost could or should be allocated to advanced services and in turn removed from the costs considered in the economic cost test and/or ROR analysis in arriving at an IUSF funding requirement is a question the Commission does not reach in this docket, as no proposals to make such adjustments to those analyses were made in the record. Under the circumstances, it is difficult to see how rejecting the filing in its entirety based on the purported presence of advanced services-related costs, outside the context of the economic cost or ROR tests, would be consistent with the manner in which these analyses and any adjustments thereto were evaluated in the 2nd Interim Order. There, the Commission noted that "ROR findings apply to the entire company on an overall basis." Where specific adjustments to those ROR results were quantified and proposed, they were duly considered and adopted where appropriate.

The record presented in this proceeding supports no further determinations on advanced services-related issues, and none are made in this order. The Commission does believe the relationship between advanced services and IUSF is a difficult issue that may warrant further consideration in future dockets.

As explained above, Staff and SBC also take issue with the necessity and timing of the upgrades in terms of supporting voice grade service. No adjustments to the economic or ROR analyses were proposed as such; rather, these arguments appear to be more in support of the basic position that the filing should be rejected in its entirety. Upon reviewing the record, it is difficult to conclude that the investment in network upgrades should be totally disregarded based on these prudency arguments.

As indicated above, Staff complained that AGTC failed to properly **allocate costs** to its unregulated subsidiaries in compensation for use of AGTC plant and services. Thereafter, three allocation adjustments were made by Alhambra in response to specific instances cited by Staff.

In view of AGTC's "subsidization practices", Staff's position is that instead of trying to determine what proportion of AGTC's costs should be allocated to A-G Long Distance, the Commission should simply consolidate the income statements of AGTC and A-G Long Distance for IUSF determination purposes. Adoption of the consolidation adjustment alone would eliminate all but $1,397 of AGTC's final IUSF funding request of $101,322. (Staff brief at 39)

Having reviewed the record, the Commission finds that Staff's consolidation proposal should not be adopted at this time. While sharing many of Staff's concerns, the Commission believes allocating such costs is the normal practice, rather than consolidating income statements, even for large companies where allocations present many difficult challenges. The Commission also notes that while Staff raised a legitimate question as to whether A-G Long distance was using AGTC's loops for DSL, without compensation, Alhambra later explained on rebuttal that A-G Long Distance actually buys DSL service from Alhambra at tariffed rates. In any event, while consolidation may be the more appropriate course in some instances, it appears that allocating costs is the more reasonable option in the instant docket.

As noted above, if its consolidation adjustment is not accepted, Staff proposes to allocate 5% of the expenses for executive functions, other general and administrative functions, accounting and finance and legal services to A-G Long Distance and 5% of such expenses to Alhambra-Grantfork Cellular. This adjustment, which Alhambra opposes, totals $20,111. (Staff Ex. 4.0 at 9-10 and Schedule 4.03)

The Commission finds that this allocation is appropriate. Based on the record, it is reasonable to conclude that the unregulated affiliates are receiving some benefit from such functions and services. The 5% allocation factor proposed by Staff represents a reasonable means of assessing a modest level of costs to the affiliates for such services.

Staff also recommends that the Commission authorize no IUSF funding until AGTC conducts a thorough review of its expenses to insure that all direct and indirect costs are properly assigned to Alhambra's non-regulated subsidiaries, using the cost allocation methodologies of 83 Ill. Adm. Code 712.

Based on the record, and the other determinations in this order on allocation and other issues, the Commission finds that no such requirement will be imposed with respect to the funding being requested in this docket. Whether such a review should be conducted with respect to any future funding requests is a question the Commission does not reach in this order, and no presumptions are created with respect thereto.

Under Section 13-301(d), IUSF support is contemplated when "economic costs" exceed the affordable rate "less any **federal universal service support** received for the same or similar costs of providing the supported services." (Staff brief at 37, quoting 220 ILCS 5/13-301)

As noted above, the basis of Alhambra's petition for IUSF support is a purported substantial change in its financial circumstances attributable to expenditures of approximately $1,350,000 in network improvements under a two-year construction project commencing in 2003.

Throughout the case, SBC and Staff have contended that Alhambra has not properly reflected the federal support it will receive as a result of this investment. For example, SBC says the financial data used to calculate FUSF High Cost Loop support is two years removed. That is, there is a two-year lag. Therefore, the inclusion of the 2004 financial data used by Mr. Schoonmaker to calculate future IUSF support should also include the 2006 FUSF HCL support that will be calculated based on adjusted 2004 data. (SBC Ex. 1.1 at 4)

Among other things, Alhambra asserts that 2006 amounts cannot be substantiated beyond 2005, and are not known and measurable.

The Commission has reviewed the record on this issue. Although Alhambra's position is well articulated in its briefs, the Commission finds that Alhambra has not properly reflected the effects of federal USF support associated with the project. It is undisputed that the request for relief is driven by the two-year upgrade commencing in 2003, and that Alhambra has included its costs of the project for both 2003 and 2004 in the “cost” element of the calculation of its purported funding requirement under Section 13-301(d).

However, Alhambra has excluded federal support for the same 2004 investment. In other words, Alhambra is including 2004 investment for the project in the cost side of the Section 13-301(d) formula, but is excluding federal support for the same 2004 investment in the federal support offset in the statutory formula. The existence of a two-year lag in the federal support, whereby support associated with the 2004 investment would not be received until 2006, does not somehow justify ignoring such support while including the costs for the same project in the cost side of the calculation. Under the circumstances, such “unbalanced equation” treatment would be illogical and asymmetrical, and would frustrate the formula in Section 13-301(d). Further, there is no rule, statutory provision or order that requires such a mismatch or the result thereof.

As indicated above, Alhambra has not properly reflected the federal USF offset contemplated in the formula in Section 13-301(d). As such, the Company has not demonstrated that its economic costs exceed the affordable rate less any federal universal service support within the meaning of Section 13-301(d). Its petition should be denied.

VII. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record, is of the opinion and finds that:

(1) Alhambra-Grantfork Telephone Company, Inc. is an Illinois corporation, a telecommunications carrier within the meaning of the Public Utilities Act, and is an incumbent local exchange carrier under Section 13-301(d) of the Act;

(2) the Commission has jurisdiction over Alhambra and the subject matter of this proceeding;

(3) the facts recited and conclusions reached in the prefatory portion of this Order are supported by the record and are hereby adopted as findings of fact and/or conclusions of law;

(4) Alhambra’s petition should be denied without prejudice as hereinafter set forth.

IT IS THEREFORE ORDERED that Alhambra-Grantfork Telephone Company, Inc.’s petition for universal service support pursuant to Section 13-301(d) of the Act is denied without prejudice.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.

By proposed order this 4th day of August, 2005.

Administrative Law Judge