STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

Illinois Bell Telephone Company	)	
	)	**Docket No. 08-0249**
Annual Rate Filing for Noncompetitive Services	)	
Under an Alternative Form of Regulation	)	

REPLY COMMENTS OF AT&T ILLINOIS

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Illinois Bell Telephone Company ("AT&T Illinois" or the "Company"), by its attorney, hereby submits its Reply to the Comments filed by the Staff of the Illinois Commerce Commission ("Staff") and the People of the State of Illinois (the "Attorney General" or "AG") in the captioned proceeding.

I. AT&T ILLINOIS' ANNUAL RATE FILING

For the second year in a row, there are no contested issues associated with the compliance of AT&T Illinois' Annual Rate Filing with the Alternative Regulation Plan approved in 1994 and re-approved in 2002. *Order in Docket Nos. 92-0448/93-0239 (Consol.)*, adopted October 11, 1994 ("*Alt Reg Order*"); *Order in Docket Nos. 98-0252/98-0335/00-0764 (Consol.)*, adopted December 30, 2002 ("*Alt Reg Review Order*"); *Order in Docket No. 07-0234*, adopted June 27, 2006 ("*2006 Annual Rate Filing Order*"). The Commission Staff reviewed AT&T Illinois' calculation of the new price index, the service quality components of the Plan and Commission orders in past Annual Rate Filing proceedings and concluded that all relevant obligations had been met. Staff concludes its Comments with the following recommendation:

> "Staff recommends that the Commission order AT&T to file the tariff changes as proposed by the company in Exhibit 7 of the annual filing to allow the rate reductions proposed in Exhibit 5 and Exhibit 8 to become effective." (Staff Comments at 13).

The Attorney General raises no *compliance* issues in its Comments, and no comments were filed by the Citizens Utility Board.

Apparently frustrated by the lack of controversy in this year's filing, the Attorney General attempts to manufacture some issues relative to earnings and service quality. Nothing raised by the Attorney General has anything to do with AT&T Illinois' compliance with the Alternative Regulation Plan nor are the issues appropriate for this proceeding.

The Attorney General complains that AT&T Illinois' return on equity ("ROE") on its jurisdictional intrastate operations is too high. (AG Comments at 1-5). However, earnings analysis is not and has never been part of the Annual Rate Filing. As the Attorney General points out, AT&T Illinois is required to submit financial results as part of its Annual Report. (AG Comments at 2). However, there is no earnings component in the Plan itself or in the Annual Rate Filing compliance requirements. Notably, the Attorney General points to none. At most, earnings analyses could be part of an overall review of the functioning of the Plan. However, even in the Alt Reg Review docket – where Staff and the consumer interveners (including the Attorney General) performed full rate-of-return analyses – the Commission concluded that earnings analyses alone were not sufficient to demonstrate that the Plan had resulted in unjust and unreasonable noncompetitive rates:

> "In the final analysis, it is the reasoned judgment of the Commission that noncompetitive rates under the Plan have been, fair, just and reasonable. Rates were set at appropriate levels in 1994 and have declined each year thereafter. Indeed POTS service is cheaper in real terms today than in 1994. While Ameritech's earnings levels have raised warning flags for us, the record evidence does not reflect that noncompetitive rates are not fair, just and reasonable. Furthermore, based on the extensive analysis of the Plan and the price index conducted by the parties, we conclude that the price index, in large part, worked the way we anticipated in 1994 and ensured that Ameritech Illinois' noncompetitive service rates remained fair, just and reasonable. Thus, the statutory requirement we consider here has been met." (*Alt Reg Review Order* at 42).

Even if this were an appropriate docket in which to attempt to make a showing that the rates subject to the Plan are not just and reasonable – and it is not – the Attorney General has not even begun to do so.

Similarly, the Attorney General's request that AT&T Illinois be penalized for every month that its service quality does not meet the prescribed benchmarks falls far outside the scope of this proceeding. It is crystal clear that the service quality ("SQ") component of the price index in the Alt Reg Plan applies on an *annual*, not a *monthly*, basis. As the Commission explained back in the original 1994 Alt Reg Order, monthly *reporting* (on which the Attorney General relies) does not equate to monthly *penalties*:

> "In response to Staff's recommendations, the Company agreed to report monthly performance for each of the eight measures. These monthly reports are intended to facilitate Staff's monitoring of service quality. *The service quality factor in the price formula will still be adjusted annually, not monthly*." (*Alt Reg Order* at 59, emphasis added).

In the 2002 Alt Reg Review proceeding, the Commission considered a range of proposals for changing the SQ measures, the benchmarks associated with those measures and the mechanism for assessing penalties for missed measures (*i.e.*, whether the SQ component of the Plan should be "inside" or "outside" the price index). No one recommended that they be applied on a monthly basis, not even the Attorney General . In making its final decision to leave the service quality penalties "inside" the price index, the Commission made clear that they would still apply on an annual basis:

> "In addition, we find troubling certain aspects of the proposals to remove the Q factor from the Plan. Ameritech demonstrated that there are inconsistencies between the penalty levels associated with removing Q from the Plan and the alternative proposals to leave the Q factor in the Plan. We reiterate that the purpose of the Q factor is to ensure that Ameritech does not allow service quality to suffer in its pursuit of higher earnings. *Ameritech also showed that removing Q from the Price Cap changes the focus from annual results to monthly results. Relying on annual data is more consistent with the*

> *manner in which the benchmarks were derived as well as the annual review of the Plan*." (*Alt Reg Review Order* at 199, emphasis added).

Therefore, there is no basis whatsoever in the Plan for the Attorney General's monthly service quality penalty proposal. It would further be completely inappropriate to consider such a major change in an abbreviated compliance proceeding such as this one.

II. ADDITIONAL RESPONSE TO THE ATTORNEY GENERAL

Although the Attorney General's contentions regarding earnings and service quality have no place in this proceeding and should be disregarded, the Company is concerned that, left unaddressed, they could be misunderstood. Therefore, AT&T Illinois will provide an additional perspective on the issues raised in Attorney General's Comments.

1. EARNINGS

The Attorney General claims that AT&T Illinois is enjoying an extraordinarily high return on equity ("ROE") in connection with its Illinois intrastate operations. Its analysis begins with the Company's reported Company-wide ROE of 30.57%; it then purports to calculate an intrastate ROE on all regulated services (competitive and noncompetitive) of 41% using various techniques of its own creation. (AG Comments at 2-3). An ROE on the noncompetitive services subject to the Plan is not developed or estimated (". . . it is not possible to disaggregate data concerning Illinois Bell's non-competitive and competitively classified services"). (*Id*.).

The Attorney General's analysis provides no useful information relative to the performance of the Plan. *First*, this ROE is not even specific to the services subject to the Plan, as the Attorney General concedes. The Commission has warned the Attorney General before that earnings analyses that include both competitive and noncompetitive services are of little value in assessing the Plan, which applies only to noncompetitive services:

> "We find the arguments put forth by CUB/AG and the GCI/City that rates are not reasonable because earnings are higher than authorized under rate of return unpersuasive. *The evidence does not show that the earnings were derived from the services subject to Alt Reg, or that the rates for those services are somehow unfair, unjust and/or unreasonable. . .*
>
> [Competitive] [s]ervice reclassifications are separate matters and the Commission has the authority to address them under other provisions of the statute." *Alt Reg Review Order* at 41-42, emphasis added.

Second, the Attorney General's ratio technique for developing an intrastate, jurisdictional ROE appears to be entirely of its own invention. No support in the financial or economic literature is provided for this approach. In fact, investor-supplied capital cannot be differentiated on a jurisdictional basis. Furthermore, it makes no sense to compare a derived ROE on a portion of the business of one subsidiary of AT&T to the total company ROE for other major corporations, as the Attorney General attempts to do. (AG Comments at 3). Without debating the merits of blindly comparing the ROE of different companies in unrelated industries, at a minimum the relevant comparator with the 30 Dow Jones Industrial Average and the Standard and Poor's 500 Index would be AT&T Illinois' *parent* – AT&T Inc. – not AT&T Illinois. As the Attorney General concedes, *AT&T Inc.*'s ROE is just 11.11% – substantially lower than the Dow Jones' average of 23.69% and the S&P companies' average of 20.72%. (*Id.*).

Third, the Attorney General's ROE "analysis" implies a far more financially robust AT&T Illinois than is the case. In fact, the Company has suffered major losses due to competition in the local exchange marketplace, as a comparison of its basic operating statistics over time demonstrates. For example, based on ARMIS data routinely reported to both the FCC and this Commission, AT&T Illinois' total company operating revenues in 2000 were

approximately $4.6 billion[1]; in 2007 they were $3.7 billion – a *19% decline*. The results for its regulated intrastate operations have been even more devastating: "local network service" revenues (the ARMIS equivalent of intrastate, jurisdictional operations) were approximately $2.7 billion in 2000 and $1.5 billion in 2007 – a *47% decline*. Over this period, on the other hand, AT&T Illinois' total operating expenses have not materially changed: they were $2.8 billion in 2000 and $2.9 billion in 2007 – a *4% increase*. In short, AT&T Illinois' operating revenues have declined dramatically but its operating costs have not. This is *not* the financial profile of a company that is making money hand-over-fist at the expense of intrastate ratepayers and putting the rest of Wall Street to shame.

Fourth, AT&T Illinois' reported returns on investment over this period do not indicate that the Company is earning substantially more now than it did at the time of the Alt Reg Review proceeding. The relative 2000 and 2007 results shown in AT&T Illinois' Annual Reports are below:

	Total Company	**Intrastate (Adj.)**
2000	22.95%	23.80%
2007	18.05%	24.72%

Moreover, these figures – and to an even greater extent the ROE figures relied on by the Attorney General – significantly overstate the Company's financial performance relative to its actual operating fundamentals. These ostensibly "healthy" reported returns on investment and equity have been significantly and variously influenced by non-regulated and non-operating items, regulatory accounting conventions and accounting changes (*e.g.*, increased nonregulated revenues, reclassification of revenues between jurisdictions, changes in depreciation rates,

[1] The rate-of-return analyses performed in the Alt Reg Review proceeding were based on a 1999 test year. Therefore, a comparison of 2000 data with 2007 data is appropriate to assess developments since that record was compiled.

differences in depreciation reserves, adoption of new financial accounting standards, adjustments related to Financial Accounting Standards ("FAS") 106 (Employers' Accounting for Postretirement Benefits Other Than Pensions), changes in accounting for affiliate billing, changes in pension settlement gains, changes in the accounting treatment of jurisdictional differences, intra-corporate dividend policies, etc.). Thus, an unexamined and simplistic reliance on reported returns (whether on investment or equity) results in a highly unrealistic and misleading view of the actual profitability of AT&T Illinois' intrastate operations.

In short, the Attorney General's "earnings analysis" provides the Commission with nothing of substance that would justify concerns about the efficacy of the Alternative Regulation Plan.

2. SERVICE QUALITY

The Attorney General's contention that AT&T Illinois' service quality in 2007 was "poor," despite the fact that it met all of the SQ measures on an annual basis, is equally flawed. In making this claim, the Attorney General relies on the fact that AT&T Illinois' service quality performance varies from month to month and that it failed to meet the benchmarks for some measures in some months of 2007. (AG Comments at 5-6). Specifically, the Attorney General points to AT&T Illinois' Out-Of-Service-Over-24-Hours ("OSS>24"), Installation-Within-5-Days ("Install w/in 5 days") and Call-Center-Speed-of-Answer performance. It further speculates that this situation is the result of the decreased number of noncompetitive services subject to the price cap formula due to the MSA-1 reclassification in late 2005, thus ". . . reducing the deterrent to service quality degradation. . ." that is incorporated in the Plan. (AG Comments at 7-8).

The uneven service quality performance pointed out by the Attorney General has nothing to do with the adequacy of the Plan and has everything to do with routine and expected month-to-month variations in the work load placed on AT&T Illinois' installation, repair and call center personnel. For example, AT&T Illinois' repair and installation performance is – and always has been – heavily influenced by weather conditions. The Attorney General points to September 2007 as AT&T Illinois' "worst performing month" for both OOS>24 and Install w/in 5 days. (AG Comments at 6). What its Comments ignore is the *reason* for that performance decline. Devastating storms and flooding took place in AT&T Illinois' service territory in late August 2007. The flooding was so severe that the Illinois Governor declared all of the highly populated counties in Northeast Illinois to be disaster areas (*i.e.*, Cook, DuPage, Lake, Kane, McHenry, Will, Grundy, LaSalle and Winnebago counties). As a result of wind and water damage to its plant, the Company experienced an extraordinary level of out-of-service and other repair problems, as shown by the 2.26 trouble reports per 100 access lines for August 2007 (most of them occurring during the last week of August).[2] The average for the other 11 months of 2007 was only 1.43 trouble reports per 100 access lines. This volume of storm-related service problems necessitated delays in clearing non-storm-related troubles as well. It took AT&T Illinois' repair crews until well into September to bring the daily level of pending repair cases back to normal.

Although these "Act of God" repair problems are not included in the OOS>24 performance calculation, in reality they created a crushing load for AT&T Illinois' repair personnel and, thus, substantially affected the Company's OOS>24 performance for the outages that were not excluded from the calculation. (This is why AT&T Illinois has consistently argued that the calculation methodology in Part 730 of the Commission's rules and used in the Alt Reg

[2] The last time trouble reports per 100 access lines exceeded 2.00 was in *2002*.

Plan is inherently unfair). *Order in Docket No. 05-0231*, adopted June 29, 2005, at 22-23, 34-36. However, repair intervals were back to normal in October (when AT&T Illinois had its best performance in 2007), demonstrating that the problems in August and September were weather-related – not a systemic deficiency in AT&T Illinois' plant or technician staffing levels. *Alt Reg Review Order*, *supra*, at 189-99.

This storm-related volume of repair problems flowed through to AT&T Illinois' installation performance as well. The Company necessarily prioritized restoring service damaged by the severe weather in August and September. This required the deferral of some installations otherwise due in August and September, resulting in an installation backlog that continued into October. However, all installations were back on track by the end of October, and the Company's Install w/in 5 days performance in November was excellent.

Moreover, month-to-month variations in installation and repair performance due to weather and other factors are nothing new. AT&T Illinois' service quality performance has always been variable. In 2007, its OOS>24 performance ranged from 2.17% (October) to 7.75% (September). In 2006 (the first year after residence services in MSA-1 were reclassified as competitive), it ranged from 2.32% to 8.10%; in 2005, it ranged from 2.06% to 11.41%; in 2004, it ranged from 3.10% to 6.20%; and in 2003, it ranged from 2.10% to 8.30%. As these data demonstrate, the spreads between AT&T Illinois' "best" and "worst" monthly performances were even larger in 2005 and 2003 – before the MSA-1 reclassification – than in 2007. Thus, contrary to the Attorney General's assertion, these month-to-month variations have nothing to do with the service reclassifications approved in the MSA-1 case or any "reduction" in the deterrent affect of the Plan's SQ penalties.[3] Notably, as a regular participant in these Annual Rate Filing

[3] Although service center performance is not affected by the weather, it is affected by other month-to-month factors. When call volumes temporarily increase or staffing levels temporarily decrease, speed of answer performance

proceedings for many, many years, these annual SQ data have been provided to the Attorney General and are available for review on e-Docket as well – if the Attorney General had actually been interested in assessing historical trends.

Finally, the Attorney General claims that more than "5% of IBT customers" waited more than 24 hours for repair in six separate months in 2007 and that "7.75% of its customers" waited longer than 24 hours in September. (AG Comments at 6). The Attorney General has its math wrong. These percentages (whether 5% or 7.75%) represent *the number of lines reporting a service outage* that did not have the outage corrected within 24 hours – not *all lines* served by AT&T Illinois. In other words, a 7.75% OOS>24 performance means that *0.072%* of AT&T Illinois' lines had to wait more than 24 hours for dial tone to be restored in September of 2007.[4] Conversely, 99.928% of AT&T Illinois' lines were unaffected by outages in that month or were restored within 24 hours. For the small number of lines that were negatively impacted, they received the compensation prescribed by the Commission's rules.

In short, the Attorney General has not even identified a service quality problem that needs to be corrected, much less raised its penalty-every-month proposal in an appropriate forum. In effect, the Attorney General is insisting that AT&T Illinois' service quality be "perfect" (in the sense that each benchmark must be met every month). This is a totally unrealistic standard; and, as the Commission recognized in the Alt Reg Review Order, it would constitute an unwarranted departure from the way in which the benchmarks and penalties were developed.

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declines for those periods. For example, call center volumes can spike as a result of rate changes or advertising campaigns. Workforce illness cycles (*e.g.*, flu season) can cause temporary labor shortages. Even routine training programs can temporarily reduce the number of call center staff manning the telephones on a particular day. Equipment problems at the call centers can also cause back-ups. These "bad days" are difficult to make up due to the nature of call center operations.

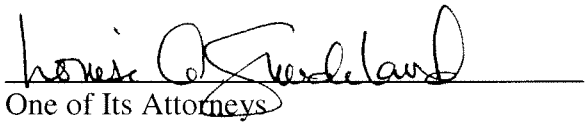
[4] There were 3,244 lines that were out of service for more than 24 hours in September of 2007. 3,244 is 0.072% of AT&T Illinois' 4,502,600 total lines in service in that month.

* * *

In conclusion, there are no contested compliance issues in this proceeding that need to be resolved. The Commission should approve AT&T Illinois' Annual Rate Filing as recommended by Staff.

Respectfully submitted,

ILLINOIS BELL TELEPHONE COMPANY



One of Its Attorneys

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VERIFICATION

I, James Deignan, on oath, state that I am Director – Regulatory for AT&T Illinois, that I have reviewed the foregoing **REPLY COMMENTS OF AT&T ILLINOIS**, and that, to the best of my knowledge, information and belief, the statements contained therein with respect to AT&T Illinois' earnings are true and correct.

James Deignan

James Deignan

Subscribed and sworn to before
me this 16 day of May, 2008

Aletha J Blackmon

Notary Public, State of Illinois

OFFICIAL SEAL
ALETHA J BLACKMON
NOTARY PUBLIC - STATE OF ILLINOIS
MY COMMISSION EXPIRES:02/06/10

VERIFICATION

I, Eric Panfil, on oath, state that I am Director – Regulatory for AT&T Illinois, that I have reviewed the foregoing **REPLY COMMENTS OF AT&T ILLINOIS**, and that, to the best of my knowledge, information and belief, the statements contained therein with respect to AT&T Illinois' service quality are true and correct.

Eric Panfil

Subscribed and sworn to before
me this 16 day of May, 2008

Notary Public, State of Illinois

OFFICIAL SEAL
ALETHA J BLACKMON
NOTARY PUBLIC - STATE OF ILLINOIS
MY COMMISSION EXPIRES:02/08/10

CERTIFICATE OF SERVICE

I, Louise A. Sunderland, an attorney, certify that a copy of the foregoing **REPLY COMMENTS OF AT&T ILLINOIS** was served on the following parties by electronic transmission on May 16, 2008.

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