

**STATE OF ILLINOIS  
ILLINOIS COMMERCE COMMISSION**

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<b>Illinois Commerce Commission</b>	)	
<b>On Its Own Motion</b>	)	
<b>vs.</b>	)	<b>Docket No. 06-0562</b>
<b>Illinois Bell Telephone Company,</b>	)	
<b>Verizon North, Inc., and Verizon South, Inc.</b>	)	
	)	
<b>Investigation into the applicability of Section</b>	)	
<b>2-202 of the Public Utilities Act to intrastate</b>	)	
<b>coin drop pay telephone revenues</b>	)	

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**JOINT DRAFT ORDER OF AT&T ILLINOIS AND VERIZON**

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**JOINT DRAFT ORDER OF AT&T ILLINOIS AND VERIZON**

By the Commission:

**I. PROCEDURAL HISTORY**

On August 16, 2006, the Illinois Commerce Commission (the “Commission”) issued an order initiating this proceeding (“*Initiating Order*”) for the purpose of investigating whether intrastate coin drop pay telephone revenues collected by Illinois Bell Telephone Company (“AT&T Illinois”) and Verizon North Inc. and Verizon South Inc. (collectively “Verizon”) are “gross revenue” as defined in the Illinois Public Utilities Act (the “PUA”) and subject to the tax on gross revenues under Section 2-202 of the PUA. *Initiating Order* at 2-3. AT&T Illinois and Verizon were made respondents to this proceeding. *Id.* The investigation was initiated upon Staff’s recommendation, as set forth in the “Telecommunications Division Staff Report” (“Staff Report”) dated August 1, 2006. The Staff Report was made a part of the record in this proceeding. *Initiating Order* at 3.

Pursuant to notice, status hearings were held on August 30 and November 20, 2006.

On September 20, 2006, a petition to intervene was filed on behalf of Gallatin River Communications L.L.C. No party objected to that petition.

In accordance with the procedural schedule established at the August 30, 2006 status hearing, AT&T Illinois, Verizon and Staff each filed verified initial comments on October 17, 2006 and reply comments on November 14, 2006. Concurrently with its initial comments, AT&T Illinois also filed supporting affidavits of Larry G. Parker, Timothy Dominak, and Louise A. Sunderland. Concurrently with its reply comments, AT&T Illinois filed the supporting reply affidavit of Timothy Dominak.

At the November 20, 2006 status hearing, AT&T Illinois and Verizon were granted an opportunity to file surreply comments for the purpose of responding to portions of Staff’s reply

comments. Also at that hearing, the parties agreed that there was no need for hearings to cross-examine witnesses with respect to the verified comments and/or the supporting affidavits.

In accordance with the schedule established at the November 20, 2006 hearing, AT&T Illinois and Verizon each filed surreply comments on December 6, 2006. AT&T Illinois and Verizon filed a joint draft order on January 19, 2007. Staff also filed a draft order on that date.

## II. BACKGROUND TO THE CASE

In 1996, Congress enacted Section 276 of the Telecommunications Act of 1996 (the “1996 Act”) “to promote competition among payphone service providers” by directing the FCC to “establish a per call compensation plan to ensure that all payphone service providers are fairly compensated for each and every completed call using their payphone.” 47 U.S.C. §§ 276(b)(1), 276(b)(1)(A). Pursuant to its authority under Section 276, the FCC concluded that, after October 7, 1997, the market “should set the compensation amount for all payphone calls, including local coin calls,” unless “market failures” can be demonstrated to exist. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC 96-388, ¶¶ 56, 60-61 (rel. Sept. 20, 1996) (the “*Payphone Order*”). The FCC concluded that a “deregulatory market-based approach to setting local coin rates is appropriate.” *Id.* at ¶ 58. In its *Order on Reconsideration*, the FCC reaffirmed this approach, which it described as the “deregulation of local coin rates.” *Order on Reconsideration*, FCC 96-439, ¶ 10 (rel. Nov. 8, 1996).

Section 276(c) of the 1996 Act provides that the FCC’s authority with respect to compensation for payphone calls is preemptive: “To the extent that any State requirements are inconsistent with the [FCC’s] regulations, the [FCC’s] regulations on such matters, shall preempt such State regulations.” 47 U.S.C. ¶ 276(c). Accordingly, the FCC’s *Payphone Order* preempts state regulation of rates for local coin payphone calls after October 7, 1997. The preemptive effect of the *Payphone Order* was recognized and affirmed on appeal. *Illinois Public Telecommunications Ass’n. v. FCC*, 117 F.3d555, 561-63 (D.C. Cir. 1997) (“*Ill. Pub. Tel. Ass’n*”) (holding that the FCC “has been given an express mandate to preempt State regulation of local coin calls”).

In a subsequent accounting order, the FCC made it clear that “the *Payphone Order* deregulated” local coin payphone service and directed that revenues from such “nonregulated payphone service” be recorded in Account 5010 of the FCC’s Uniform System of Accounts (“USOA”), which has been adopted by this Commission. *Local Exchange Carriers Permanent Cost Allocation Manual for the Separation of Regulated and Nonregulated Costs*. AAD 97-9, et al., *Memorandum Opinion and Order*, DA 97-1244, ¶¶ 16, 17 (rel. June 13, 1997). The FCC later authorized ILECs to transfer payphone revenues in Account 5010 to Account 5280, “Nonregulated Revenues.” *United States Telephone Association Petition for Waiver of Part 32 of the Commission’s Rules*, AAD 97-103, Order (rel. Dec. 31, 1997). In accordance with these accounting rules, beginning in 1997, AT&T Illinois has recorded revenue from the provision of local (Bands A and B) coin payphone services in Account 5280, “Nonregulated Revenue.”

Pursuant to the *Payphone Order's* preemptive deregulation of local coin payphone rates, AT&T Illinois filed tariff sheets (Advice No. 5819) on March 25, 1998, to implement the detariffing of its local coin payphone rates, effective March 31, 1998. As explained in both the transmittal letter and the Background Memorandum accompanying the filing, the only rates being detariffed were those for local (Bands A and B) coin sent calls, i.e., the rates for which state regulation was preempted by the FCC. AT&T Illinois has not detariffed rates for non-local (Band C and intraLATA toll) coin calls or rates for non-sent paid calls (collect and calling card calls). (Parker Affidavit, ¶¶ 8, 9). The detariffing of local coin payphone rates was allowed to take effect and the Commission has never initiated an investigation into the March 25, 1998 filing.

AT&T Illinois and Verizon each file an Annual Gross Revenue Return with the Commission each year. The Annual Gross Revenue Return is used to calculate the amount of Gross Revenue subject to the public utility fund ("PUF") tax under Section 5/2-202 of the PUA. In calculating Gross Revenue, AT&T Illinois deducts nonregulated revenue booked to Account 5280. For each year beginning with 1997, the revenue booked to Account 5280 (and, consequently, the revenue deducted from reported taxable Gross Revenue) has included revenue derived from local coin payphone service. (Dominak Affidavit, ¶ 4). Since 1997, Verizon has also consistently excluded local coin payphone revenue from the calculation of taxable Gross Revenue.

The Commission Staff first contacted AT&T Illinois and Verizon regarding their treatment of local coin payphone revenues for PUF tax purposes on November 8, 2004, when Bill Baima of the Commission's Financial Information Section sent a letter to each company asserting that payphone revenues are "taxable and should also be tariffed." ("Baima Letter," Exhibit A to Verizon's Initial Comments). Mr. Baima requested that AT&T Illinois and Verizon review their Annual Gross Revenue Tax Returns for the years 1998 through 2003 "and verify that these revenues were properly calculated and included in the tax calculations on the tax returns filed for these years." (*Id.*).

Verizon responded to Mr. Baima's letter by advising in a December 29, 2004 letter from Philip J. Wood ("Wood Letter," Exhibit B to Verizon's Initial Comments) that Verizon "respectfully disagrees that unregulated payphone and collocation revenues ("P & C Revenues") must be included in the calculation of the ICC administration fee under 220 ILCS 5/2-202." The Wood Letter noted that unregulated payphone revenues are not subject to the Commission's regulatory oversight and therefore not properly included in the calculation of the PUF tax, since unregulated payphone rates are not subject to the tariffing requirements of 220 ILCS 5/9-102. Verizon also noted that it had not deviated from its past PUF tax calculation practices (which the Commission had never before challenged), and that in any event, the amount at issue was minimal.

In a letter dated December 22, 2004, AT&T Illinois also responded to Mr. Baima's letter, explaining that "while [AT&T Illinois] agrees that revenue derived from intrastate payphone services for which rates are subject to Commission regulation are subject to the PUF tax, that tax does not apply to revenues from non-regulated payphone operations, including the provisioning of local coin payphone service and payphone customer premises equipment ("CPE")." (Sch.

TD-2). AT&T Illinois advised Mr. Baima that it had “reviewed its Annual Gross Tax Returns for each of the years 1998 through 2003 and verified that it correctly included revenues from regulated intrastate payphone operations in the calculation of Gross Revenues on which the PUF tax was calculated for each year.” (*Id.*, ¶ 7).

AT&T Illinois further informed Mr. Baima that, in the course of its review, AT&T Illinois discovered that it had overstated the amount of taxable Gross Revenue for the years 1998 through 2001 as a result of the inclusion of certain revenues, including wholesale revenues, mobile access revenues, fees, non-regulated semi-public payphone revenues, and imputed revenues for which no actual billing is received and no cash is ever realized. (Dominak Aff., Sch. TD-2, p. 2; Dominak Reply Aff., ¶ 2). AT&T Illinois, therefore, submitted with its letter Amended Returns for the years in question. As a result of the Amended Returns, AT&T Illinois asserts that it is owed a PUF tax credit of \$905,318. Follow-up requests for issuance of the credit were made by AT&T Illinois in letters sent to Mr. Baima on April 27, 2005 and June 30, 2006. AT&T Illinois has not yet received any portion of the claimed PUF tax credit from the Commission. (Dominak Affidavit, ¶ 7).

Prior to the initiation of this proceeding on August 16, 2006, when the August 1, 2006 Staff Report was made available for review, neither AT&T Illinois nor Verizon received any response from the Staff or the Commission to the explanations of their positions on the applicability of the PUF tax to nonregulated local coin payphone revenues, as set forth in their December 2004 letters to Mr. Baima. In its Report, Staff continues to contend that PUF taxes are due on revenues from intrastate coin drop rates for pay telephone services provided in Illinois.

### **III. GOVERNING STATUTES**

#### **A. 220 ILCS 5/2-202(c)**

Section 2-202(c) of the PUA sets forth the PUF tax obligations of providers in pertinent part as follows:

A tax is imposed upon each public utility subject to the provisions of this Act equal to .08% of its gross revenue for each calendar year commencing with the calendar year beginning January 1, 1982, except that the Commission may, by rule, establish a different rate no greater than 0.1%. For purposes of this Section, "gross revenue" shall not include revenue from the production, transmission, distribution, sale, delivery, or furnishing of electricity. "Gross revenue" shall not include amounts paid by telecommunications retailers under the Telecommunications Infrastructure Maintenance Fee Act.

#### **B. 220 ILCS 5/3-120**

Section 3-120 of the PUA defines “intrastate public utility business” as follows:

As used in Section 3-121 of this Act, the term "intrastate public utility business" includes all that portion of the business of the public utilities designated in Section 3-105 of this Act and over which this Commission has jurisdiction under the provisions of this Act.

**C. 220 ILCS 5/3-121**

For purposes of the PUF tax provisions of Section 2-202, Section 3-121 of the PUA defines “gross revenue” as follows:

As used in Section 2-202 of this Act, the term "gross revenue" includes all revenue which (1) is collected by a public utility subject to regulations under this Act (a) pursuant to the rates, other charges, and classifications which it is required to file under Section 9-102 of this Act and (b) pursuant to emergency rates as permitted by Section 9-104 of this Act, and (2) is derived from the intrastate public utility business of such a utility. Such term does not include revenue derived by such a public utility from the sale of public utility services, products or commodities to another public utility, to an electric cooperative, or to a natural gas cooperative for resale by such public utility, electric cooperative, or natural gas cooperative. "Gross revenue" shall not include any charges added to customers' bills pursuant to the provisions of Section 9-221, 9-221.1 and 9-222 of this Act or consideration received from business enterprises certified under Section 9-222.1 of this Act to the extent of such exemption and during the period in which the exemption is in effect.

**D. 220 ILCS 5/9-102**

Section 9-102 of the PUA provides as follows:

Every public utility shall file with the Commission and shall print and keep open to public inspection schedules showing all rates and other charges, and classifications, which are in force at the time for any product or commodity furnished or to be furnished by it, or for any service performed by it, or for any service in connection therewith, or performed by any public utility controlled or operated by it. Every public utility shall file with and as a part of such schedule and shall state separately all rules, regulations, storage or other charges, privileges and contracts that in any manner affect the rates charged or to be charged for any service. Such schedule shall be filed for all services performed wholly or partly within this State, and the rates and other charges and classifications shall not, without the consent of the Commission, exceed those in effect on December 31, 1985. But nothing in this section shall prevent the Commission from approving or fixing rates or other charges or classifications from time to time, in excess of or less than those shown by said schedules.

Where a schedule of joint rates or other charges, or classifications is or may be in force between two or more public utilities such schedules shall in like manner be printed and filed with the Commission, and so much thereof as the Commission shall deem necessary for the use of the public shall be filed in every office of such public utility in accordance with the terms of Section 9-103 of this Act. Unless otherwise ordered by the Commission a schedule showing such joint rates or other charges, or classifications need not be filed with the Commission by more than one of the parties to it: Provided, that there is also

filed with the Commission a concurrence in such schedule by each of the other parties thereto.

Every public utility shall file with the Commission copies of all contracts, agreements or arrangements with other public utilities, in relation to any service, product or commodity affected by the provisions of this Act, to which it may be a party, and copies of all other contracts, agreements or arrangements with any other person or corporation affecting in the judgment of the Commission the cost to such public utility of any service, product or commodity.

**E. 220 ILCS 5/13-503**

Section 13-503 of the PUA provides as follows:

With respect to rates or other charges made, demanded or received for any telecommunications service offered, provided or to be provided, whether such service is competitive or noncompetitive, telecommunications carriers shall comply with the publication and filing provisions of Sections 9-101, 9-102, and 9-103.

**IV. OVERVIEW OF THE PARTIES' POSITIONS**

**A. SUMMARY OF AT&T ILLINOIS' POSITION**

AT&T Illinois takes the position that revenue derived from local coin payphone calls is not subject to the PUF tax. According to AT&T Illinois, the PUF tax is a tax imposed on a public utility's "gross revenues." 220 ILCS 5/2-202(c). For purposes of the PUF tax, "gross revenues" means "revenue which is collected by a utility subject to regulations under this Act (a) pursuant to the rates, other charges, and classifications which it is required to file under Section 9-102 of this Act and . . . (2) is derived from the intrastate public utility business of such a utility." 220 ILCS 2/3-121. Section 9-102 of the PUA refers to the tariff filing requirements to which the regulated rates and charges of telecommunications services are subject pursuant to 13-503 of the PUA. 220 ILCS 5/13-503. The term "intrastate public utility business" means that portion of a public utility's business "over which this Commission has jurisdiction under the provisions of this Act." 220 ILCS 5/3-120.

Based on these statutory provisions, AT&T Illinois contends that "Gross Revenues" do not include revenues collected under rates or charges that are not subject to regulation (including tariffing requirements) under the PUA and over which the Commission does not have jurisdiction. According to AT&T Illinois, the FCC, pursuant to its authority under Section 276 of the 1996 Act, preempted state regulation of the rates charged by AT&T Illinois for coin-sent local payphone calls, effective October 7, 1997. *Payphone Order*, ¶¶ 55-61; *Illinois Public Telecommunications Ass'n. v. FCC*, 117 F.3d 555, 561-63 (D.C. Cir. 1997) (holding that FCC "has been given an express mandate to preempt State regulation of local coin calls"). AT&T Illinois notes that, in its Reply Comments, Staff expressly acknowledges that the FCC has "removed state authority" to regulate the rates charged by AT&T Illinois and other carriers for coin-sent local payphone rates. (Staff Reply Comments, p. 2). Accordingly, AT&T Illinois

concludes, revenues derived from local coin payphone calls clearly do not constitute “gross revenues” within the meaning of Section 3-121 of the PUA and, therefore, are not subject to the PUF tax.

In response to the Staff Report’s assertion that states “retain jurisdiction over payphone services although they no longer set local coin rates” (Staff Report, p. 2), AT&T Illinois argues that the fact that the Commission may retain jurisdiction over some aspects of payphone services other than local coin rates does not make the revenues derived from local coin rates part of “gross revenues” under Section 3-121 of the PUA. According to AT&T Illinois, under Section 3-121, the relevant factor in determining whether the PUF tax applies is whether the rates and charges for a particular service are subject to regulation, including the tariffing requirement under Section 9-102 of the PUA. If the rates for a service are *not* subject to such regulation, the revenues derived from those rates are not subject to the PUF tax even if the Commission retains jurisdiction to regulate non-rate aspects of the service. Thus, for example, the Illinois Appellate Court has held that because the Commission has “excluded the cellular industry from rate regulation,” rates charged by cellular companies are not subject to PUF tax liability even though the Commission retains authority to regulate other aspects of cellular service. *Chicago SMSA Limited Partnership v. Illinois Dept. of Revenue*, 306 Ill. App. 3d 977, 984 (1<sup>st</sup> Dist. 1999), citing *Chicago SMSA, Ltd. Partnership v. Illinois Commerce Commission*, 284 Ill. App. 3d 326 (1996).

AT&T Illinois notes that the Staff Report also asserts that “states continue to have the ability to set rates for local collect calls from payphones” and that regional Bell operating companies are required by the FCC to “tariff wholesale payphone service rates.” (Staff Report, p. 2). AT&T Illinois contends that these assertions are irrelevant, because the only intrastate retail payphone revenues that AT&T Illinois excludes from “gross revenues” are revenues from local coin-sent calls; AT&T Illinois has always paid the PUF tax on local *collect* calls. AT&T Illinois notes that revenues from wholesale payphone service, on the other hand, are excluded from “gross revenues” pursuant to the provision of Section 3-121 which states that the term “gross revenues” “does not include revenue derived by such a public utility from the sale of public utility services, products or commodities to another public utility . . . for resale by such public utility.” 220 ILCS 5/3-121. According to AT&T Illinois, the wholesale service exclusion from the definition of “gross revenues” is not at issue in this case.

AT&T Illinois observes that Staff devotes nearly all of its initial Comments to arguing that the statutory provisions governing the PUF tax were not preempted by the Payphone Order as either “improper rate regulation” or a “barrier to entry or exit” (Staff Comments, pp. 6-16). AT&T Illinois asserts that Staff’s arguments are beside the point because the question is not whether the statutory provisions governing application of the PUF tax have been preempted; AT&T Illinois does not make such an assertion. Rather, the question is whether those provisions, by their terms, apply to revenues collected under rates which are not subject to regulation and the Section 9-102 tariffing requirement. According to AT&T Illinois, the answer to that question is unquestionably “no.” Therefore, because rates for local coin-sent payphone calls are not subject to regulation, including the Section 9-102 tariffing requirement, revenues collected under those rates are not, as a matter of state law, subject to the PUF tax.

AT&T Illinois also responds to Staff's argument that the FCC did not preempt the imposition of tariff requirements for payphone services. AT&T Illinois notes that, in support of this position, Staff relies on the FCC's statement that states "remain free to impose regulations, on a competitively neutral basis, to provide customers with information and price disclosure." (Staff Init. Comments, p. 11). AT&T Illinois, however, contends that the FCC did not state that such "information and price disclosure" can, or should, take the form of a tariff. Furthermore, AT&T Illinois argues, for purposes of the definition of "gross revenues" under Section 3-121, the relevant question is whether local coin payphone rates constitute rates that telecommunications carriers are "required to file under Section 9-102" of the PUA. 220 ILCS 5/3-121. AT&T Illinois asserts that, contrary to Staff's suggestion (Comments, p. 16), Section 9-102 is not merely a "regulation tending to provide 'price disclosure.'" Rather, as the Illinois Appellate Court has expressly held, Section 9-102 is an integral part of the PUA's scheme for "regulat[ing] public utilities with respect to the reasonableness of rates." *Citizens Utility Board v. Illinois Commerce Commission*, 275 Ill. App. 3d 329, 338 (1<sup>st</sup> Dist. 1995).

In fact, AT&T Illinois contends, there is no "informational only" tariffing requirement for nonregulated rates under any provision of the PUA. AT&T Illinois asserts that this fact was recognized by the Commission's Office of General Counsel ("OGC") in 1998 when it agreed with AT&T Illinois that the *Payphone Order* allowed AT&T Illinois to detariff its local payphone coin rates. (Sunderland Affidavit, ¶ 8). AT&T Illinois argues that, contrary to Staff's suggestion (Comments, pp. 16-17), the Section 9-102 tariffing requirement is no less a form of rate regulation when applied to competitive telecommunications services than it is when applied to noncompetitive telecommunications services. Tariffed competitive service rates are required to be "just and reasonable" (220 ILCS 5/13-101) and are subject to Commission review for reasonableness in complaint or investigatory proceedings under Section 9-250 (220 ILCS 5/13-505(b)).<sup>1</sup>

Thus, AT&T Illinois concludes, the FCC's reference to states' ability to require "information and price disclosure" does not permit the Commission to impose the PUA's tariffing requirements on local coin payphone rates. Rather, the *Payphone Order* would allow the Commission to adopt information and price disclosure requirements that do not involve Section 9-102 tariffs. For example, the FCC would permit states to require a certain amount of rate disclosure on the payphone placard or require the establishment of toll-free numbers where customers can obtain payphone rate quotes. By preempting the Commission from regulating local coin payphone rates, however, the FCC necessarily also preempted the Commission from imposing the tariffing requirement under Section 9-102.

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<sup>1</sup> According to AT&T Illinois, the fact that tariffing requirements are an aspect of rate regulation is recognized by the Uniform System of Accounts for Telecommunications Carriers in Illinois. The instructions for "regulated accounts" states that "regulated accounts shall be interpreted to include the investments, revenues and expenses associated with those telecommunications products and services to which the tariff filing requirements are applied, except as may be otherwise provided in 83 Ill. Admin. Code 711.15 or 712.15." 47 U.S.C. § 32.14, as modified and adopted in 83 Ill. Admin. Code Section 710.14. The accounting instructions further provide that "[p]reemptively deregulated activities . . . will be classified as 'non-regulated.'" 47 U.S.C. § 32.23, as modified and adopted in 83 Ill. Admin. Code Section 710.23. Pursuant to the FCC's direction, AT&T Illinois accounts for local coin payphone revenue as "non-regulated."

AT&T Illinois argues that, in the event that the Commission disagrees with AT&T Illinois' position and accepts the Staff Report's argument that local coin payphone revenues are subject to the PUF tax because they are subject to an "informational tariffing" requirement, the PUF tax should be imposed on AT&T Illinois on a prospective basis only. According to AT&T Illinois, it acted in good faith, with the full knowledge of the Commission and its Staff, and with the express approval of the OGC, when it made the filing to detariff its local coin payphone rates in March of 1998. The Commission has never investigated that filing. Accordingly, AT&T Illinois concludes, even if the Commission deems it appropriate to now impose a tariffing requirement (and any such action would be in violation of the *Payphone Order's* ruling preempting state regulation of local coin payphone rates), it would be improper and unfair for the Commission to apply that tariffing requirement retroactively in an attempt to collect PUF taxes on payphone revenues that AT&T Illinois has properly excluded from "gross revenues."

In its Surreply Comments, AT&T Illinois observes that, in its Reply Comments, Staff appears to have abandoned its argument that non-regulated rates must be tariffed as a means of "price disclosure." Rather, Staff argues for the first time that the PUF tax obligation is triggered by the inclusion of the word "classifications" in Section 3-121, which defines "gross revenue," in relevant part, to mean "all revenue which is (1) collected by a public utility subject to rates, other charges, and *classifications* which it is required to file under Section 9-102 of this Act . . ." 220 ILCS 5/13-121 (emphasis added). (Staff Reply Comments, p. 2). This language tracks the first sentence of 9-102, which requires a public utility to file tariffs "showing all rates, and other charges, and classifications . . . for any service performed by it." 220 ILCS 5/9-102. Staff argues that the word "classifications" as used in Sections 3-121 and 9-102 refers to the classification of a telecommunications service as "competitive" or "noncompetitive" under Section 13-502. 220 ILCS 5/13-502. Staff concludes, therefore, that because payphone service generally is classified as competitive, "AT&T and Verizon each collect revenue pursuant to the *classification* of pay telephone service, including local coin drop revenue, that they are required to file under Section 9-102." (Staff Reply Comments, pp. 2-3) (emphasis in original).

AT&T Illinois contends that Staff's new argument does not advance its position in the slightest. According to AT&T Illinois, because local coin payphone rates have been deregulated, they are not "classified" as either competitive or noncompetitive. AT&T Illinois states that the competitive/noncompetitive classifications in Article XIII are fundamentally rate-related: *inter alia*, they determine the amount of advance notice required for proposed changes in tariff rates and whether the Commission has authority to suspend the effectiveness of such changes pending investigation. 220 ILCS 5/13-101 (applying the notice and suspension provisions of Section 9-201 to noncompetitive, but not to competitive, rates and service); 220 ILCS 5/13-505 (providing that changes in competitive rates shall be permitted upon filing, but remain subject to review for reasonableness under Section 9-250). Under Article XIII, the requirement to classify a service as "competitive" or "noncompetitive" is driven by whether the service is required to be tariffed, not vice versa. 220 ILCS 5/13-502 (requiring that telecommunications service provided "under tariff" shall be classified as "competitive" or "noncompetitive"). Thus, AT&T Illinois argues, if the services are not subject to tariffing requirements, then they do not have to be "classified" either. Because the tariff requirement is part and parcel of rate regulation, AT&T Illinois asserts, the tariff requirement does not apply to non-regulated rates. Accordingly, AT&T Illinois

concludes, when the FCC preempted the regulation of local coin payphone rates, it necessarily also preempted application of both the PUA's tariff and classification requirements to such rates.

AT&T Illinois further argues that, even if local coin payphone service does have to be "classified," Staff's interpretation of Section 9-102 is incorrect. According to AT&T Illinois, the phrase "rates, and other charges, and classifications," as used in that section, and numerous other sections of Article IX ("Rates") of the PUA, is a carryover from the Public Utilities Act of 1921 and, therefore, was in existence long before the 1986 rewrite of the PUA which introduced Article XIII ("Telecommunications") and the concept of "competitive" and "noncompetitive" telecommunications services. Thus, AT&T Illinois concludes, the term "classification," as used in the phrase "rates and other charges and classifications," has absolutely nothing to do with the competitive and noncompetitive classifications of telecommunications service under Section 13-502. Rather, the word "classifications," as used in the phrase "rates, and other charges, and classifications," refers to *rate* classifications, such as the classification of rates as business and residential rates.

According to AT&T Illinois, the fact that the term "classification" as used in Section 9-102 refers exclusively to the concept of rates, and not to the competitive or noncompetitive "classifications" of telecommunications services, is apparent from the context in which the phrase "rates and other charges, and classifications" is used in Section 9-102 and other provisions of Article IX. For example, the third and fourth sentences of Section 9-102 state as follows:

Such schedule shall be filed for all services performed wholly or partly within this State, and *the rates and other charges and classifications shall not, without the consent of the Commission, exceed those in effect on December 31, 1985.* But nothing in this section shall prevent the Commission approving or fixing *rates or other charges or classifications from time to time in excess of or less than those shown by such schedules.*

220 ILCS 5/9-102 (emphasis added). AT&T Illinois contends that the phrases "not to exceed" and "in excess of or less than," as used in the above sentences, make sense only if the phrase "rates and other charges and classifications" refers exclusively to the rates and other forms of compensation demanded by a utility in exchange for a product or service. As another example, AT&T Illinois asserts, Section 9-227 states that "it shall be proper for the Commission to consider as an operating expense, for the purpose of determining whether a *rate or other charge or classification* is sufficient, donations made by a public utility for the public welfare or for charitable scientific, religious, or educational purposes, provided that such donations are reasonable in amount." 220 ILCS 5/9-227 (emphasis added). According to AT&T Illinois, it is clear from the context that the term "classifications," when used as part of the phrase "rates or other charges or classifications," refers to the monetary compensation demanded in exchange for a utility service.

In support of its position that the term "classifications," as used in Section 9-102, does not include the "classification" of telecommunications service as "competitive" or "noncompetitive," AT&T Illinois also cites Section 13-503, which makes the Section 9-102 tariff filing requirement applicable to "rates or other charges made, demanded or received for any

telecommunications service offered, provided or to be provided, whether such service is competitive or noncompetitive.” 220 ILCS 5/13-503. AT&T Illinois notes that Section 13-503 does not say that a carrier shall file its “competitive” or “noncompetitive” “classification” pursuant to the requirements of Section 9-102. Rather, Section 9-102 is made applicable to telecommunications services only “with respect to rates or other charges.” AT&T Illinois reiterates that the Section 9-102 tariff requirement, as incorporated through Section 13-503, is part and parcel of the regulation of rates under Illinois law and, therefore, does not apply to unregulated rates.

Finally, AT&T Illinois responds to Staff’s argument, based on the second sentence of Section 9-102, that, in addition to requiring the tariffing of regulated rates, Section 9-102 also requires that each utility “file and include as part of such [rate] schedule and shall state separately all rules, regulations, storage or other charges, privileges and contracts that in any manner affect the rates charged or to be charged for such service.” 220 ILCS 5/9-102. (Staff Reply Comments, p. 4). According to AT&T Illinois, this language refers to “rules, regulations, storage, or other charges, privileges and contracts” that “in any manner affect” the *regulated* rates which a utility is required to file pursuant to the first sentence of Section 9-102. Thus, AT&T Illinois concludes, the second sentence of Section 9-102, like the first sentence, does not apply to services (like local coin payphone service) for which rates are not subject to regulation.

AT&T Illinois further contends that, even if, as Staff apparently intends to suggest, the second sentence of Section 9-102 requires carriers to tariff all non-rate terms and conditions of local coin payphone service (and it does not), such a requirement would not trigger application of the PUF tax. The definition of “gross revenues” under Section 3-121 refers to “revenue which is collected . . . pursuant to the rates, other charges and classifications which it is required to file under Section 9-102.” 220 ILCS 5/13-121. As previously stated, this language tracks the first sentence in Section 9-102, which requires the filing of “rates and other charges and classifications.” AT&T Illinois contends that the phrase “rates and other charges and classifications” refers to regulated rates and other forms of monetary consideration demanded in exchange for the provision of service. According to AT&T Illinois, Section 3-121 does *not* contain language tracking the second sentence of Section 9-102 and does not define “gross revenues” to include all revenues obtained from services for which the Commission may have jurisdiction over non-rate-related aspects of the services.

AT&T Illinois concludes that the clear intent of Section 3-121 is to apply the PUF tax only to revenues collected under rates which are subject to regulation. Local coin payphone rates are indisputably not subject to regulation. Therefore, such rates are not subject to the PUF tax.

AT&T Illinois asserts that Staff’s Comments misstate the facts, as well as the relevant law. Specifically, AT&T Illinois contends, Staff erroneously asserts that it was not until 2003 that AT&T Illinois “withdrew its tariffs for, and ceased remitting the PUF tax upon payphone coin-drop revenues.” (Staff Comments, p. 5). In fact, AT&T Illinois asserts, AT&T Illinois detariffed its local coin payphone rates in March of 1998, shortly after the deregulation of such rates became effective pursuant to the *Payphone Order*. (Dominak Aff., Sch. TD-2, p. 3; AT&T Ill. Init. Comments, pp. 4-5). AT&T Illinois states that it did so with the full knowledge of Staff and the approval of the OGC. (*Id.*). As the December 2004 Letter states, AT&T Illinois has not

remitted the PUF tax on local coin payphone revenues since that time (although it has continued to remit PUF taxes on revenues from non-sent paid (collect and credit card) and non-local coin payphone calls). (*Id.*).

AT&T contends that Staff is also confused about the nature of the PUF tax credits that AT&T Illinois has requested and continues to request. According to AT&T Illinois, it has pending requests for the issuance of credits in the total amount of \$905,318, which represents amounts which AT&T Illinois overpaid in PUF taxes for the years 1998 through 2001. AT&T Illinois states that, contrary to Staff's apparent misconception (Comments, p. 5), no portion of the requested credits is related to taxes paid on local coin sent payphone revenues, since AT&T Illinois did not pay PUF taxes on such revenues during the years in question. Rather, the requested credits represent overstatements of Gross Revenues resulting generally from the improper inclusion of wholesale revenues, mobile access revenues, fees, non-regulated semi-public payphone revenues, and imputed revenues for which no actual billing is received and no cash is ever realized. (Dominak Aff., Sch. TD-2, p. 2; Dominak Reply Aff., ¶ 2).

AT&T Illinois asserts that, despite repeated requests for issuance of the credit, AT&T Illinois has not yet received any portion of the credit from the Commission. (Dominak Aff., ¶ 7). It is AT&T Illinois' understanding that Staff has opposed issuance of the full amount of the requested credit based on its position that there should be an offset for the amount of PUF taxes that AT&T Illinois would have paid on local coin-sent payphone revenues since 1998 if they had been included in the gross revenues subject to the PUF tax since 1998. AT&T Illinois contends that it is not liable for any portion of that amount and, therefore, is entitled to receive the entire amount of the requested \$905,318 credit. AT&T Illinois further contends that, even if the Commission were to accept Staff's position that AT&T Illinois is liable for PUF taxes on local coin-sent payphone revenues for prior periods, AT&T Illinois has never received an explanation for why it has not yet been issued a credit for the difference between the requested credit of \$905,318 and the amount allegedly owed for PUF taxes for local coin-sent payphone revenues. (Dominak Reply Aff., ¶ 5).

## **B. SUMMARY OF VERIZON'S POSITION**

Verizon contends that Illinois law does not require it to pay PUF tax on revenues from intrastate coin drop rates for pay telephone services provided in Illinois because those rates are unregulated and not subject to the PUF tax. Verizon also notes that the Commission investigation against Verizon is financially unjustified, since the additional tax sought from Verizon is negligible – less than \$700 each year for 2005 and 2006, and less than \$20,000 in the aggregate for the past eight years. Verizon makes a number of arguments in support of its position.

Verizon notes that this issue first arose on November 8, 2004, when Bill Baima of the Commission's Financial Information Section sent his letter asserting that "[p]ayphone and collocation revenues are taxable and should also be tariffed." (*See* Exhibit A to Verizon's Initial Comments). The Baima Letter requested that Verizon identify prior years' intrastate pay telephone revenues and/or collocation revenues, review prior gross revenue tax returns, and

submit revised tax returns if Verizon “did not correctly report these revenues and/or calculate the tax amount.” (*Id.*).

Verizon responded to the Baima Letter with the Wood Letter, which stated that Verizon “respectfully disagrees that unregulated payphone and collocation revenues (“P & C Revenues”) must be included in the calculation of the ICC administration fee under 220 ILCS 5/2-202.” (*See* Exhibit B to Verizon’s Initial Comments). The Wood Letter noted that unregulated P & C revenues were not subject to the Commission’s oversight and therefore not properly included in the calculation of the PUF tax, since unregulated payphone and collocation rates were not subject to the tariffing requirements of 220 ILCS 5/9-102. (*Id.*). The Wood Letter also noted that Verizon had not deviated from its past PUF tax calculation practices (which the Commission had never before challenged), and that in any event, the amount at issue was minimal. (*Id.*). Verizon heard nothing more from the Commission until the initiation of this investigation nearly two years later by order dated August 16, 2006. (*See generally, Initiating Order*).

Verizon argues that the definition of “gross revenue” is critical to whether PUF taxes are due on revenues from intrastate coin drop rates for pay telephone services provided in Illinois. Verizon notes that the Staff Report acknowledges that “gross revenue” “includes all revenue which is (1) collected by a public utility subject to regulation under [the Illinois Public Utilities Act (“PUA”)] (a) pursuant to the rates, other charges, and classifications which it is required to file under Section 9-102 of [the PUA] and (b) pursuant to emergency rates as permitted by Section 9-104 of [the PUA], and (2) is derived from the intrastate public utility business of such a utility.” (*See* Staff Report at 1; *see also* 220 ILCS 5/3-121).

Verizon points out that while Section 9-102 of the PUA requires public utilities to file schedules of rates and classifications and gives the Commission ultimate authority to approve rates different than those filed by providers, Section 9-102 only applies to regulated services. Verizon cites *Cerro Copper Products v. Illinois Commerce Commission*, 83 Ill. 2d 364, 415 N.E. 2d 345 (1980) (noting that fundamental purpose of providing a rate schedule is rate regulation); *Chicago SMSA Limited Partnership v. Illinois Commerce Commission*, 672 N.E.2d 37, 39 (Ill. App. 3<sup>rd</sup> Dist. 1996) (“*Chicago SMSA*”)<sup>2</sup> (since services in question do not generate any “gross revenue” under Section 3-121 of the PUA, no PUF tax liability exists under Section 2-202); and *Chicago SMSA L.P. v. Illinois Dept. of Revenue*, 715 N.E.2d 719, 724 (Ill. App. 1<sup>st</sup> Dist. 1999) (“*Illinois DOR*”) (explaining that *Chicago SMSA* court “held cellular providers bore no tax liability under the act because the ICC had excluded the cellular industry from rate regulation”) in support of this point.

Verizon further observes that “intrastate public utility business” is defined as including “all that portion of the business of the public utilities designated in Section 3-105 of [the PUA] and over which this Commission has jurisdiction under the provisions of [the PUA].” (*See* 220 ILCS 5/3-120). Verizon submits that rates for intrastate coin drop payphone services fall outside the Commission’s jurisdiction in light of the FCC’s preemption of state regulation of such rates. Verizon also indicates that since revenue from intrastate coin drop rates for pay telephone

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<sup>2</sup> Verizon explains that although Staff attempts to distinguish this case (*see* Staff’s Initial Comments at 17), it relies on a distinction without a difference, since the fact that the ICC’s authorization to regulate rates in Chicago SMSA was eliminated by ICC order – versus FCC order here – is irrelevant.

services provided in Illinois is plainly not collected “pursuant to emergency rates as permitted by Section 9-104 of [the PUA],” it can only be subject to the PUF tax if it is *both* under the Commission’s jurisdiction *and* collected “pursuant to the rates, other charges, and classifications which [the public utility] is required to file under Section 9-102 of the [PUA].”

Verizon explains that because revenues from intrastate coin drop rates for pay telephone services provided in Illinois do not meet either of these mandatory criteria, they are not subject to the PUF tax. Importantly, Verizon does *not* claim that the PUF tax is preempted or a barrier to market entry or exit, or an impermissible form of rate regulation. Verizon explains that Staff’s discussion seeking to refute these purported arguments is therefore moot (*see* Staff’s Initial Comments at 6; 9; 13-15), since neither Verizon nor AT&T has ever advanced such arguments. Verizon posits that Staff is simply seeking to divert the Commission’s attention from the real issues in this proceeding. Verizon submits that the real question is not whether the *PUF tax* is preempted as rate regulation and/or a barrier to market entry or exit, but rather whether *regulation of intrastate coin drop rates for pay telephone services* is.

Verizon advises the Commission that Staff’s “brief assay” into preemption law fails to highlight 47 U.S.C. § 276(c), which states unequivocally that “[t]o the extent that any State requirements are inconsistent with the [Federal Communication’s] Commission’s regulations, the Commission’s regulations on such matters shall preempt such State requirements.” As a result, Verizon asserts that the FCC has flatly barred states from regulating intrastate coin drop rates for pay telephone services. *See Payphone Order; Order on Reconsideration; Ill. Pub. Tel. Ass’n*. Verizon points out that Staff admits that 47 C.F.R. § 64.1330(a) preempts any state regulations that impose market entry or exit requirements (*see* Staff’s Initial Comments at 4) – the hallmark example being rate regulation. (*See Illinois DOR* at 724, describing “rate and market entry regulation” as “heart of regulation”). Verizon also argues that Staff’s citation to the Commission’s June 11, 2002 order in Docket 01-0614 (*see* Staff’s Initial Comments at 18) is inapposite, since in that proceeding, the Commission found that the FCC had not yet spoken on the preemption question before the Commission. Here, Verizon points out, the FCC has spoken clearly in preempting state regulation of local payphone rates, and the Commission need only comply with the FCC’s explicit findings.

Verizon also discusses the 1997 deregulation of payphone CPE and local service rates, citing the *Payphone Order* and *Order on Reconsideration*. Verizon additionally points out that Staff’s own report to the Commission acknowledges this. (Staff Report at 2). Verizon also notes that after certain parties appealed the FCC’s decision to deregulate local payphone rates, the D.C. Circuit unequivocally affirmed, finding that the FCC “has been given an express mandate to preempt State regulation of local coin calls.” *See Ill. Pub. Tel. Ass’n*. Verizon thus argues that there is no question that intrastate coin drop rates for pay telephone services that Verizon provides in Illinois are deregulated and not under Commission jurisdiction.

As a result of the FCC’s deregulation of local payphone service rates, Verizon submits that this Commission is not permitted to regulate intrastate coin drop rates for pay telephone services provided in Illinois, nor may it require them to be tariffed, citing *Cerro Copper*, *Chicago SMSA* and *Illinois DOR*. Because state regulation of such rates has been preempted, Verizon alleges that there can be no PUF tax due on them, since the “gross revenue” condition of

220 ILCS 5/2-202 cannot be met. The revenue in question does not constitute “gross revenue” as defined in 220 ILCS 5/3-121, states Verizon, because it was not collected pursuant to rates regulated under Section 9-102 of the PUA.

Verizon also contends that Staff’s disagreement with this point is ultimately irrelevant because until very recently (as detailed below), neither Staff nor the Commission had asserted or held that tariffing of intrastate coin drop rates for pay telephone services is required under 220 ILCS 5/9-102, and had instead consistently cited 220 ILCS 5/13-501 as the basis for requiring payphone providers to tariff their services. Verizon reminds the Commission that this is the position that Staff took during the ICC workshops that followed the issuance of the FCC’s *Payphone Order* and *Payphone Reconsideration Order*. Citing 220 ILCS 5/13-501, Staff asserted that end user payphone rates should be declared competitive, and therefore moved from local exchange carriers’ non-competitive tariffs into their competitive tariffs (as defined in 220 ILCS 5/13-502). Verizon disagreed, but decided to undertake such tariffing on a voluntary basis. Following the workshops, the Commission issued an order directing payphone providers to detariff their payphone CPE offerings as a result of the FCC’s newly-issued payphone orders, again citing 220 ILCS 5/13-501 as the origin of the tariffing requirement. (*See Order, Illinois Commerce Commission on Its Own Motion v. Illinois Bell Tel. Co. et al.*, ICC Docket 97-0630, 1997 Ill. LEXIS 856, \*2 (December 3, 1997)).

Although Staff argues that a tariffing requirement does not constitute a barrier to market entry or exit (*see* Staff Comments at 16-18), Verizon disagrees. Staff alleges that since a “tariffing requirement constitutes a regulation tending to provide ‘price disclosure,’” it is “perfectly proper state regulation.” (*Id.* at 16). However, Verizon notes that the PUA is devoid of any provisions providing for “informational tariffs,” a point which AT&T notes was already conceded by the ICC’s Office of General Counsel. (*See* AT&T Comments at 4).

Verizon argues that Staff’s reliance on the “competitive telecommunications service” tariffing requirements of Section 13-501 of the PUA to support Staff’s contention that intrastate coin drop rates for pay telephone services provided in Illinois must be tariffed (*see* Staff Comments at 16-17) fails to recognize the distinction between permissible regulation of competitive and noncompetitive services that are subject to some regulatory oversight and impermissible regulation of intrastate coin drop payphone rates (via an ostensible tariff requirement) that are not regulated at all by the ICC. Verizon argues that Section 13-501 does not authorize regulation of rates for intrastate coin drop pay telephone rates.

Verizon also disputes Staff’s contention that Section 13-501’s requirements do not constitute a barrier to market entry or exit because Section 13-505(a) requires only one day’s notice for such filings, and does not provide for suspensions. (*See* Staff Comments at 16-17). Verizon explains that requiring the filing of a tariff affects both market entry and exit because a provider must tariff a service before offering it, and must seek approval to withdraw a tariff in the event of market exit, and notes that Staff’s citation to *Cellular Telecommunications Industry Ass’n v. Federal Communications Comm’n*, 168 F.3d 1332 (D.C. Cir. 1999) is flawed. Verizon argues that the D.C. Circuit found only that a mandate to make USF contributions did not constitute impermissible rate regulation of wireless service simply by virtue of increasing the cost of doing business in the state (*see Cellular Telecommunications*, 168 F.3d at 1336), but that

the D.C. Circuit did not disagree that state tariffing requirements were a barrier to entry. (*Id.*). Verizon further argues that Staff overlooks that Section 13-505(a) only applies to *increases or decreases in rates or charges* for competitive services, not to the *introduction or withdrawal* of a service, and states that to assess whether the ostensible tariffing requirement is a barrier to market entry or exit, the Commission must look to Section 13-501, which sets forth the tariffing requirements for the *introduction* of a competitive service. Section 13-501 does not allow for one-day notice filings, but instead provides for tariff suspension, investigation and hearing. In addition, for carriers like Verizon that offer both competitive and non-competitive services, tariffs offering a new competitive service, or newly reclassifying a non-competitive service as a competitive service, cannot take effect until certain cost study filing requirements are met. (*See* 220 ILCS 5/13-502(d)). These are all barriers to market entry and exit.

Verizon asserts that all of this is ultimately irrelevant since until recently, neither Staff nor the Commission had ever asserted that Section 9-102 imposes a tariffing requirement for intrastate coin drop rates for pay telephone services. As detailed above, intrastate coin drop rates are not regulated under Article 9 of the PUA, and thus, do not meet the definition of “gross revenue” under 220 ILCS 5/3-121. Consequently, Verizon argues, even if the Commission ultimately determines that providers are somehow required to file “informational tariffs” under Section 13-501 for intrastate coin drop rates for pay telephone services (despite the fact that the Commission is barred from regulating those rates), that would not subject payphone providers to paying PUF tax on the revenues therefrom.

Verizon notes that it was not until Staff filed its November 14, 2006 Reply Comments in this proceeding that Staff advanced its new theory that Section 9-102 was the origin of the ostensible tariffing requirement for intrastate coin drop payphone services. (*See* Staff’s Reply Comments at 2-8). Verizon makes several points in response to Staff’s new contention.

First, Verizon notes that it advised the Commission in the Wood Letter that Section 9-102 of the PUA did not require the payment of PUF tax on revenues from intrastate coin drop payphone service. Yet, Staff ignored the Wood Letter (as well as similar correspondence from AT&T) for almost two years before the Commission initiated the instant investigation in response to AT&T’s pursuit of the \$905,318 PUF tax refund due to it. In its *Initiating Order*, the Commission made the August 1, 2006 Staff Report part of the record of this docket. (*See Initiating Order* at 3). Verizon points out that neither the *Initiating Order* nor the Staff Report referenced Section 9-102 of the PUA as the basis for Verizon’s and AT&T’s alleged liability for PUF tax payments on intrastate coin drop pay telephone revenues collected by those companies, despite the fact that the legal issue had been raised by Verizon nearly two years prior. Rather, Staff had previously asserted that the ostensible tariffing requirement that triggered the alleged PUF tax liability arose under Section 13-501 of the PUA, not Section 9-102.

Verizon also remarks that AT&T’s filings in this docket demonstrate that the Commission’s Office of General Counsel long ago disagreed with Staff on this point, and instead concurred with AT&T that there was no tariffing requirement relating to intrastate coin drop pay telephone services. Verizon observes that even after Staff requested and obtained the opportunity to supplement the Staff Report by filing verified comments on October 17, 2006 (the same day Verizon and AT&T were required to respond to the Staff report), Staff once again

made no assertion that Section 9-102 was the basis of Staff's theory of liability. Verizon claims that only after it noted that Staff had *never* made such an argument, and pointed out that this was fatal to Staff's position, did Staff do so for the first time on reply. (See Staff Reply Comments at 2-8).

Verizon next argues that even Staff does not dispute that the Commission may not set, review, or otherwise regulate intrastate coin drop pay telephone rates, recognizing that "federal law removed state authority to set prices for local coin calls from pay telephones" and conceding that "the Commission may not regulate the *price* for intrastate local coin pay telephone service...." (See Staff Reply Comments at 2; Italics in original). As a consequence, Verizon submits that these rates are not subject to regulation under Article IX of the PUA, which governs only *regulated rates*, because statutory tariffing and rate approval requirements such as those set forth in Article IX are the hallmark example of rate regulation, citing *Citizens Utility Board v. Illinois Commerce Commission*, 655 N.E.2d 961, 967 (Ill. App. 1<sup>st</sup> Dist. 1995) ("*CUB*") ("[t]hese plenary requirements embody the Commission's plenary jurisdiction to regulate public utilities with respect to the reasonableness of rates.") and *Illinois DOR* (describing "rate and market entry regulation" as "heart of regulation"). Verizon argues that Staff attempts, unconvincingly, to argue that "Section 9-102 is not limited to regulated prices" (Staff Reply Comments at 3), but that the provisions of Section 9-102 quoted by Staff only confirm that the statute's purpose is regulating rates and any associated rate-affecting terms and conditions of service. For example, Verizon notes that the formal title of Article IX of the PUA is "RATES," and that rate regulation is the fundamental purpose of Article IX. Section 9-101 explicitly mandates that the rates subject to Article IX be "just and reasonable." See 220 ILCS 5/9-101. Subsequent sections of Article IX confirm that the rates required to be filed and published thereunder are subject to ICC review and approval; may not be changed without 45 days notice to the ICC; and are subject to suspension pending a hearing on the "propriety" thereof. (See, e.g., 220 ILCS 5/9-104 and 9-201(b)). In Verizon's view, Staff's argument that unregulated rates are somehow subject to the rate regulation requirements of Article IX turns the whole concept of regulation on its head.

Verizon next addresses Staff's argument that revenues derived from intrastate coin drop pay telephone services provided in Illinois are subject to the PUF tax because Verizon "collect[s] revenue pursuant to the *classifications* which [it is] required to file under Section 9-102 of the PUA." (See Staff Reply Comments at 2). Verizon states that the essence of Staff's argument is that because Verizon's local payphone services are "classified" as competitive services, the revenues therefrom are collected due to the "classification" of those services as competitive. The next step in Staff's logic, Verizon explains, is that since competitive services are classified in Article XIII of the PUA, and Section 13-503 references the filing requirements of Section 9-102, Verizon's intrastate coin drop pay telephone revenues are collected under "classifications" Verizon is required to file under Section 9-102.<sup>3</sup> Rounding out Staff's theory is that since these

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<sup>3</sup> Verizon notes that Staff claims that AT&T agrees with Staff's contention in this regard (Staff Reply Comments at 5). However, Verizon explains that an actual review of AT&T's words demonstrates that AT&T merely confirmed that Section 9-102 sets forth a tariffing requirement to which "*regulated* rates and charges of telecommunications services are subject to 13-503 of the PUA." *Id.* (Italics added). Staff ignores that AT&T has consistently argued throughout this proceeding that intrastate coin drop payphone rates are *deregulated* and therefore not subject to this requirement. Moreover, footnote 2 to AT&T's Reply Comments plainly states that "[e]ven if the Commission were to conclude that it has authority to impose an informational-only tariff

revenues are collected pursuant to Section 9-102's filing requirement, they meet Section 3-121's definition of "gross revenues," and are consequently subject to the PUF tax under Section 2-202.

Verizon argues that Staff's creative statutory "daisy chain" argument is fatally flawed because Staff ignores that intrastate coin drop pay telephone rates are deregulated, and therefore not subject to the rate regulation provisions of Article IX of the PUA regardless of Section 13-503's internal reference to the filing processes outlined in Section 9-102. Verizon points out that Staff also fails to recognize the critical distinction between Section 13-503 referring to the filing provisions of Section 9-102, and the unreasonable leap that Staff makes in asserting that Section 9-102 is therefore fully applicable to services like those at issue here, even though the rates for those services are not subject to regulation.

Verizon argues that even if the Commission is inclined to entertain Staff's sudden shift in position that the ostensible "informational tariffing requirement" for intrastate coin drop payphone services arises not out of Section 13-501 (as the Commission has posited for more than a decade), but under some combination of Sections 13-503 and 9-102, revenues from competitive services are not, by virtue of Section 13-503's internal reference to Section 9-102, "collected" pursuant to filings required by Section 9-102. If they are "collected" pursuant to any alleged filing requirement, argues Verizon, it would be pursuant to a filing required by Section 13-503. In other words, the mere fact that Section 13-503 incorporates filing parameters set forth in Section 9-102 does not translate into a requirement that rates for intrastate coin drop payphone service be filed *pursuant to Section 9-102*, because Section 9-102 requires only the filing of rates *regulated* under Article IX of the PUA. Moreover, Verizon observes that even if the legislature had intended to subject *all* rates for *all* services to the rate regulation requirements of Section 9-102 (including filing a schedule of regulated rates) by referencing that filing process in Section 13-503, the FCC has preempted the legislature from doing so. Verizon asserts that the only rates required to be filed under Section 9-102 are those subject to regulation by the Commission for their compliance with the "just and reasonable" standard. Intrastate coin drop payphone rates do not meet this condition – as Staff has conceded – because they are not subject to any regulation. Accordingly, Verizon concludes that revenues from local coin pay telephone service are not collected pursuant to rates required to be filed under Section 9-102.

Consequently, Verizon states, PUF taxes cannot be due on the revenues derived from the intrastate coin drop pay telephone services Verizon provides in Illinois. Verizon reiterates the relevant portions of the statutory definition of "gross revenue," claiming that to be subject to the PUF tax, revenues must be "*collected ... pursuant to the rates, other charges and classifications which [a public utility] is required to file under Section 9-102 of this Act.*" Verizon observes that Staff attempts to deflect the import of these words by focusing the Commission's attention solely on the word "classifications," rather than the phrase "rates, other charges and classifications" as a cohesive unit by asserting, without any basis, that the term "classifications" refers to the competitive and non-competitive *service* classifications of Article XIII of the PUA, rather than *rate* classifications that arise under Article IX – *e.g.*, business, residential, etc. (*See*

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requirement on non-regulated rates (and it does not), such authority clearly does not emanate from Section 9-102." (*See* AT&T Reply Comments at 8, FN 2).

Staff Reply Comments at 3).<sup>4</sup> Verizon references the discussion set forth in AT&T's surreply comments explaining that the term "classifications" in Article IX dates back many decades prior to the enactment of Section 13-502 of the PUA, which states that telecommunications services will be classified as competitive or non-competitive. Verizon argues that given that Article IX deals with rates, whereas Article XIII deals with competitive/non-competitive services and was enacted years later, the only logical interpretation of the reference to "classifications" in the context of Section 9-102 is that it refers to *rate* classifications, not to competitive and non-competitive *service* classifications.

As a result, Verizon posits that its intrastate coin drop payphone revenues are not "collected" pursuant to "rates, other charges and classifications" required to be filed under Section 9-102 of the PUA. Verizon reminds the Commission that under Section 3-120 of the PUA, "intrastate public utility business" of a utility is limited to public utility business over which the Commission has *jurisdiction*, and thus, several requirements of Section 3-121's definition of "gross revenues" cannot be satisfied here. Verizon also notes that the Illinois Appellate Court has unambiguously determined that revenues excluded from the definition of "gross revenues" cannot be subject to the PUF tax, citing *Chicago SMSA* at 39 and *Illinois DOR* at 724.

Verizon also disputes Staff's effort to conjure up a new, non-statutory basis for its ostensible "informational filing requirement" by relying on 83 Ill. Admin. Code § 745.20. Verizon points out that the reach of that administrative rule is necessarily limited to those matters over which the Commission has jurisdiction. Verizon submits that the FCC has preempted the Commission's authority to regulate intrastate coin drop payphone rates, including the Commission's authority to require them to be tariffed. Since the Commission cannot regulate intrastate coin drop payphone rates, Verizon argues that it cannot require them to be tariffed, notwithstanding Staff's bold assertion that detariffing cannot occur absent a Commission order. Verizon dismisses any contention that the Commission must first issue an order acknowledging that preemption has occurred before preemption can occur as unworkable since 47 U.S.C. § 276(c) states unequivocally that "[t]o the extent that any State requirements are inconsistent with the [Federal Communication's] Commission's regulations, the Commission's regulations on such matters shall preempt such State requirements."

In sum, Verizon believes that Staff is attempting to generate a new source of PUF tax revenue to offset the "unusually large" PUF tax refund that AT&T has previously advised the Commission is due and owing for the 2001 tax year. Verizon argues that Staff's basis for asserting that intrastate coin drop rates for pay telephone services provided in Illinois are subject to the PUF tax is legally flawed. Because the FCC has deregulated those rates, and because the revenues therefrom do not constitute "gross revenue," Verizon asserts that there is no legal basis for Staff's contention that Verizon must pay PUF tax on such revenues, and urges the

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<sup>4</sup> Verizon also notes that earlier in Staff's Reply Comments, Staff chooses to ignore altogether the portion of the definition of "gross revenues" that relates to Section 9-102, identifying only the portion of Section 3-121 that mandates that "gross revenues" be "derived from the intrastate public utility business of [a public] utility," without mentioning that they must also be collected pursuant to "rates, other charges and classifications" required to be filed under Section 9-102. (*See* Staff Comments at 1).

Commission to close this investigation with a conclusive finding that PUF taxes are not appropriately collected on such revenues.

### C. SUMMARY OF STAFF'S POSITION

AT&T Illinois and Verizon respectfully defer to Staff's summary of its position.

### V. COMMISSION ANALYSIS AND CONCLUSION

The Commission agrees with AT&T Illinois and Verizon that revenues collected under local coin payphone rates are not "gross revenues," as defined in Section 3-121 of the PUA and, therefore, are not subject to the PUF tax. This conclusion is supported by the plain language of Section 3-121 which, for purposes of the PUF tax, defines "gross revenues" to mean "revenue which is collected by a utility subject to regulations under this Act (a) pursuant to the rates, other charges, and classifications which it is required to file under Section 9-102 of this Act and . . . (2) is derived from the intrastate public utilities business of such a utility." 220 ILCS 5/3-121. Section 9-102 refers to a tariff filing requirement applicable to regulated rates and charges. 220 ILCS 5/9-102. The term "intrastate public utility business" means that portion of a public utility business "over which this Commission has jurisdiction under the provisions of this Act." 220 ILCS 5/13-120. Thus, "gross revenues" do not include revenues collected under rates that are not subject to regulation under the PUA (including the Section 9-102 tariffing requirement) and over which the Commission does not have jurisdiction. This is true even if the Commission retains jurisdiction to regulate non-rate aspects of the service at issue. *Chicago SMSA Limited Partnership v. Illinois Dept. of Revenue*, 306 Ill. App. 3d 977, 984 (1<sup>st</sup> Dist. 1999) (noting that, because cellular service is "excluded" from "rate regulation," rates charged by cellular carriers are not subject to the PUF tax liability even though the Commission retains authority to regulate other aspects of cellular service, citing *Chicago SMSA, Ltd. Partnership v. Illinois Commerce Commission*, 284 Ill. App. 3d 326 (1996)).

It is undisputed that the FCC, pursuant to its authority under Section 276 of the 1996 Act, preempted state regulation of the rates charged by carriers, including AT&T Illinois and Verizon, for coin-sent local payphone calls, effective October 7, 1997. *Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-128, FCC 96-388, ¶¶ 56, 60-61 (rel. Sept. 20, 1996) (the "Payphone Order"); *Illinois Public Telecommunications Ass'n v. FCC*, 117 F.3d 555, 561-63 (D.C. Cir. 1997) (holding that FCC "has been given an express mandate to preempt State regulation of local coin calls"). Moreover, because local coin payphone rates are not subject to regulation by the Commission, they are also not subject to the Section 9-102 tariffing requirement, which is part and parcel of rate regulation under Illinois law. *Citizens Utility Board v. Illinois Commerce Commission*, 275 Ill. App. 3d 329, 338 (1<sup>st</sup> Dist. 1995) (holding that Section 9-102 "embod[ies] the Commission's plenary jurisdiction to regulate public utilities with respect to the reasonableness of rates"). Accordingly, pursuant to the plain language of Section 3-121, the Commission finds that revenues derived from local coin payphone calls do not constitute "gross revenues" subject to the PUF tax.

In its Comments, Staff argued that the FCC has not preempted the Illinois statutory provisions as either “improper rate regulation” or a “barrier to entry or exit.” The Commission agrees with AT&T Illinois and Verizon that Staff’s arguments miss the point. Neither AT&T Illinois nor Verizon has asserted that the *Payphone Order* preempted the provisions governing applicability of the PUF tax. Rather, it is the position of AT&T Illinois and Verizon that, as a matter of state law, the PUF tax is not applicable to revenues collected under local coin sent payphone rates because such rates are not subject to regulation, including the tariffing requirements of Section 9-102 of the PUA. As previously stated, the Commission agrees that this is a correct interpretation and application of state law. Accordingly, there is no need to address Staff’s arguments regarding implied preemption.

Staff also argues that despite the FCC’s preemptive deregulation of local coin payphone rates, the FCC did not preempt the imposition of tariff requirements for payphone service. In support of this position, Staff relies on the FCC’s statement in the *Payphone Order* that states “remain free to impose regulations, on a competitively neutral basis, to provide customers with information and price disclosure.” As AT&T Illinois correctly points out, however, the FCC did not state that such “information and price disclosure” can, or should, take the form of a tariff.<sup>5</sup> Furthermore, for purposes of the definition of “gross revenues” under Section 3-121, the relevant question is whether local coin payphone rates constitute rates that telecommunications carriers are “required to file under Section 9-102” of the PUA. 220 ILCS 5/3-121. Contrary to Staff’s suggestion, Section 9-102 is not merely a “regulation tending to provide ‘price disclosure.’” Rather, as the Illinois Appellate Court has expressly held, Section 9-102 is an integral part of the PUA’s scheme for regulating rates in Illinois:

To ensure that rates are in fact “just and reasonable,” the Act mandates that “every public utility shall file with the Commission and shall print and keep open to public inspection schedules showing all rates and other charges, and classifications, which are in force at the time for any product or commodity furnished or to be furnished by it, or for any service performed by it in connection therewith, or performed by any public utility controlled or operated by it.” (Emphasis added). (220 ILCS 5/9-102 (West 1992)).

\* \* \* \*

*These requirements embody the Commission’s plenary jurisdiction to regulate public utilities with respect to the reasonableness of rates.*

*Citizens Utility Board v. Illinois Commerce Commission*, 275 Ill. App. 3d 329, 338 (1<sup>st</sup> Dist. 1995) (emphasis added).

Thus, the FCC’s reference to states’ ability to require “information and price disclosure” does not permit the Commission to impose the PUA’s tariffing requirements on local coin payphone rates. There is no state law which authorizes the Commission to require the tariffing

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<sup>5</sup> The language of the *Payphone Order* relied on by Staff would permit the Commission to adopt price and information disclosure requirements that do not involve Section 9-102 tariffs. For example, the FCC would permit states to require a certain amount of rate disclosure on the payphone placard or require the establishment of toll-free numbers where customers can obtain payphone rate quotes.

of rates (such as local coin payphone rates) which are unregulated and over which the Commission has no regulatory jurisdiction. Thus, by preempting the Commission from regulating local coin payphone rates, the FCC necessarily also foreclosed the Commission from imposing the tariff requirement under Section 9-102.

The Commission also rejects Staff's argument, made for the first time in its Reply Comments, that the PUF tax obligation is triggered by the inclusion of the word "classifications" in Section 3-121, which defines "gross revenue," in relevant part, to mean "all revenue which is (1) collected by a public utility subject to rates, other charges, and *classifications* which it is required to file under Section 9-102 of this Act . . ." 220 ILCS 5/13-121 (emphasis added). (Staff Reply Comments, p. 2). This language tracks the first sentence of 9-102, which requires a public utility to file tariffs "showing all rates, and other charges, and *classifications* . . . for any service performed by it." 220 ILCS 5/9-102. Staff argues that the word "classifications" as used in Sections 3-121 and 9-102 refers to the classification of a telecommunications service as "competitive" or "noncompetitive" under Section 13-502. 220 ILCS 5/13-502. Staff concludes, therefore, that because payphone service generally is classified as competitive, "AT&T and Verizon each collect revenue pursuant to the *classification* of pay telephone service, including local coin drop revenue, that they are required to file under Section 9-102." (Staff Reply Comments, pp. 2-3) (emphasis in original).

Staff's conclusion is erroneous. Because local coin payphone rates have been deregulated, they are not "classified" as either competitive or noncompetitive. Moreover, Staff's interpretation of Section 9-102 is incorrect. For all the reasons discussed by AT&T Illinois and Verizon, the term "classification," as used in the phrase "rates and other charges and classifications," has absolutely nothing to do with the competitive and noncompetitive classifications of telecommunications service under Section 13-502.

The Commission also rejects Staff's suggestion that the second sentence of Section 9-102 requires carriers to tariff all non-rate terms and conditions of local coin payphone service and that such a requirement triggers application of the PUF tax. The second sentence of Section 9-102, like the first sentence, applies only to services for which rates are subject to regulation. Furthermore, the definition of "gross revenues" under Section 3-121 refers to "revenue which is collected . . . pursuant to the rates, other charges and classifications which it is required to file under Section 9-102." 220 ILCS 5/13-121. As previously stated, this language tracks the first sentence in Section 9-102, which requires the filing of "rates and other charges and classifications," a phrase that refers to regulated rates and other forms of monetary consideration demanded in exchange for the provision of service. Section 3-121 does *not* contain language tracking the second sentence of Section 9-102 and does not define "gross revenues" to include all revenues obtained from services for which the Commission may have jurisdiction over non-rate-related aspects.

For all of the reasons discussed, the Commission concludes that the clear intent of Section 3-121 is to apply the PUF tax only to revenues collected under rates which are subject to regulation. Local coin payphone rates are indisputably not subject to regulation. Therefore, such rates are not subject to the PUF tax.

As discussed in the “Background To The Case,” above, AT&T Illinois has, over the past several years, presented numerous requests to the Commission for issuance of PUF tax credits for the years 1998 through 2001. Those requested credits, which total \$905,318, are supported by Amended Gross Revenue Returns filed by AT&T Illinois for the years in question and represent overpayments of the PUF tax resulting from incorrect inclusion in gross revenues of wholesale revenues, mobile access revenues, fees, non-regulated semi-public payphone revenues and imputed revenues for which no actual billing is received and no cash is ever realized. (Dominak Aff., Sch., TD-2, p. 2; Dominak Reply Aff., ¶ 2). According to AT&T Illinois, Staff has opposed issuance of the requested credits based on its position that there should be an offset for the amount of PUF taxes that AT&T Illinois would have paid, and did not pay, on local coin payphone revenues since 1998. AT&T Illinois also asserts that Staff has never explained why, at a minimum, a credit for an amount net of the alleged PUF tax liability has not been issued.

Based on our findings above, the Commission concludes that AT&T Illinois and Verizon were both justified in excluding local coin payphone revenues from the “gross revenues” reported in their Annual Gross Revenue Returns since 1997. Accordingly, there is no basis for an offset to the credits requested by AT&T Illinois. The Commission, therefore, concludes that, unless there is another, legitimate, objection to the requested credit, the full amount of the PUF tax credits requested by AT&T Illinois for the years 1998 through 2001 should be issued. If Staff has such an objection(s), AT&T Illinois is entitled to an explanation and an opportunity to respond to and/or contest that objection(s). For these reasons, the Commission hereby directs Staff to respond to AT&T Illinois’ request within 30 days of the date of this Order by either issuing the requisite credit memorandum in the amount of \$905,318 pursuant to the provisions of Section 2-202(f)(1) of the PUA or explaining with specificity what objection(s), if any, Staff has to the requested credit. Staff’s response should provide support for and quantify the effect of each such objection. If Staff responds with an objection(s) to a portion, but not all, of the requested credit, Staff’s response should also include the issuance to AT&T Illinois of a credit memorandum for that portion of the requested credit which is not subject to a Staff objection.

## **VI. FINDINGS AND ORDERING PARAGRAPHS**

The Commission, being fully advised in the premises, is of the opinion and finds that:

- (1) Illinois Bell Telephone Company (“AT&T Illinois”) and Verizon North Inc. and Verizon South Inc. (collectively “Verizon”) are Illinois corporations engaged in the business of providing telecommunications services to the public in the State of Illinois and, as such, are telecommunications carriers within the meaning of Section 13-202 of the Illinois Public Utilities Act (the “Act”);
- (2) the Commission has jurisdiction over the parties and the subject matter of this proceeding pursuant to the Act;
- (3) the recitals of facts and law and conclusions reached in the prefatory portion of this Order are supported by the record, and are hereby adopted as findings of fact and law;

- (4) revenues collected pursuant to local coin payphone rates are not now, and have not been since 1997, “gross revenues” within the meaning of Section 3-121 of the PUA and, therefore, are not subject to the public utility fund tax on gross revenues under Section 2-202 of the PUA;
- (5) no public utility fund taxes are due on intrastate coin drop pay telephone revenues previously or subsequently collected by AT&T Illinois and Verizon;
- (6) within 30 days of the date of this Order, Staff should respond to AT&T Illinois’ request for a PUF tax credit in the amount of \$905,318 by either issuing the requisite credit memorandum for that pursuant to the provisions of Section 2-202(f)(1) of the PUA or explaining with specificity what objection(s), if any, Staff has to the requested credit. Staff’s response should provide support for and quantify the effect of each such objection. If Staff responds with an objection(s) to a portion, but not all of the requested credit, Staff’s response should also include the issuance to AT&T Illinois of a credit memorandum for that portion of the requested credit which is not subject to a Staff objection.

IT IS THEREFORE ORDERED that revenues collected pursuant to local coin payphone rates are not “gross revenues” within the meaning of Section 3-121 of the PUA and, therefore, are not subject to the public utility fund tax and Section 2-202 of the PUA.

IT IS FURTHER ORDERED that no public utility fund taxes are due on intrastate coin drop pay telephone revenues previously or subsequently collected by AT&T Illinois and Verizon.

IT IS FURTHER ORDERED that, within 30 days of the date of this Order, Staff respond to AT&T Illinois’ request for a PUF tax credit in the amount of \$905,318 by either issuing the requisite credit memorandum for that amount pursuant to the provisions of Section 2-202(f)(1) of the PUA or explaining with specificity what objection(s), if any, Staff has to the requested credit. Staff’s response shall provide support for and quantify the effect of each such objection. If Staff responds with an objection(s) to a portion, but not all of the requested credit, Staff’s response shall also include the issuance to AT&T Illinois of a credit memorandum for that portion of the requested credit which is not subject to a Staff objection.

IT IS FURTHER ORDERED that any objections, motions or petitions not previously disposed of are hereby disposed of consistent with this Order.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Act and 83 Ill. Admin. Code 200-880, this Order is final; it is not subject to the Administrative Review Law.

By Order of the Commission this \_\_\_\_\_ day of \_\_\_\_\_, 2007.

Chairman

Respectfully submitted,

ILLINOIS BELL TELEPHONE COMPANY

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**CERTIFICATE OF SERVICE**

I, Karl B. Anderson, an attorney, certify that a copy of the foregoing **JOINT DRAFT ORDER OF AT&T ILLINOIS AND VERIZON** was served on the following parties by U.S. Mail and/or electronic transmission on January 19, 2007.

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Karl B. Anderson

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