STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

| | | |
|---|---|---|
| ILLINOIS BELL TELEPHONE COMPANY | : | |
| | : | 08-0249 |
| Annual Rate Filing for non-competitive services under an alternative form of regulation. | : | |

STAFF'S VERIFIED REPLY COMMENTS
TO THE VERIFIED INITIAL COMMENTS OF
THE PEOPLE OF THE STATE OF ILLINOIS

The Staff of the Illinois Commerce Commission ("Staff"), by and through its undersigned counsel, hereby files its Verified Reply Comments to the Verified Initial Comments of the People of the State of Illinois.

**A. The AG's Request that the Commission Investigate AT&T's Return on Equity is Outside the Scope of this Proceeding.**

In response to Illinois Bell Telephone Company's ("AT&T" or the "Company") Alternative Regulation Plan filing, the Attorney General ("AG") submits comments that request that the Commission "investigate the extraordinary return on equity reported by Illinois Bell Telephone Company and the uneven service quality provided to Illinois consumers."[1] In Staff's view, the AG seeks relief outside the scope of the instant proceeding. Appendix A, Section II, Subsection A of the Commission's Alt. Reg. Order[2] describes procedures for rate adjustments made by AT&T pursuant to its alternative regulation plan. Pursuant to Appendix A, Section II, Subsection B of the Alt. Reg. Order, after AT&T makes its rate adjustment filing and after comments and reply

---

[1] AG Comments at 8.

[2] *Final Commission Order*, Illinois Bell Telephone Company: Petition to Regulate Rates and Charges of Noncompetitive Services Under an Alternative Form of Regulation, ICC Docket Nos. 92-0448/93-0239 (Consol.) (October 11, 1994)(hereafter "Alt. Reg. Order").

comments are filed regarding AT&T's rate adjustments by interested parties, the Commission approves a Price Cap Index ("PCI") that will be applicable during that year. Pursuant to Appendix A, Section II, Subsection D of the Alt. Reg. Order, tariffed rate changes included in AT&T's annual rate filing that are found to be consistent with the PCI and individual rate limitations of the alternative regulation plan "shall enjoy the presumption that they are just and reasonable and, absent special circumstances, shall become effective without suspension or investigation under Article 9 of the Act."[3] Thus, the purpose of this proceeding is to evaluate "mechanically" whether AT&T's rate adjustments are consistent with the PCI and individual limitations of its Alternative Regulation Plan. Notably, the AG's comments do not allege that AT&T's rate adjustments are inconsistent with the PCI or individual limitations of the alternative regulation plan. AT&T's filing in this cause are in full compliance with the Alt Reg Review Order and the rules established under the Alt Reg Order, and Staff recommends the Commission so find in its order in this proceeding.

It is not entirely clear to what end the investigation recommended by the AG is intended. Because the AG is proposing changes to service quality requirements of the Alternative Regulation Plan, Staff assumes that the AG is asking the Commission to look beyond AT&T's compliance with the PCI or individual limitations of the alternative regulation plan to whether <u>the Alternative Regulation Plan itself</u> requires amendment. In fact, the AG's assertions regarding AT&T's competitively classified rates and related earnings suggest that the AG's request is not even confined to matters involving the Alternative Regulation Plan, but rather extends to an inquiry into competitively classified rates, which are not currently subject to the Alternative Regulation Plan. Whatever

[3] Alt Reg. Order, Appendix A, Section II, Subsection D.

purpose the AG's comments are intended to serve, it is clear that this purpose is outside the scope of this proceeding.

While the AG's comments do not address matters within the scope of this proceeding, they do raise the question of whether the Commission should initiate a proceeding (or proceedings) to amend the Alternative Regulation Plan, investigate the propriety of the competitive classifications of some or all of AT&T's rates, and/or investigate the just and reasonableness of some or all of AT&T's rates. AT&T's current Alternative Regulation Plan was developed, reviewed, and approved by the Commission in several orders over a period of nearly fourteen years, in the course of which significant time and effort was expended by all parties and the Commission itself to carefully adduce and examine a substantial body of record evidence. Likewise, the Commission's decision to approve competitive reclassifications sought by AT&T in MSA-1 was made only after substantial investments of time and effort, and after much careful consideration. This difficult work should not be undone or repeated without a compelling reason to do so.

The AG does not, however, state such a compelling reason. The AG's requests are ambiguous and its support for them is incomplete. First, it appears to the Staff that the AG's return on equity calculation is flawed. In table 1, Calculation of IBT 2007 Intrastate Return on Equity, in the Declaration of Colin B. Weir, Mr. Weir's analogy in computing the ROE is incorrect and the result overstated. Mr. Weir allocated the IBT Common Equity proportionally into intrastate and interstate amounts according to Operating Income proportions. In this manner he reduced, in a subjective manner, the denominator used to compute the ROE. Because of this subjective adjustment, his

comparison between his calculated number and the ROEs for other companies, for which no such subjective apportionment has been made, is like comparing apples with oranges. Intrastate operating income, when measured against total company equity, contributed 27.31% of ROE in Illinois. This figure, which reflects the contribution of AT&T's intrastate operations to the company's ROE, is considerably less than the ROE figures presented by the AG.

On a more basic level, the AG's Comments miss the purpose of this proceeding. The AG suggests, in essence, that AT&T is over-earning.[4] However, in doing so, the AG is merely reprising an argument that it has repeatedly made, and the Commission and courts have repeatedly rejected. The Commission noted in its Alt. Reg. Review Order: "[the AG and co-parties] **cannot seem to break away from the idea that earnings, such an integral part of ROR regulation, do not hold the same prominence under alternative regulation.**"[5] In the same Order, the Commission made clear that a strict earnings review: "is not viable at this juncture **where ROR has long been abandoned in favor of alternative regulation.**"[6] Indeed, the Commission further stated that:

> We cannot help but note that the GCI assertions for an earnings review and corresponding rate reinitialization in this instance were foreshadowed by the arguments that were presented to the [Appellate] Court in its review of the Alt Reg Order, to wit:
>
> > CUB assets, without support, that the original purpose of the Act was to protect 'the public from public utilities charging rates that produce excess profits.' CUB argues that Section 13-506.1 'subverts' this original purpose. Illinois Bell

---

[4] AG Comments at 1-5.

[5] *Final Commission Order* at 157, 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")(emphasis added).

[6] Id. at 158 (emphasis added).

> Telephone Company v. Illinois Commerce Commission, 283 Ill.App.3d 188 at 202, 669 N.E. 2d 919 (2d Dist.1996).

In response thereto, the Court reasoned that:

> Assuming arguendo that CUB is correct about the purpose of the Act and its "subversion' by Section 13-506.1, this does not render Section 13-506.1 beyond the state's police power… The police power provides the authority to legislate for the public good; it does not specifically define the public good or the manner in which the legislature should act pursuant to its police power. The police power, therefore, does not mandate legislation to prevent excess profits. Even if the [Public Utilities] Act's purpose were to prevent excess profits, this would not require all subsequent regulation of public utilities to share this purpose.
> [citation omitted].

With this pronouncement, the Court made clear that under alternative regulation pursuant to Section 13-506.1, **earnings do not, and need not, hold the prominence once afforded them under rate of return regulation. Still further, the Court reasoned that the legislature carefully adopted and tailored Section 13-506.1 to secure affordable telecommunications services by use of competitive mechanisms in place of ROR regulation in a manner that attempts to avoid collateral effects "unrelated to the legislative objective".** (Id.)

….

> … **Given the nature of their arguments, however, the GCI/City have made earnings out to be the sole indicator of just and reasonable rates. Neither the concept of alternative regulation, nor our construction and assessment of the Plan in all its particulars, is in accord with such a view.**

Contrary to the GCI/City's exceptions, the Commission did consider the Company's earnings level, but did so in the context of the Plan and not in the way earnings are treated under traditional regulation. **In other words, earnings are relevant in a tangential way under the Plan whereas the rates themselves are the direct, main and critical focus.** This is true for both historical review and for purposes of going forward. To shift the focus from rates onto earnings, in the way the GCI/City suggest, would give undue prominence to a collateral matter or effect that is "unrelated to the legislative objective" in Section 13-506.1.[7]

[7] Id. (emphasis added).

It is Staff's view that, within the limited context of this proceeding, the Commission's view, as expressed in the Alt. Reg. Review Order, is every bit as applicable today as it was in 2002. This proceeding is convened to calculate a PCI applicable to rates for non-competitive services based on inflation, exogenous factors, service quality performance, and other factors. This proceeding is not a forum for reviewing the conditions of the plan, or indeed the fundamental precepts of price cap regulation generally. Such a review, however, is what the AG seeks here.

This is not to suggest that the AG is foreclosed from seeking from the Commission some variant of the relief it requests here. The AG may, for example, challenge rates under the Plan. Section 13-506.1(e) of the Public Utilities Act provides that: "[a]ny person may file a complaint alleging that the rates charged by a telecommunications carrier under a[n] alternative [regulation plan] are unfair, unjust, unreasonable, unduly discriminatory, or otherwise not consistent with the requirements of … Article [XIII of the Public Utilities Act]."[8] Indeed, the AG may seek rescission of the Plan; the same section provides that: "[u]pon petition by … any person …, the Commission may rescind its approval of an alternative [regulation plan] if … it finds that the conditions [precedent to the Commission adopting a plan] can no longer be satisfied."[9] Likewise, to the extent that the AG is aggrieved by AT&T's rates for competitively-classified services, it is authorized by the Public Utilities Act to seek a Commission investigation of the competitive classification or classifications in question.[10]

---

[8] 220 ILCS 5/13-506.1(e).
[9] Id.
[10] 220 ILCS 5/13-502(b).

What the AG cannot do, however, is request, in the context of this proceeding, that the Commission conduct what is essentially an earnings review of a company subject to alternative regulation.

Despite Staff's criticism of AG's procedural approach, it is Staff's view that regulating the ever-evolving telecommunications market in Illinois requires, as the AG's comments indicate, a continual reevaluation of the propriety of existing rules and regulations. In fact, Staff shares many of the general concerns expressed by the AG's comments. However, acting on these concerns requires that they be more clearly and fully identified, directed, and supported, and brought before the Commission in an appropriate procedural vehicle.

### B. AT&T's 2007 Service Quality Performance Satisfied the Annual Standard of Performance, and the AG's Proposal to Require Month-By-Month Compliance Should be Rejected.

The AG states that: "[a]lthough AT&T] technically met the annual benchmarks, as the 2007 month-by-month report demonstrates, these benchmarks were missed several months this past year."[11] The AG indicates that this "uneven" service quality performance left some consumers frustrated and disappointed,[12] and states that three service quality measures that were particularly problematic, specifically:

- Average Speed of Answer – Customer Calling Centers
- Out of Service > 24 Hours
- Installation Within 5 Business Days

[11] AG Comments at 5.
[12] Id. at 5-6.

For all three measures, AT&T performance was, according to the AG, "uneven," meaning that in some months AT&T did not satisfy the Commission-established benchmark for the measures.[13]

The AG also notes that in both previous alternative regulation proceedings, the Commission identified the tension between service quality and higher earnings. The AG concludes that the Commission should adjust the service quality calculation so that each month is treated separately.[14] In any month that AT&T's service quality fails to satisfy the standard, the AG seeks a 1/12 annual service quality penalty from AT&T.[15]

At the outset, the Staff notes that the statutory provision authorizing the Commission to approve alternative regulation plans, Section 13-506.1 of the Public Utilities Act, provides in relevant part that, to approve a plan, the Commission must first find that the plan "will maintain the quality … of telecommunications services."

Staff understands that consumers might feel frustrated and disappointed when AT&T misses a monthly service quality standard, and would also prefer that AT&T satisfy each of the standards each month. However, by requiring AT&T to satisfy service quality standards on a month-by-month basis, the Commission would be requiring a new, more rigorous, level of service quality performance from AT&T, and such a requirement would be inconsistent with how the Commission developed service quality standards in both previous alternative regulation proceedings. Accordingly, Staff is unable to support the AG's position on service quality standards.

The Commission has determined that alternative regulation service quality standards, generally, should be based on an average of AT&T's actual service quality

---

13 Id.
14 Id. at 7.
15 Id. at 7-8.

performance. The Commission considered this to be the proper approach because, under Section 13-506.1, alternative regulation plans must "maintain" service quality. As the Commission noted in its Alt. Reg. Review Order:

> Pursuant to Section 13-506.1, the Commission may approve the plan or modify the plan and authorize its implementation only if it finds, after notice and hearing, that the plan or modified plan at a minimum, will meet certain standards. In particular, we note that this Section provides that such implementation or modification "will maintain the quality and availability of telecommunications services". (220 ILCS 13/506.1(b)(6)).[16]

Where there was no actual historical data, or AT&T's average performance did not meet Part 730 standards, the Commission relied on Part 730 standards as a minimum level of performance.[17] For all three measures identified by the AG, Average Speed of Answer, Customer Calling Centers, Out of Service > 24 Hours, and Installation Within 5 Business Days, the Commission therefore relied on Part 730 standards as a minimum level of performance.

In response to the directive to "maintain" service quality standards, the Commission determined that an average of previous years' performance would develop the most useful standard. The Commission noted:

> While the Commission prefers to establish benchmarks on a case-by-case basis for each of the measures adopted, as a general proposition, we believe that using five years of data better accounts for year-to-year and seasonal variations in conditions that affect service quality performance.[18]

By averaging AT&T's five-year service quality performance, the Commission intended to allow for fluctuations caused by seasonal variations, thereby creating a standard calculated to "maintain" service quality levels as required by statute. This is

---

16 Alt. Reg. Review Order at 168-69.
17 Id.
18 Id.

clear evidence of the Commission's preference for data that tends to show whether AT&T is maintaining service quality at historic levels.

The AG's proposal would constitute a substantial departure from this. Mathematically speaking, an average, in this context, represents the sum of performance levels for each period divided by the total number of periods. It follows that there will be periods where service quality is above the average, periods where it is below the average, and some periods that might actually precisely correspond to the average. Staff's experience has been that reported AT&T's monthly data typically fluctuates both above and below the annually reported performance.[19]

To now require AT&T's monthly service quality performance to remain at or above an annual average in any given month would mathematically be the same as, and would be de facto the same as, making AT&T's average service quality standards more stringent than those the Commission established in the Alt Reg Review Order for use in the Plan. This is because, while AT&T would, under the AG's proposal, be penalized for the provision of *worse* service in any given month than required by the standard, it would realize no benefit for the provision of *better* service required in one or more months in a year. Under the current standard, AT&T benefits from the provision of superior service in one month, since this can offset substandard service quality in another. – Such a standard as the AG proposes would be tantamount to requiring AT&T to provide levels of service quality that exceed what it has previously provided – AT&T's service quality would have to be, on a *monthly* basis, as good as or better than

[19] It should be noted that AT&T's annual reported calculation is not technically an average of 12-months data. AT&T maintains actual data on a yearly, running-total, basis. It breaks out data and reports it to the Commission on a monthly basis, but because of variations in monthly levels of installations, for example, a simple averaging of reported months would not necessarily match AT&T's reported performance for the year.

it previously had been on a *yearly* basis. This expectation would be inconsistent with the Commission's stated desire, based on the express statutory language, to "maintain the quality and availability of telecommunications services." The AG's proposal would, in fact, require performance that exceeds historic levels, thereby requiring AT&T do better than the statutorily-mandated "maint[enance of] the quality … of service" within the meaning of Section 13-506.1(b)(6).

In all years since the inception of alternative regulation in 1995, there have been months in which AT&T failed some measure or measures, so AT&T's failure to satisfy service quality requirements in one or more months of 2007 is not evidence that service quality is any more "uneven" from month to month than it has been during the pendency of the plan. Moreover, AT&T's service quality performance in 2007 does not represent significant deviation from previous years' filings. For each of the 10 service quality measures, AT&T's 2007 service quality performance satisfied the annual standard of performance, as it has been calculated in previous annual alternative regulation filings.

In summary, the Staff is of the opinion that AT&T's failure to satisfy some service quality requirements in some months of 2007 is considerably less important than its success in satisfying them for the entire year of 2007, which is in fact what the Commission's Alt Reg Review Order requires. The Staff monitors service quality performance on a monthly basis and will promptly bring any evidence of declining service quality to the Commission's attention.

WHEREFORE, the Staff of the Illinois Commerce Commission respectfully requests that its recommendations be adopted in their entirety consistent with the arguments set forth herein.

Respectfully submitted,

_____

Matthew L. Harvey
Megan C. McNeill
Counsel for the Staff of the
Illinois Commerce Commission

Illinois Commerce Commission
Office of General Counsel
160 North LaSalle Street
Suite C-800
Chicago, Illinois 60601
(312) 793-2877

May 16, 2008

# VERIFICATION

I, Samuel S. McClerren, being first duly sworn, depose and state that I am an Economic Analyst in the Engineering Department of the Telecommunications Division of the Illinois Commerce Commission; that I have read the foregoing Staff's Verified Reply Comments to the Verified Initial Comments of the People of the State of Illinois and know the contents thereof; and that the statements contained in the Reply Comments are true, correct to the best of my knowledge, information and belief.

Samuel S. McClerren
Illinois Commerce Commission

Subscribed and sworn to before me
this 13th day of May, 2008.

Notary Public

OFFICIAL SEAL
ELIZABETH A. ROLANDO
NOTARY PUBLIC, STATE OF ILLINOIS
MY COMMISSION EXPIRES 11-6-2011