

BEFORE THE
ILLINOIS COMMERCE COMMISSION

Alhambra – Grantfork Telephone)
Company:) Docket No. 04-0354
)
Petition for Universal Service Support)

STAFF OF THE ILLINOIS COMMERCE COMMISSION'S
BRIEF ON EXCEPTIONS

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Now comes the Staff of the Illinois Commerce Commission ("Staff"), by its attorneys, and pursuant to Section 200.830 of the Commission's Rules of Practice, 83 Ill. Adm. Code 200.830, and for its Brief on Exceptions in the above-captioned proceeding, states as follows:

I. Overview

Staff supports the ultimate conclusion reached by the Proposed Order in this proceeding, namely that the petition from Alhambra-Grantfork Telephone Company ("AGTC," "Alhambra," or "Company") for an adjustment to its universal service support should be denied. PO at 30. The Proposed Order correctly concludes that Alhambra's petition has not properly reflected likely increases in federal USF support that will arise from approximately \$1,350,000 in investments the Company undertook to upgrade its network. PO at 29-30. To be eligible for Illinois Universal Service Fund ("IUSF") support, under Section 13-301(d) of the Public Utilities Act, a small company, such as AGTC, must first fairly account for federal universal service support it is likely to receive. 220 ILCS 5/13-301(d). AGTC has, as the Proposed Order correctly finds, patently failed to account for its federal universal service support; consequently, the Commission is statutorily obligated to reject Alhambra's request for financial relief.

Although Staff agrees with the Proposed Order's overall conclusion, Staff recommends that the Commission use this proceeding to (1) establish filing guidelines for other small companies who may seek additional IUSF funding at

some point in the future (2) require small companies seeking IUSF support to separate investments and costs associated with IUSF supported services from investments and costs associated with non-IUSF supported services (i.e. advanced services) and (3) require small companies seeking IUSF support to follow the Commission's cost allocation rules. The Commission can achieve these three goals by adopting Staff's language in its order as proposed below.

II. The Commission should adopt the Compelling Rationale Test proposed by Staff

The Proposed Order concludes that the compelling rationale test advocated by Staff should not be applied in this proceeding. PO at 27. Although the Proposed Order acknowledges that Staff's underlying policy concerns are "not without merit," it further determines that the compelling rationale test appears "considerably more restrictive than the guidance provided in the Second Interim Order¹ in Docket Nos. 00-0233 and 00-0335 (Cons.), especially if the compelling rationale test is applied on other than a prospective basis". PO at 27.

As it stands currently, the Proposed Order provides no guidance for small companies seeking additional IUSF support over and above that granted in the Commission's several Orders in Docket Nos. 00-0233/0335. The Staff is of the

¹ Second Interim Order, Illinois Independent Telephone Association: Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act, ICC Docket Nos. 00-0233 / 00-0335 (Consolidated) (September 18, 2001).

opinion that the Commission ought, in its final Order in this proceeding, to provide precisely such guidance.

Establishing a compelling rationale test as contemplated by Staff will have several benefits. First, it will reduce regulatory expenses for small companies and the Commission by clearly articulating the circumstances under which small companies can apply for increased funding. Second, and conversely, adoption of the compelling rationale test will make clear the circumstances under which small companies do not qualify for additional IUSF support, thereby injecting a further degree of certainty into the process. Staff IB at 23.

As proposed by the Staff, the compelling rationale test would 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. Staff recommends a 3% threshold to ensure that a company can only apply for additional IUSF monies when there is a significant, as opposed to a trivial, deterioration in its finances. Second, a company would have to demonstrate that its 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) legislative requirements that impose additional costs, (b) a sudden increase or decrease in the number of lines served (5% since the Second Interim order on Rehearing), (c) a sudden increase or decrease in total access minutes (20% since the Second Interim Order on Rehearing), and (d) a sudden increase or decrease in input prices (interest rates and equipment costs, but not wages). Staff IB at 23-24. The Commission has, in the past, approved the use of a

mechanism very much like the compelling rationale test, since it is patterned after the “Z” term in SBC’s price cap regulation formula (Docket No. 98-0252). Staff RB at 11.

In the Second Interim Order, the Commission concluded that “we will examine [the] issue [of whether the fund size should be mitigated by sums expected to be forthcoming from recent enactments by the FCC] as well as determine the necessity of and, if found necessary, the manner in which the USF fund will be adjusted in the future[.]” Second Interim Order at 58. Staff has, in this proceeding, recommended a procedure by which the IUSF fund should be adjusted in the future, precisely as the Commission urged in the Second Interim Order. Staff has clearly articulated a solution that has worked in the Alternative Regulation proceeding² and will similarly prove viable for small companies in future IUSF proceedings.

The Proposed Order appears to conclude that, if enacted, the compelling rationale test should only be applied on a prospective basis. PO at 27. Staff sees merit in this recommended conclusion, since it might appear to be unfair to judge AGTC’s application for increased IUSF support by criteria that did not exist at the time that AGTC filed for increased funding. Consequently, Staff proposes the following wording change to the Proposed Order at 27:

² See, e.g., Final Commission Order, Illinois Bell Telephone Company: Application for review of alternative regulation plan / Illinois Bell Telephone Company: Petition to Rebalance Illinois Bell Telephone Company’s Carrier Access and Network Access Line Rates / Citizens Utility Board and the People of the State of Illinois -vs- Illinois Bell Telephone Company: Verified Complaint for a Reduction in Illinois Bell Telephone Company’s Rates and Other Relief, ICC Docket No. 98-0252/0335; 00-0764 (consol.) (December 30, 2002) (hereafter “Alt Reg Review Order”)

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

III. The Commission should require AGTC to allocate some of its investment upgrade costs to advanced services if it files for rehearing in this case

The Proposed Order correctly declines, based on the record of this proceeding, to add advanced services to the list of USF supported services. PO at 27. The Proposed Order notes that these services have not been designated as supported services by the FCC, and the record does not dictate it for this proceeding. Id. However, the Proposed Order then concludes that, although AGTC's upgrades appear to support both voice and advanced services, AGTC should not be required to allocate some of its investment upgrade costs to advanced services in arriving at an IUSF funding requirement. PO at 27-28. In support of this line of reasoning, the Proposed Order quotes the Second Interim Order's observation that "ROR [rate of return] findings apply to the entire company on an overall basis".³ PO at 28, *citing Second Interim Order* at 38.

³ The Second Interim Order's observation that "ROR findings apply to the entire company on an overall basis[.]" should be viewed in its proper context. The Commission determined that ROR information was, "inherently an inappropriate tool for the task at hand and cannot be relied upon," and the Commission could not "place much reliance on the ROR information available to [it]", precisely because it applies to the entire company. Second Interim Order at 38.

Staff concurs in the Proposed Order's conclusion that the relationship between advanced services and IUSF is a difficult issue that may warrant further consideration in future proceedings. Indeed, the Commission at some point in time may decide to deem advanced services eligible for IUSF support. However, at this time the Commission has not determined that advanced services should be eligible for IUSF support under Section 13-301(d); consequently, the costs associated with advanced services must be removed from AGTC's IUSF funding request. If the Proposed Order does not require AGTC to allocate some of its investment costs to advanced services and subsequently remove these allocated advanced service costs from its IUSF funding request, then the Proposed Order will have implicitly allowed AGTC subsidies for advanced services, a policy which is inconsistent with its own explicit findings in this proceeding.

The Proposed Order determines that no cost allocations between supported services and advanced services need be made, since none were proposed by the parties. PO at 27-28. This finding, however, ignores several pertinent matters.

First, the Proposed Order ignores the fact that Staff did indeed propose an allocation methodology, albeit a somewhat unusual one. AGTC made no attempt whatever to allocate costs to its unregulated affiliates until Staff's investigation; by carefully reviewing AGTC's books, Staff was able to demonstrate 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 Ex. 1.0 at 4-5; 2.0 at 13-16. AGTC itself recognized that this was the case, and

adjusted its funding request accordingly. AGTC Ex. 4.0 at 2 – 3. AGTC has reduced its request for funding by over 50% as a result of Staff’s review. AGTC Ex. 5.0 at 23. Indeed, the Proposed Order implicitly recognizes the validity of Staff’s concern by requiring AGTC to allocate 5% of expenses associated with its executive functions, general and administrative functions, and accounting, finance and legal services to its wireless affiliate, and 5% of these costs to its long distance affiliate, consistent with Staff’s recommendation that this be done. PO at 29; see *also* Staff Ex. 1.0 at 4-5, Staff Ex. 4.0R at 9-10, Schedule 4.03, and Schedule 4.01, line 28, column c; and Staff IB, Schedule 1, line 28, column c.

In light of all of this evidence of improper allocation pervading AGTC’s operations, Staff recommended that AGTC’s income and expenses be consolidated with those of its long distance affiliate. Staff Ex. 2.0 at 13-15; 4.0 at 13; Staff Ex. 2.0, Schedule 2.01, line 28, columns d and e; Schedule 2.06. It cannot therefore be said that Staff has not proposed allocations; indeed, it has proposed – in its Direct Testimony – consolidation as the best available course in light of AGTC’s demonstrated failure to make proper allocations. Id.

Second, and related, AGTC – and no other party – is responsible for allocation of costs and expenses; as the Commission found in its Fourth Interim Order⁴, “AGTC bears the burden of establishing that additional USF support is

⁴ Fourth Interim Order, Illinois Independent Telephone Association: Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with Section 13-301(d) of the Public Utilities Act / Illinois Commerce Commission On Its Own Motion: Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act, ICC Docket Nos. 00-0233 / 00-0335 (Consolidated) (April 7, 2004).

appropriate[.]” Fourth Interim Order at 8. Accordingly, AGTC has the burden of proof in this proceeding. AGTC, however, concedes that the network improvements that are the subject of this proceeding were undertaken, “partially in response to the passage of 220 ILCS 5/13-517 (which requires all ILECS to provide advance [sic] services to 80% of their subscribers by January 1, 2005)[.]” AGTC IB at 10. Moreover, as the Proposed Order recognizes, AGTC seeks a declaration that advanced service (provided by AGTC, at least) be declared supported services within the meaning of Section 13-301(d). AGTC Petition, ¶6.

This being the case, it is clear that some allocation is necessary in this case. The fact remains, however, that the party with the burden of proof, AGTC, also has the burden of making this allocation, but has failed to do so. The Petition can, and in the Staff’s view, should be rejected on this basis.

Staff has argued in this proceeding that AGTC could have sought a waiver under Section 13-517, thereby avoiding the cost of improvements needed to provide advanced services. See, e.g., Staff IB at 26-27. The Proposed Order addresses this argument by noting that the basic objective in Section 13-517 is to make advanced services available to subscribers, not to encourage waivers. PO at 27. This finding, while correct in its appraisal of legislative intent, nonetheless ignores that fact that the same legislation contains provisions that permit the Commission to grant waivers where “compliance with the requirements of ... Section [13-517] would be unduly economically burdensome ... or otherwise impractical in exchanges with low population density.” 220 ILCS 5/13-517(b). The Staff does not argue that waivers are desirable; rather, it argues that seeking one

may be a proper course of action for a carrier that would experience undue economic burdens if it were in fact required to provide advanced services – which are, after all, not supported by the IUSF. If AGTC considered it likely that provisioning advanced services in order to meet its statutory obligations would place a financial strain upon the company, or otherwise be economically burdensome, it could have sought a waiver pursuant to Section 13-517(b). The company, however, made the business decision not to pursue a waiver, and the proper conclusion for the Commission to reach is that AGTC must have believed that it did not need a waiver, and was able to provide advanced services in compliance with Section 13-517 through the use of its own resources, since the IUSF does not support advanced service provision. Its attempt to recover from the IUSF costs associated with the provision of advanced services is therefore improper.

Further, in traditional rate of return (“ROR”) cases, the Commission has frequently disallowed expenses attributed to the regulated entity, and removed these expenses from the ROR calculation, because it was more appropriate to assign these disputed costs to unregulated affiliates. Indeed, as the Proposed Order recognizes, PO at 28, the Commission did precisely this in its Second Interim Order, when, for example, it declined to recognize for IUSF purposes a lease expense that the Moultrie Independent Telephone Company attempted to recover. Second Interim Order at 39-41, 53-54. Similarly, in this proceeding the Commission should disallow advanced service investment costs for ROR and IUSF determination purposes. Advanced service investment costs should be

assigned to AGTC's unregulated advanced service affiliate and not be part of the parent company's ROR base. Consequently, the "ROR findings" that the Second Interim Order deemed applicable to the entire company should be interpreted to mean ROR findings for the entire company's voice grade services and only for the entire company's voice grade services. The advanced service cost allocation issue was not well developed in the record of the Second Interim Order, but is ripe for ruling in this proceeding.

In this proceeding, AGTC made no effort to allocate any of its investment costs to advanced services, even though AGTC itself acknowledges that company management fully intended its recent capital expenditures to be used in part to support advanced services. See, e.g., AGTC IB at 10. AGTC, and not Staff, has the burden to make the proper allocation of AGTC's investments to advanced services, as noted above. To ensure that advanced service costs are not improperly subsidized by the IUSF, the Commission must order AGTC (and other small companies who wish to apply for increased IUSF funding in the future) to remove advanced service costs from any future ROR and IUSF funding request. Consequently, Staff proposes the following wording change to the Proposed Order at 27-28:

With respect to the purpose and use of Alhambra upgrades, they do appear to support both voice grade and advanced services. ~~Whether~~ Consequently, 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. What portion is a ~~question~~ decision the Commission does not reach in this docket, as no

~~proposals to make such adjustments to those analyses were made in the record, notwithstanding the fact that AGTC had the burden of making and justifying such allocation inasmuch as the Commission denies the Petition on other grounds. Nevertheless, the Commission orders that in future IUSF filings small companies must properly allocate investment costs between those costs that are necessary for voice services and those costs that are more appropriately assigned to advanced services. Furthermore any costs assigned to advanced services must be removed from the economic cost test/ROR analysis. Under the circumstances, it is difficult to see how rejecting the filing in its entirety based on 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 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.~~

IV. The Commission should require the use of allocation methodologies contained in the Commission's rules in future IUSF filings

The Proposed Order fails to require AGTC to conduct a thorough review of its allocations to ensure that all costs are properly assigned to AGTC non-regulated subsidiaries using the cost allocation methodologies of 83 Ill. Adm. Code 712, "Cost Allocation for Small Local Exchange Carriers." PO at 29. Since the Proposed Order recommends denial of AGTC's petition without prejudice, such a review is unnecessary here. However, the Commission should require a proper review of assignment of costs to non-regulated affiliates in any subsequent filing by AGTC or any other carrier seeking increased IUSF support.

In its current form, the Proposed Order declines to require small companies to follow the Commission's cost allocation rules when seeking additional IUSF support. However, Code Part 712 is clearly intended for precisely the purpose for which Staff advocates its use here: namely, to allocate costs among affiliates and to "apportion costs to regulated and nonregulated activities in each local exchange carrier." 83 Ill. Adm. Code 712.25 and 712.100. Code Part 712 directs the allocations of costs among affiliates, such as the long-distance affiliate and the cellular affiliate and the apportionment of costs to non-regulated advanced services activities within the local exchange carrier. Id. Requiring the assignment of costs pursuant to 83 Ill. Adm. Code 712, as recommended by Staff, would reduce regulatory expenses for small companies and the Commission, by removing this regulatory uncertainty, and is, in any case, required by the rule itself.

The Proposed Order nonetheless concludes that AGTC should not have to assign costs in the manner required by the Commission's own administrative rule. Consequently, Staff proposes the following wording changes to the Proposed Order at 29:

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. The Commission finds that the use of the cost allocation and apportionment methodologies of 83 Ill. Adm. Code 712 will be an aid in properly assigning costs to non-regulated affiliates, and, accordingly, directs its use in all future filings in which increased IUSF support is sought.

~~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.~~

V. Conclusion

WHEREFORE, for all of the reasons articulated above, the Staff of the Illinois Commerce Commission hereby requests that its recommendations to the Commission be adopted.

Respectfully submitted,

/s/ _____

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