

STATEMENT OF THE CASE

The Alternative Regulation Review portion of the case was initiated upon the direction of the Illinois Commerce Commission (ICC) based on the Order in ICC Docket Nos. 92-0448 and 93-0239 (Consol.). The Rate Rebalancing portion of the case initially began pursuant to a petition by Illinois Bell Telephone Company d/b/a Ameritech Illinois. The dockets were consolidated. The Citizens Utility Board (CUB) and the Illinois Attorney General's Office (AG) also filed a complaint to reduce rates. A motion to dismiss was filed by Ameritech Illinois.

I. PARTIES OVERALL SUMMARY OF THE CASE – COOK COUNTY STATE’S ATTORNEY’S OFFICE’S POSITION

A. Introduction

Alternative regulation was adopted for Ameritech Illinois to, among other goals, promote the public interest, safeguard service quality, and ensure just and reasonable rates in the face of technology changes and the emergence of competition in the local exchange market.

Unfortunately, the alternative regulation plan has allowed Ameritech Illinois to achieve excessive, unwarranted, and increasing profit levels while harming consumers. GCI Ex. 1.0 at 4 (TerKeurst).

Ameritech Illinois’ intrastate earnings have increased significantly, from a 9.43 percent return on investment in 1995 to a 19.15 percent return on investment in 1999.¹ (These results reported by Ameritech Illinois are unaudited and unadjusted. Other GCI witnesses present evidence regarding the needed adjustments and the resulting effect on Ameritech Illinois earnings.) Ameritech Illinois’ reported intrastate return on investment during 1999 is about double the intrastate return on investment of 9.64 percent authorized in the Alt. Reg. Order.² GCI witness Ralph Smith has estimated Ameritech Illinois’ intrastate return on equity in 1999 to be 24.57%, as explained in his direct testimony, which is more than twice the return on equity of 11.36% adopted by the Commission for Ameritech Illinois in the Alt. Reg. Order.³

Ameritech Illinois asserts that its earnings levels are due to a variety of factors, including aggressive cost cutting measures, increased sales of high-margin services such as vertical

¹Ameritech Illinois response to data request AG 1.2

²Alt. Reg. Order at 174-175.

³Alt. Reg. Order at 174-175.

features and data services, and favorable economic conditions.⁴ Consistent with Ameritech and SBC's assurances to the Commission during their merger proceeding and to investors since the merger consummation, Ameritech Illinois' earnings may increase further as the merged companies continue to enhance Ameritech Illinois' efficiency and sales.

At the same time, the alternative regulation plan adopted in 1994 has failed to ensure that overall consumer prices (including both competitive and noncompetitive services) are fair, just and reasonable. Instead, excessive earnings have been tolerated over the last five years that under rate-of-return regulation likely would have triggered a rate case and overall rate decreases. In addition, because competitive revenues are not subject to the price cap mechanism, Ameritech Illinois has prematurely reclassified its services to competitive status and increased the rates for those services. GCI Ex. 1.0 at 5-6 (TerKeurst). Alternative regulation has not protected consumers against severe, widespread, and worsening degradation in service quality, including the use of misleading and overly aggressive marketing techniques (e.g., the marketing of the SimpliFive and CallPack plans) by Ameritech Illinois to generate higher revenues. Indeed, one would expect that the incentives created by price cap regulation would encourage Ameritech Illinois to take such steps, since the resulting profits go to shareholders. GCI Ex. 1.0 at 6 (TerKeurst).

In addition, Ameritech Illinois has recommended a number of modifications to the alternative regulation plan that would, in essence, gut the plan's limited ability to protect captive ratepayers from Ameritech Illinois' market power. For example, Ameritech Illinois is proposing that all Commission-mandated rate changes be offset by exogenous factor treatment, effective

⁴Ameritech Illinois Ex. 1.1 at 31-33 (Gebhardt); Ameritech Illinois Ex. 8.0 at 18 (Gebhardt).

within 30 days without waiting for the next annual filing. Ameritech Illinois' proposal would strip the Commission of any discretion to determine whether mandated rate changes should be granted exogenous factor treatment. Adoption of Ameritech Illinois' proposal would place tremendous upward pressure on Ameritech Illinois' noncompetitive rates. Of course, if exogenous factor treatment of mandated rate changes is itself a Commission-mandated rate change, Ameritech Illinois' proposal is circular and nonsensical. Regardless, it should be rejected. GCI Ex. 1.0 at 5-6 (TerKeurst).

In an effort to increase its (upward) pricing flexibility for noncompetitive services, Ameritech Illinois is proposing an increase in the cap on allowable rate increases from the change in the price cap index (PCI) plus 2 percent to the change in the PCI plus 15 percent, as well as the consolidation of all services into a single basket. However, there is no evidence to suggest that the existing cap on rate increases has harmed Ameritech Illinois' need for pricing flexibility. Moreover, Ameritech Illinois' proposal would necessarily promote its ability to use Ramsey pricing (i.e., the increase in the rates of less elastic services and the reduction in the rates for more elastic services) to maximize overall profit regardless of harm to customers and the Commission's objections to use of such a pricing approach. GCI Ex. 1.0 at 7 (TerKeurst).

Ameritech Illinois is also attempting to reduce the amount of noncompetitive revenues subject to the price cap mechanism, and thus subject to required annual rate reductions and service quality-related rate adjustments, by proposing the exclusion of a number of noncompetitive services from its service baskets. This is a thinly veiled attempt to minimize the reflection of efficiency gains and service quality degradation in lower noncompetitive rates and should be rejected.

In an attempt to circumvent the infrastructure investment requirements imposed by the Commission in the SBC/Ameritech Merger Order, Ameritech Illinois is proposing that investments by its advanced services affiliate count toward meeting the commitment-investments geared to enhancing the profitability of that affiliate as opposed to targeting such investment to the enhancement of Ameritech Illinois services. Ameritech Illinois is also proposing to dilute the investment reporting requirements imposed in the Merger Order, thereby making it difficult to ascertain how investments have benefited various customer classes and Ameritech Illinois services. Ameritech Illinois' proposals should be rejected. GCI Ex. 1.0 at 7-8 (TerKeurst).

If alternative regulation is retained, significant modifications are necessary because the existing terms and conditions have not met the statutory requirements. First, several safeguards should be adopted that would discourage Ameritech Illinois from prematurely reclassifying services to competitive status. These safeguards include a financial consequence mechanism for premature reclassification as well as expedited customer refund requirements for any overcharges resulting from the premature reclassification. Secondly, the actual price index (API) should be modified to reflect changes in effective, as well as changes in tariffed rates, in order to ensure that manipulations to discount schedules which raise the rates for noncompetitive services are captured by the price cap mechanism. Thirdly, the Commission should explicitly define new services to exclude the bundling of existing services in order to eliminate Ameritech Illinois' ability to raise the rates of existing noncompetitive services outside the price cap mechanism by relabeling them as new services. GCI Ex. 1.0 at 8 (TerKeurst).

Finally, the Commission should adopt an earnings sharing mechanism which would help protect customers against improper cost reductions leading to service quality degradation or improper revenue enhancements due to deceptive and overly aggressive marketing strategies. GCI Ex. 1.0 at 9 (TerKeurst).

For the reasons set forth herein, the alternative regulation plan, as currently crafted, has harmed consumers. Alternative regulation of Ameritech Illinois should not continue unless significant modifications are made to the terms and conditions that were adopted in 1994. Further, Ameritech Illinois' proposed modifications to the alternative regulation plan should be rejected. If the Commission is unwilling to strengthen the alternative regulation plan as GCI suggests, it is recommended that it revert to rate-of-return regulation for Ameritech Illinois. GCI Ex. 1.0 at 9 (TerKeurst).

B. Review of Alternative Regulatory Plan

The alternative regulatory plan adopted by this Commission for Ameritech Illinois in October 1994, has not lived up to expectations. Illinois law requires that, when evaluating an alternative regulatory plan, the Commission must make a number of findings prior to offering its approval. In 1994, Ameritech Illinois was able to convince the Commission to ultimately approve its plan for alternative regulation (Plan) based upon a number of findings made by the Commission, although many of these findings were necessarily based upon expectations of how the Company would respond to the incentives that were to be created by the alternative regulation plan. Now after over six years, the Commission can, and must, reexamine these findings to determine if the Plan has met the policy goals specified in the Illinois statute. Chicago Ex. 1.0 at 4 (Selwyn).

C. Statutory Goals

The key statutory goals set forth in the Public Utilities Act require that the Plan is “in the public interest” and is “a more appropriate form of regulation.” 220 ILCS Sections 13-103 and 13-506.1.

Specifically review of the alternative regulation plan under the Act requires that the Commission evaluate the effects of the plan on consumers (just and reasonable rates, technology improvements, maintenance of service quality), on the Commission (reduced regulatory delay and costs), and on Illinois markets (greater service innovation and efficiency).

There is no evidence that alternative regulation has, in fact, worked to provide the consumer, regulatory, and societal benefits that were anticipated by the Act. Virtually none of the statutory goals have been realized since adoption and implementation of alternative regulation in 1994.

Under the Plan, retail and wholesale service quality has deteriorated; competition effective in constraining Ameritech Illinois’ persistent market power has not developed; and there are strong indications that rates produced by the alternative regulation plan may no longer be just and reasonable. Chicago Ex. 1.0 at 6 (Selwyn).

Where, as here, alternative regulation is shown not to be “a more appropriate form of regulation,” the Act requires that the Commission either reinstate traditional rate base rate of return regulation, or make substantive modifications to the alternative regulation plan so as to remedy each and all of its infirmities. Chicago Ex.1.0 at 7 (Selwyn).

D. Public Policy Goals

The Illinois statute contains numerous goals to which any telecommunications regulatory plan must adhere. In particular, 220 ILCS 5/13-102 (g) finds that:

protection of the public interest requires changes in the regulation of telecommunications carriers and services to ensure, to the maximum feasible extent, the reasonable and timely development of effective competition in all telecommunications service markets.

Concurrently, regulatory burdens are to be reduced, but only to the extent “consistent with the furtherance of market competition and protection of the public interest.” See 220 ILCS 5/13-103 (b). Despite the Commission’s efforts over the past six years, the attainment of competition in local service markets has been conspicuously absent from the Illinois policy landscape. The Commission must reevaluate the situation and take whatever additional steps are necessary to bring about the statutory goals and protect the “public interest.”

Also, 220 ILCS 5/13-506.1(b) requires the Commission to find that an alternative regulation plan “specifically identifies how ratepayers will benefit from any efficiency gains, cost savings arising out of the regulatory change, and improvements in productivity due to technological change,” in order to adopt such a plan. GCI Ex. 3.0 at 43 (Selwyn).

With the benefit of hindsight, the Commission can now make a proper determination as to whether or not Ameritech’s alternative regulation plan has met the statutory requirements, and thus determine whether or not the plan should be continued for Ameritech Illinois. Chicago Ex. 1.0 at 14 (Selwyn). In order for the Commission to perform the necessary evidentiary review and analysis to support the kinds of findings that are *required* by the Illinois statute, it is

necessary that a traditional rate-of-return type of examination be undertaken as a threshold matter before any extension or modification of the current alternative regulation plan can be approved. The statute requires that the Commission find that ratepayers have benefited by adoption of alternative regulation.

E. Price Cap Formula, X-Factor

Ameritech Illinois proposes a revised alternative regulation plan that would actually work to exacerbate the one-sided flow of benefits under its current plan. If the Commission determines that it is in the public interest to continue alternative regulation, the Commission should ignore Ameritech Illinois' proposed changes in favor of the following specific recommendations.

The X-factor should be increased so as to better reflect realized productivity growth (as reflected in Ameritech Illinois' overall return on equity growth over the period) and to assume that those gains are flowed through to Illinois consumers. If the Commission determines that price cap regulation should continue in effect, it should utilize the 6.5% X-factor for application to the Company's intrastate services that has been adopted by the FCC for the interstate jurisdiction. This 6.5% X factor includes a 0.5% consumer productivity factor (CPD); however, if the Commission approves an X-factor lower than 6.5%, the Commission should retain the 1% CPD that presently applies. GCI Ex. 3.0 at 46 (Selwyn).

The Commission should also introduce an M-factor to Ameritech Illinois' price cap plan to ensure the flow through of merger to savings to ratepayers. GCI Ex. 3.0 at 46 (Selwyn).

In addition, due to excessive earnings achieved by Ameritech Illinois, the Commission

should institute earnings sharing in Ameritech Illinois' price cap plan. GCI Ex. 3.0 at 46 (Selwyn). Specifically, the Commission should re-establish the "going-in" rate levels, as it did in Docket 92-0448, so as to permit Ameritech Illinois to earn only its authorized return on equity at the outset of the plan. As the company improves its efficiency over time, increases the volume of services it furnishes to consumers, and takes other measures aimed at increasing its overall profitability (subject, of course, to service quality and other constraints that the Commission may properly impose), it will then be able to once again enjoy earnings growth. GCI Ex. 3.0 at 45 (Selwyn).

When reclassifying services from noncompetitive to competitive, Ameritech Illinois basically takes the position that as long as it is theoretically possible for an entrant to offer service, the entire market is "addressable" and is therefore properly categorized as "competitive." The Company must instead establish "market presence" as opposed to the far more theoretical "addressability" standard that it has used in the past and that Ameritech persists in supporting.

The Commission should reject efforts to expand the scope of exogenous cost changes.

Ameritech Illinois' proposed revisions to the service quality adjustment should be rejected, and new stricter standards should be introduced in an effort to enhance service quality in Illinois. Further, Ameritech Illinois' efforts to (a) exclude certain noncompetitive services from application of the PCI; (b) collapse all noncompetitive services into a single basket to which the PCI would apply; and (c) increase pricing flexibility within that basket to 15%, should be rejected due to the anticompetitive effect that these changes would have upon consumers and competitors. GCI Ex. 1.0 at 7-8 (Selwyn).

Upon review of the Company's rate rebalancing request, the proposed \$2 increase in the basic residential access line rate should be rejected. There are other residential revenue sources derived from usage and vertical features that have no existence independent of the access line. These other sources are more than sufficient to make up any nominal "shortfall" in the basic residential access line rate element that the Company claims to exist. In addition, no increase in the residential access line rate would be necessary to "offset" the recent decrease in switched access charges. GCI Ex. 1.0 at 9 (Selwyn).

F. Service Quality Degradation

It is a well-established fact that pure price cap regulation, to which Ameritech Illinois is currently subject, creates an incentive for telecommunications carriers to allow their service quality to degrade as they aggressively cut costs and maximize profit. The service quality incentive mechanism within Ameritech Illinois' alternative regulation plan was intended to curtail Ameritech Illinois' incentive to allow service quality to decline, thereby safeguarding service quality and protecting Ameritech Illinois' customers. GCI Ex. 2.0 at 4 (TerKeurst).

It is obvious that the service quality incentive mechanism has failed to achieve its intended goals. Service quality data that is of particular relevance is compiled in GCI Ex. 2.1. Almost immediately following adoption of alternative regulation, Ameritech Illinois' service quality took a serious nose-dive. Ameritech Illinois' performance in answering calls from residential customers declined and the number of customer complaints that were escalated to higher levels of Ameritech management increased dramatically. GCI Ex. 2.0 at 5 (TerKeurst).

In addition, Ameritech Illinois' performance in restoring service to customers within 24 hours of a reported outage (i.e. the OOS>24 measure) declined dramatically. Ameritech Illinois' performance regarding the % Out of Service over 24 hours (OOS>24) measure has been one of the most publicized shortcomings because this measure is part of the alternative regulation plan's service quality incentive mechanism and failure to meet the established standard is subject to financial consequences. GCI Ex. 2.0 at 5 (TerKeurst).

Through the years, Ameritech Illinois has dedicated countless hours and reams of paper to the provision of excuses to the Commission regarding its persistent failure to meet the OOS>24 standard. Penalties have been imposed by the Commission, but none have been effective. Ameritech Illinois has continued on its way to more cost cuts and profit enhancements at the expense of customers. GCI Ex. 2.0 at 6 (TerKeurst).

Ameritech Illinois has also been very creative in masking other service quality problems plaguing its plain old telephone service (POTS). For example, Ameritech Illinois has disguised its performance regarding installation of new service by commingling substandard performance data for POTS installation with performance data for services such as vertical features, which can be turned on almost instantaneously at the customer's request. Installation intervals for such non-POTS features were never intended to be part of the measure.

Ameritech Illinois and its new parent SBC have allowed service quality to decline even further since the Ameritech/SBC merger. It has been reported that some customers are waiting weeks for service outages to be resolved; waits of weeks even months for new service installation are not uncommon. The Commission is well aware of the high level of vocal

consumer dissatisfaction and has made efforts in recent months to convince SBC of the need to turn its service quality problems around. GCI Ex. 2.0 at 5 (TerKeurst). Indeed, Ameritech's service quality problems are region-wide and state regulatory commissions throughout the region and even the Federal Communications Commission (FCC) have initiated investigations on the subject. Several states have taken steps to motivate SBC to correct its service quality problems. The service quality remedies in Illinois should be no less stringent. GCI Ex. 1.0 at 6 (TerKeurst).

SBC has blamed Ameritech Illinois' service quality problems on a host of factors, including "unanticipated" retirement, tight labor markets, the weather and changes in federal pension laws. SBC has alleged that it "inherited" the problems from Ameritech, which supposedly developed as Ameritech Illinois slashed costs to be a more attractive merger partner. SBC has acknowledged that one contributing factor has been the labor-intensive nature of DSL installations, all of which require customer premises visits, oftentimes multiple visits. DSL, of course, is a competitive service and should not be provisioned to the detriment of Plain Old Telephone Service (POTS). However, SBC has yet to hold it accountable, as Ameritech Illinois' parent, for the worsening service quality problems, especially in POTS provisioning. Nowhere in SBC's explanation is an acknowledgment of the financial windfalls that it has reaped due to the staffing reductions and other corner-cutting efforts that have elevated the goal of profit maximization over the quality of service offered to customers. This reluctance to accept accountability only heightens concerns over SBC's credibility concerning the resolution of service quality problems on anything more than a temporary basis. GCI Ex. 2.0 at 6 (TerKeurst)

SBC has recently assured this Commission and commissions in the other Ameritech states that it has been attempting to "fix" its service quality problems in response to the

commissions demanding results. Ameritech Illinois has been issuing progress reports touting the improvements that it has made. In fact, Ameritech Illinois announced recently that it has reduced the pending repair and installation backlog by 35% since September 19, 2000. The evidence show that SBC's assurances are hollow. Without incentives, the service quality will continue to degrade because SBC otherwise has scant incentives to "fix" the problem.

SBC and Ameritech Illinois propose in this proceeding to weaken the existing, already seriously deficient, service quality incentive mechanism. Ameritech Illinois hopes, of course, that if it convinces the Commission that it is taking steps to resolve the current crisis, it can show that it is capable of providing high quality service, all will be forgiven, and it can get the company-friendly alternative regulation plan it has requested with weakened rather than strengthened service quality safeguards.

The Commission should be very skeptical of the sincerity or longevity of SBC's current flurry of activity. The question becomes, if SBC and Ameritech Illinois have been able to reduce the backlog so quickly, why didn't they do it right in the first place and maintain service quality? If the recent reports are correct, Ameritech Illinois is capable of marshaling the resources to do the job. GCI Ex. 2.0 at 7 (TerKeurst). Unfortunately, one is left with the answer that SBC and Ameritech Illinois will respond and spend the needed money only under pressure.

For this reason, if alternative regulation is continued, the Commission should continue to apply pressure on SBC and Ameritech Illinois to immediately and permanently resolve the extensive service quality problems. A detailed review of Ameritech Illinois' service quality performance should be a critical part of the Commission's evaluation of the terms and conditions of Ameritech Illinois' alternative regulation mechanism, and the service quality incentive mechanism should strengthen in a number of critical aspects.

First, the service quality incentive mechanism should be divorced from the price cap mechanism, so that the financial consequences of service quality degradation are not diminished as services are reclassified as competitive and so that compensation remains available for all customer classes. Second, several crucial service quality measures should be added to the service quality incentive provisions. Third, the financial consequences of failure to meet the established service quality standards should be increased to levels that would act as a true deterrent to service quality degradation. Fourth, a meaningful customer credit program and a cellular telephone loaner programs should be adopted so that the individual customers who have fallen victim to poor service quality have access to basic telecommunications services and are compensated for their costs and inconvenience. GCI Ex. 2.0 at 8 (TerKeurst) Finally, Ameritech Illinois should be required to report and make publicly available data on its service quality performance. The combination of the above-mentioned elements should help ensure that Ameritech Illinois pays more attention to its service quality on a prospective basis. GCI Ex. 1.0 at 9 (TerKeurst).

G. LRSIC

GCI witness Dunkel provided testimony to address rate design issues; Ameritech's long run service incremental cost (LRSIC) of service study; depreciation expense and to purpose "reinitialized" rates under alternative regulation. The Commission should adopt the rates as set forth in his testimony.

First, the Commission should expressly conclude that loop and port facility cost should not be included in the LRSIC for the NAL service, and the residential and business NAL rates should be reduced by \$1.30 to insure that Ameritech's rates do not exceed its revenue requirement as calculated by Ralph Smith. It is important to note that these proposed rates, the NAL and EUCL rate elements by themselves contribute more than 100% of the loop and port facility cost, even though GCI witness Dunkel testified that this high level of contribution is still improper and excessive. Dunkels overall rate design proposal and the associated revenue impact are summarized on GCI Ex. 8.5. Specifically, Ameritech's proposal to increase residential NAL rates by \$2 per line per month should be denied. The current residential NAL rates are well above their long run service incremental cost (LRSIC).

The Commission rules and accepted economic principles require that the costs of shared/joint common facilities are excluded from the properly calculated (LRSIC) of any of the services, which share those facilities. Even if basic exchange service were not "produced" the cost of the loop facility would still be incurred. The loop facility would still be needed for line sharing, ADSL, vertical features and interstate services, even if basic exchange service (or "NAL" network access line service) were not produced. The properly calculated basic exchange LRSIC should exclude the loop costs because they are shared; just as the toll LRSIC excludes the loop cost.

Further, it is reasonable to price services which share the loop facility above their properly calculated LRSIC to provide a contribution to the loop facilities, which they share with other services. As long as service is priced equal to or above its properly calculated LRSIC, it is not receiving a subsidy. The proposed \$1.30 NAL reduction does not reflect the fact that the

loop facility is shared. The NAL and EUCL are contributing 100% of the loop and port facility cost in this proposal. Recognition of the shared nature of the loop cost justifies a further reduction.

H. Rate Design

Secondly, virtually all of the residential and business usage rates should be reduced. These rates are currently producing significant contributions over LRSIC. Ameritech proposed reducing only one usage rate, the Band B additional minute rate in MSA 1. Ameritech's proposed reduction would have made the contribution for that usage rate approximately **

** . A reduction of rates for other usage services that will produce contributions of the same magnitude. The current Ameritech SimpliFive or 5&5 Plan becomes the SimpliTwo or 2&2 Plan. At these rates, this service would be producing an ** the LRSIC for local usage.

Also, the major residential and business vertical feature rates should be reduced. For example, residential caller ID's present rate is \$5.00. GCI witness Dunkel's proposed rate of \$1.50 should be adopted. The LRSIC (per Ameritech) is ** **. These and other vertical service rate proposals are shown on GCI Ex. 8.25 and 826. Further, the charge for residential and business non-published services should be eliminated as there is ** ** cost for these services. Also, the Commission should consider various changes to miscellaneous listing services as proposed by Dunkel.

Ameritech's proposal to reduce the residential order charges is appropriate. This results in a decrease from the current rate of \$53.55 to \$25 for a new residential service order

establishing one line. These proposed rates are one of several steps that should be taken to improve the level of universal service in Illinois. However, Ameritech's calculation of the cost of the loop and port facilities contains numerous errors that overstate the properly calculated costs, as shown on GCI Ex. 8.15 Ameritech's claimed costs are ** ** in access area A, B and C respectively. When these errors are corrected, the loop and port facilities costs are ** ** in access areas A, B and C, respectively.

I. Depreciation

Finally, the intrastate depreciation expense should be calculated by using the FCC approved parameters for purposes of identifying the appropriate Ameritech revenue requirement in this proceeding. This results in an intrastate depreciation expense of ** ** for 1999. Ameritech initially claimed 1999 intrastate depreciation expenses of ** **, GCI Ex. 8.0 at 10 (Dunkel) This amount was later adjusted by the Company to ** **, GCI Ex. 9.9 at 1 (Dunkel) The use of FCC parameters would prevent Ameritech from double recovery.

The FCC parameters produce a depreciation expense that is reasonable. This result is similar to the result using the ICC approved parameters. The proposed parameters are forward looking, and include a large allowance for the possibility that technological change, competition or other future events will significantly shorten the lives as compared to the lives that have actually occurred in Illinois in the recent past. The ICC should require the Company use the parameters adopted by the ICC in this proceeding for future reporting purposes.

J. Directory Advertising Revenue Imputation

Historically, the ICC has included directory advertising revenue imputation. In the Order that established the current alternative regulatory structure for Ameritech, the ICC included directory-advertising revenue. In their Order, the ICC stated:

The Commission has always included revenues from IBT's Yellow Pages advertising in the calculation of the Company's revenue requirements...

The Commission finds that during the 1990 negotiations which involved IBT's exclusive option to renew the directories agreement, IBT, Ameritech, and API failed to engage in arms length negotiations. Instead, Ameritech and API used IBT's option as bargaining leverage in negotiating an agreement that benefited only API-- Ameritech's unregulated subsidiary. By diverting the contract revenues from IBT to API, Ameritech shareholders received a windfall by not having the revenues count towards IBT's revenue requirements.

ICC Docket Nos. 92-0448/93-0239 (Consol.)(October 11, 1994), Order at 101.

The Commission should continue to include directory-advertising revenues when analyzing Ameritech-Illinois' revenue requirement. The high revenues generated by the LEC "endorsed" directory are a by-product of the provision of basic local exchange service. As a by-product of providing basic local exchange service, the local LEC becomes the known "expert" on the telephone numbers they serve. Because it is the recognized expert on local telephone numbers, the LEC's "endorsement" of a local directory has great value. The high profits of the local LEC "endorsed" directory are directly related to the provision of local exchange service for several reasons:

First, it is reasonable to expect that customers generally are aware that the LEC is the only original authority for the complete and up-to-date names and phone numbers of the LEC's subscribers. It is the LEC that first assigns customers a telephone number. Customers know that if they want to change their telephone numbers, they call their LEC. Therefore, it is reasonable to believe customers generally know that it is the LEC that is the expert for the complete, accurate, and up-to-date telephone numbers for that LEC's subscribers.

Secondly, because the LEC is the recognized expert in local telephone numbers, the LEC's "endorsement" of a directory has great value. If there is a choice of directories, customers generally will prefer using the directory, which they expect to be the most complete, accurate, and up-to-date. Customers expect that will be the directory "endorsed" by the LEC serving that area, because customers are aware that LEC is the only original "expert" for the complete, accurate, and up-to-date telephone numbers of the customers that LEC serves.

Finally, advertisers prefer to advertise in the directory that the public uses the most. Quite simply, the high directory advertising profits of the LEC "endorsed" directory is a direct by-product of the LEC's provision of local exchange service. GCI Ex. 7.0 at 1-3 (Dunkel).

For the reasons stated above, the Commission should continue its practice of including imputed directory revenues in the revenue counted towards meeting Ameritech's intrastate revenue requirement as quantified by Mr. Ralph Smith in his testimony. GCI Ex. 7.0 at 8 (Dunkel).

K. Intrastate Revenue Requirement, Rate Base, Net Operating Income and Adjustment Summaries

As shown in Schedule A in GCI Exhibit 6.1 the Company is significantly over-earning on its Illinois intrastate rate base. GCI Ex. 6.0 at 1 (Smith). Therefore, Ameritech rates should be

reduced significantly before any new regulatory plan- alternative or otherwise-is established by the Commission. Mr. Smith made a number of adjustments, not made by the Company in its presentation, that should be reflected in the Commission's determination of Ameritech's intrastate rate base and net operating income. When those adjustments are considered, the amount of intrastate revenue excess is significantly larger than suggested by the above calculations. GCI Ex. 6.0 at 7-8 (Smith)

L. Conclusion

Upon review of the Company's rate rebalancing request, the proposed \$2 increase in the basic residential access line rate should be rejected because there are other residential revenue sources derived from usage and vertical features that have no existence independent of the access line that are more than sufficient to make up any nominal "shortfall" in the basic residential access line rate element that the Company claims to exist. In addition, and in view of the recommendation that Ameritech Illinois' rates overall be reinitialized to produce, at the outset of any extended price cap plan or reversion to rate of return regulation, no more than the 11.36% return on investment that the Commission had used in initially setting the "going-in" rate levels for the current alternative regulation plan- no increase in the residential access line rate would be necessary to "offset" the recent decrease in switched access charges. Chicago Ex. 1.0 at 9 (Selwyn)

Several safeguards must be adopted that would discourage premature reclassification of services to competitive status and the Commission should explicitly define new services to exclude the bundling of existing services. In addition, the actual price index (API) should be modified to reflect changes in effective, as well as changes in tariffed rates. The Commission should adopt an earnings sharings mechanism.

Finally, the Commission must apply pressure on Ameritech to immediately and permanently resolve the extensive service quality problems. Alternative regulations should not continue unless significant modifications are made to the terms and conditions that were adopted in 1994.

II. Review of Alternative Regulation Plan – Introduction

The Commission is faced with a historic opportunity to review and fine-tune the Alternative Regulation plan. The Commission should take steps to modify the old plan or begin a new Alternative Regulation Plan in order to bring it in compliance with the Illinois Public Utilities Act.

The Public Utilities Act provides for the alternative regulation of non-competitive telecommunications services. 220 ILCS 5/13-506.1.⁵ On October 11, 1994, the Illinois Commerce Commission approved an alternative regulation plan for Illinois Bell Telephone Company.⁶ The Commission provided that Illinois Bell submit an application for review of the alternative regulatory plan by March 31, 1998 when it submits its annual report for 1997. ICC Docket Nos. 92-0448/93-0239 (Consol.)(October 11, 1994), Order at 94-95. The Cook County State’s Attorney’s Office throughout this brief urges the Commission to adopt a variety of changes to the alternative regulation plan.

In addition, Illinois Bell filed a petition to rebalance rates. ICC Docket 98-0335. This petition has been consolidated with the Alternative Regulation Review docket in 98-0252.

A. Scope of the Review Proceeding

Illinois Bell in its testimony proposes various changes to the current plan. However, the Public Utility Act provides that a modified plan must at a minimum meet certain requirements,

⁵The provisions of Article XIII of the Public Utilities Act are repealed effective July 1, 2001. 220 ILCS 5/13-803.

⁶*ICC Docket Nos. 92-0448 and 93-0239 (Consol.) (October 11, 1994) Illinois Bell Telephone Company – Petition to Regulate Rates and Charges of Noncompetitive Services Under an Alternative Form of Regulation. Citizens Utility Board vs. Illinois Bell Telephone Company – Complaint for an Investigation and Reduction of Illinois Bell Telephone Company’s Rates Under Article IX of the Public Utilities Act; Note: There was also an Order on Remand dated July 7,*

including:

- [it] is the public interest;
 - will produce fair, just and reasonable rates for telecommunications services;
 - [and] will maintain the quality and availability of service.
- 220 ILCS 5/13-506.1(b).⁷

Since Ameritech Illinois is seeking modification to the plan, the Commission needs to insure compliance with the applicable provisions of the Act. Additionally, the Act provides the Commission with authority to “...rescind its approval of an alternative form of regulation if, after notice and hearing, it finds that the conditions set forth in subsection (b) of this Section can no longer be satisfied...” 220 ILCS 5/13-506.1(e).

The Public Utilities Act also provided various considerations for the Commission to consider in determining the appropriateness of any alternative form of regulation. These are in addition to the policy goals declared in Section 13-103. The Act provides that the Commission shall consider whether it will:

- (1) reduce regulatory delay and costs over time;
- (2) encourage innovation in services;
- (3) promote efficiency;
- (4) facilitate the broad dissemination of technical improvements to all classes of ratepayers;
- (5) enhance economic development of the State; and
- (6) provide for fair, just and reasonable rates.

220 ILCS 5/13-506.1 (a)(1)-(6).

Ameritech Illinois contends that the scope of this proceeding is relatively narrow. Ameritech points out that this is a review proceeding, not a proceeding to establish the plan in the first instance. Ameritech Illinois Ex. 1.1 at 21-22 (Gebhardt).

1997.

⁷See 220 ILCS 5/13-506.1 (b) for a listing of various minimum requirements that a plan or modified plan needs meet.

The Commission should reject, Ameritech Illinois' position on the scope of this proceeding. As stated by witness TerKeurst " Because the Commission's review is subject to all the goals and requirements of Sections 13-103 and 13-506.1 of the PUA, there is no reason to conclude that a lesser effort should be taken in this review compared to 1993/94." GCI Exhibit 1.0 at 19 (TerKeurst).

The Commission needs to conduct a comprehensive evaluation of Ameritech's earnings "...in order to ensure that rates remain just and reasonable and to promote allocative efficiency." GCI Ex. 1.0 at 13 (TerKeurst). The Commission should reject Ameritech Illinois' contention that "...it would be antithetical to everything that price regulation stands for to resolve just and reasonable issue based on earnings." Ameritech Illinois Ex. 1.1 at 76 (Gebhardt). Ameritech goes and that "any earnings analysis under Section 13-506.1 must by statute be limited to earnings on noncompetitive services. Ameritech Illinois Ex. 1.1 at 77 (Gebhardt). The Commission should reject Ameritech Illinois' interpretation and adopt the approach of witness TerKeurst:

Section 13-506.1(a) specifically authorizes the Commission to adopt an alternative regulation plan that contains an earnings sharing provision and does not limit the shared earnings to those derived from noncompetitive services. Further, the policy goals and requirements applicable to an alternative regulation plan require that the alternative regulation plan result in just and reasonable rates, with this requirement not limited to noncompetitive rates or services. GCI Exhibit 1.0 at 13-14 (TerKeurst).

The scope of this proceeding under both the Act and the Order, allow the Commission to conduct a comprehensive review of the Alternative Regulation Plan. We urge the Commission to adopt the following sweeping changes to the Alternative Regulation Plan.

B. Commission Goals for the Plan

The Commission in the Alternative Regulation Order, discussed the statutory policies and criteria for alternative regulation. ICC Docket No. 92-0448/93-0239 (Consol.)(October 11, 1994). The statute and the original alternative regulation order discuss both policy and legal requirements for an alternative regulation plan. We address these issues throughout this brief.

C. Issues Specified in the 1994 Order

The Commission provided for an application for review in the alternative regulation Order. ICC Docket Nos. 92-0448/93-0239(Consol.) (October 11, 1994) Order at 94-95. The Commission provided a list of issues that the application for review should address. The application for review was required to address the following issues:⁸

- a. Whether the inflation index and the manner in which it is applied provide an adequate reflection of economy wide inflation.
- b. An assessment of productivity gains for the economy as a whole, for the telecommunications industry to the extent data are available, and for Illinois Bell during the period that the alternative regulatory framework has been in place, and whether the adopted general adjustment factor should be modified.
- c. Whether the adopted monitoring and reporting requirements should be retained or adjusted.
- d. The extent to which Illinois Bell has modernized its network, and additional modernization plans for the near term.
- e. A listing of all services in each basket and a report of the cumulative percentage changes in prices for each service during the period the price cap mechanism has been in effect.
- f. A listing of any services that have been withdrawn during the period.
- g. A listing of all services that have been reclassified as competitive or noncompetitive during the period.
- h. A summary of new services which have been introduced during the period.
- i. Information regarding any changes in universal service levels in Illinois Bell's service territory during the price cap period.
- j. Whether, and the extent to which, the adopted regulatory framework has met each of the established statutory and regulatory goals.

⁸ICC Docket No. 92-0448 and 93-0239(Consol.)(October 11, 1994) Order at 94-95.

D. Meeting the Statutory Criteria

The main provision governing any alternative regulation plan is found in (b) of 13-506.1 where the Act provides:

(b) A telecommunications carrier providing noncompetitive telecommunications services may petition the Commission to regulate the rates or charges of its noncompetitive services under an alternative form of regulation. The telecommunications carrier shall submit with its petition its plan for an alternative form of regulation. The Commission shall review and may modify or reject the carrier's proposed plan. The Commission also may initiate consideration of alternative forms of regulation for a telecommunications carrier on its own motion. The Commission may approve the plan or modified plan and authorize its implementation only if it finds, after notice and hearing, that the plan or modified plan at a minimum:

- (1) is in the public interest;
 - (2) will produce fair, just, and reasonable rates for telecommunications services;
 - (3) responds to changes in technology and the structure of the telecommunications industry that are, in fact, occurring;
 - (4) constitutes a more appropriate form of regulation based on the Commission's overall consideration of the policy goals set forth in Section 13-103 and this Section;
 - (5) specifically identifies how ratepayers will benefit from any efficiency gains, cost savings arising out of the regulatory change, and improvements in productivity due to technological change;
 - (6) will maintain the quality and availability of telecommunications services; and
 - (7) will not unduly or unreasonably prejudice or disadvantage any particular customer class, including telecommunications carriers.
- 220 ILCS 5/13-506.1.

In addition, the Public Utilities Act provides for public policy goals that should be considered. 220 ILCS 5/13-506.1(a). See also: 220 ILCS 13-103.

The current plan should be analyzed to see if the various statutory provisions were met under the plan. See also Chicago Ex. 1.0 at 13-15 (Selwyn). The Commission needs to also see if the various statutory provisions will be met under any proposed plan.

1. Just and Reasonable Rates

The rates under the expired alternative regulation plan are not just and reasonable. The Public Utilities Act provides that the Commission “...may implement alternative forms of regulation in order to establish just and reasonable rates for noncompetitive telecommunication services including, but not limited to, price regulation, earnings sharing, rate moratoria, or a network modernization plan.” 220 ILCS 5/13-506.1(a). The Public Utilities Act also provides:

...The Commission may approve the plan or modified plan and authorize its implementation only if it finds, after notice and hearing, that the plan or modified plan at a minimum:..

...(2) will produce fair, just and reasonable rates for telecommunications services;...220 ILCS 5/13-506.1(b)(2).

As noted in the direct testimony of Ralph Smith, “Before the Commission establishes a new regulatory plan for IBT, alternative or otherwise, the Company’s going-in rates must be recalibrated to reflect a just and reasonable level. The excess intrastate return indicates that the Company is due for a significant intrastate rate reduction.” GCI Exhibit 6.0 at 4 (Smith).

Clearly, a rate reduction is needed. Ralph Smith in his rebuttal testimony stated: “The 19.15% return on investment is almost double the authorized cost of capital from Docket 92-0448 of 9.64%... [T]he excess return earned intrastate operations indicates that the Company is due for a significant intrastate rate reduction.” GCI Ex. 6.2 at 4 (Smith). Ralph Smith also noted: “Using the Company’s revised adjusted amounts, as shown in the above table, on intrastate operations, IBT is earning approximately 24.53% on equity. This is more than double the cost of common equity of 11.36% approved by the Commission on page 175 of its Price Cap Order in Docket Nos. 92-0488/93-0239.” GCI Ex. 6.2 at 5 (Smith).⁹

⁹Note: Number and analysis are subject to later adjustment if requested, due to a variety of

In arguing against the appropriateness of certain reporting requirements, Ameritech Illinois witness David Gebhardt contends that: “Under price regulation, a carrier’s rates are deemed “just and reasonable” in reference to a price index - - not earnings. Price regulation is, in fact, earnings deregulation.” Ameritech Illinois Ex. 1.0 at 10 (Gebhardt). Gerhard’s position under alternative regulation is the company can earn skies the limit. Tr. at 435 (Gebhardt). Gebhardt admitted the company earned well, yet did not consider the earnings that the company achieved to be excessive. Tr. at 435 (Gebhardt). The Commission need reject the skies the limit view and apply the just and reasonable standard and make reductions as appropriate.

An analysis of Ameritech Illinois’ earnings is appropriate in this docket, as noted by witness TerKeurst: “A comprehensive evaluation of Ameritech Illinois’ earnings under the alternative regulation plan is not only appropriate but necessary in order to ensure that rates remain just and reasonable and to promote allocative efficiency.” GCI Exhibit 1.0 at 13 (TerKeurst).

If you are to consider any earnings analysis under 13-506.1, Ameritech Illinois contends they should be limited to consideration of earnings on noncompetitive services. Ameritech Illinois Ex. 1.1 at 77 (Gebhardt). The Commission should reject this approach. The Act requires that any rates have to be fair, just and reasonable for telecommunications services and this is not necessarily limited to noncompetitive services. See 220 ILCS 5/13-506.1(b)(2); 220 ILCS 5/13-506.1(a)6). If the Commission were to just look at earnings for noncompetitive services, this would significantly understate Ameritech Illinois’ earnings. GCI Exhibit 1.0 at 15 (TerKeurst). The Commission should examine Ameritech Illinois’ earnings from both competitive and non-

factors including corrections, updates and evaluations of the record evidence. Above statements were from the pre-filed testimony.

competitive services and reduce rates as appropriate to a just and reasonable level.

2. Universal Service

The Commission needs to take steps to reduce the declining universal service that has occurred during alternative regulation in Illinois. Any alternative regulation plan needs to be “in the public interest”. 220 ILCS 5/13-506.1(b)(1). Declining universal service in Illinois is not in the public interest. Further, Section 13-102 (a) notes the General Assembly’s finding that “universally available and widely affordable telecommunications services are essential to the health, welfare and prosperity of all Illinois citizens;...” 220 ILCS 5/13-102(a). The Federal Telecommunications Act also provides that: “ The Commission and the States should ensure that universal service is available at rates that are just, reasonable and affordable.” 47 USC 254(i). See also GCI Ex. 9.0 at 4-5 (Dunkel). The Commission should utilize all the tools at its disposal in order to improve universal service in Illinois. Ameritech Illinois’ proposed \$2 NAL increase would increase the rates charged to lifeline customers. GCI Dunkel’s proposal would reduce them.

The original alternative regulation order provided for a basic residential service rate cap. This Commission noted: “The rate cap will protect access to the telecommunications network and a base level of universal service for every citizen of Illinois during a period in which the Commission must turn its attention toward reexamining the appropriate scope of universal service, and must grapple with the complex social and economic issues associated with new technologies and emerging competition.” ICC Docket No. 92-0448/93-0239 (Consol.) (October 11, 1994), Order at 65.

William Dunkel testified that under the alternative regulation plan, the penetration rate worsened in Illinois. GCI Exhibit 8.0 at 6-7 (Dunkel). He testified that “The Illinois penetration

rate declined from 93.6% in 1995 to 91.8% in 1999. This is a statistically significant change in percent penetration. During this period, the FCC's study indicates that nationwide penetration rate actually increased slightly from 93.9% in 1995 to 94.2% in 1999, in contrast to the sharp decline in penetration rates in Illinois." GCI Exhibit 8.0 at 7 (Dunkel). Dunkel goes on to note that Illinois has the seventh lowest penetration rate in the nation. GCI Exhibit 8.0 at 8 (Dunkel). Dunkel also points out that penetration rates are an acknowledged measure of the extent of universal service. GCI Exhibit 8.0 at 9 (Dunkel). Also, in the recent FCC report, a map identifies Illinois as the only state, which experienced a "significant decrease" in penetration. GCI Ex. 9.0 at 1 (Dunkel); GCI Ex. 9.1 (Dunkel).

William Dunkel contends that his rate design recommendations are designed to benefit universal service. GCI Exhibit 8.0 at 10 (Dunkel). Some of Dunkel's changes that he testified will benefit universal service include: "1. Reducing the current high Ameritech residential installation and connection non-recurring charges. 2. Reducing the rates for local usage, which are currently priced substantially above cost. 3. Reducing the residential network access line (NAL) rates." GCI Ex. 8.0 at 10 (Dunkel).

3. Network Investment and Modernization

The Commission should adopt TerKeurst's recommendation of maintaining the \$3 billion investment requirement.

TerKeurst noted in testimony: "Particularly in light of concerns regarding whether Ameritech Illinois will maintain an arms-length and nondiscriminatory relationship with AADS, I recommend that the Commission maintain the \$3 billion investment requirement while specifying that Project Pronto and any other investments made to support advanced services that would be provided by AADS cannot be used to meet the investment requirement." GCI Ex. 1.0

at 83 (TerKeurst). At the time of her direct testimony, TerKeurst could not make a recommendation regarding the proper level of investment with respect to AADS and Project Pronto given Ameritech's refusal to provide any information regarding AADS' investment plans. GCI Ex. 1.0 at 83 (TerKeurst).

In the original alternative regulation case the Commission noted: "Illinois Bell also has made an explicit commitment to spend at least \$3 billion to grow and modernize its network." ICC Docket No. 98-0448/93-0239 (October 11, 1994) (Consol.), Order at 182. "Under alternative regulation, Ameritech Illinois has incentives to reduce expenditures throughout its operations." GCI Ex. 1.0 at 72 (TerKeurst). The SBC-Ameritech merger order had a provision related to the \$3 billion infrastructure investment commitment. See Merger Order ICC Docket 98-0555. This was made subject to adjustment in the proceeding reviewing the Alternative Regulation Plan.

III. Going Forward Proposal

A. Relative to Existing Components

1. Price Index Formula

In the Alternative Regulation Order the Commission adopted a price regulation formula that utilized GDPPI minus 4.3%. ICC Docket No. 92-0448/93-0239 (Consol.), Order at 40. The Commission indicated that "...a 4.3 X- factor would yield just and reasonable rates." ICC Docket No. 92-0448/93-0239 (Consol.), Order at 40. In the instant case, Illinois Bell reviews more recent evidence on the values of the X factor components used in the price index formula. Ameritech Illinois Ex. 2.1 at 5-11 (Meitzen). Meitzen indicates:

The recent LEC industry evidence from 1992 through 1998 shows a TFP differential of 2.3 percent and an input price differential of

1.0 percent, which would also produce an X factor of 3.3 percent. Using Ameritech Illinois data from 1992 through 1999, the combination of the TFP differential (2.9 percent) and the input price differential (0.6) would produce an X factor of 3.5 percent. Ameritech Illinois Ex. 2.1 at 11 (Meitzen).

Ameritech proposes a forward looking X factor of 3.3%. Ameritech Illinois Ex. 3.0 at 8 (O'Brien).

Substantial record evidence indicates that the Commission should adopt the 6.5% X factor that Dr. Lee Selwyn suggests in his testimony. GCI Witness Dr. Lee Selwyn recommended that the Commission reject the alternative regulation plan proposed by Ameritech Illinois. However, if the Commission decides that price cap regulation should continue, Dr. Selwyn indicates that the Commission should use “the 6.5% X factor for application to the Company’s intrastate services that has been adopted by the FCC for the interstate jurisdiction.” GCI Ex. 3.0 at 46 (Selwyn). This 6.5% includes a 0.5% consumer productivity dividend. Dr. Selwyn goes on to recommend that if the Commission adopts an X-factor of less than 6.5%, that the Commission should retain the 1% consumer productivity dividend that presently applies. GCI Ex. 3.0 at 46 (Selwyn).

2. Price Cap Productivity Factor and Input Price Differential

The Commission should reject Ameritech Illinois’ proposed X factor of 3.3%. The Commission should adopt Dr. Selwyn’s recommendation “...that this Commission *conform* the Illinois price cap formula to that adopted by the FCC, since the FCC’s 6.5% X-factor was based on *total company* productivity results.” GCI Ex. 3.0 at 23-24 (Selwyn)¹⁰. As noted by Dr. Selwyn, Ameritech Illinois “was a signatory to the CALLS proposal, a petition that would,

¹⁰See GCI Ex. 13.0 (Selwyn) for discussion of Dr. Selwyn’s view of the effect of the US Court of Appeals remand of the decision to adopt the 6.5% X-factor.

among other things, retain an X-factor of 6.5% until switched access charges reach 0.55 cents per minutes for the Bell Companies and GTE, ..." GCI Ex. 3.0 at 25 (Selwyn). Ameritech agreed to the CALLS before the FCC, and the ICC should adopt the number as a reasonable number based on the record in the instant case. See also: Tr. at 712.

Dr. Selwyn "calculated a productivity factor that, had it been in effect from the inception of the alternative regulation plan, would have allowed Ameritech Illinois to achieve its allowed return of 11.36%." and "...The resulting X-factor was 11.06%."¹¹ GCI Ex. 3.0 at 26 (Selwyn). Dr. Selwyn did not recommend that the Commission use the 11.06% productivity factor in its alternative regulation plan and recommended the Commission use 6.5%. GCI Ex. 3.0 at 35-36 (Selwyn). Dr. Selwyn's implicit X-factor analysis "simply illustrates that this is clearly within the realm of possibility for achievement for Ameritech Illinois and that, in fact, the Company should still be able to reap the rewards of its productivity gains." GCI Ex. 3.0 at 36 (Selwyn). Dr. Selwyn points out that the current X-factor is inadequate, and rates could have been reduced more. Further, the 6.5% may still be quite conservative in light of the merger. GCI Ex. 3.0 at 36 (Selwyn).

Dr. Selwyn notes, "An appropriate X-factor calculated using a TFP study consists of the following three component parts: Measure of productivity growth; Input price growth differential, and a Consumer Productivity Dividend." GCI Ex. 3.0 at 7 (Selwyn). A productivity differential and an input price differential are a part of the price regulation formula.

¹¹Dr. Selwyn stated: "My calculation of 11.06% for Ameritech Illinois was based upon Ameritech Illinois data and results of operations. I would note, however, that I have utilized *unseparated* Ameritech Illinois data and have thus calculated an implicit X-factor based upon *total company* results rather than intrastate-only jurisdictional results for Illinois, which is the same approach adopted by the FCC..." GCI Ex. 3.0 at 26 (Selwyn). See also GCI Ex. 3.0 at 33-

In the Alternative regulation order the Commission adopted an input price differential of 2.0% and a productivity differential of 1.3%. ICC Docket No. 92-0448/93-0239 (Consol.), Order at 40 (October 11, 1994). Ameritech Illinois recommends that 2.3 % points per year be used for the productivity differential component of the X factor, and proposes an input price differential of 1.0 %. Ameritech Illinois Ex. 3.0 at 9 (O'Brien). The Commission should reject Ameritech Illinois' approach and adopt the approach taken by Dr. Selwyn and use 6.5%.

3. GDPPI – Measure for Economy Wide Inflation

The Alternative Regulation Order adopted GDPPI as a measure of economy wide inflation. ICC Docket Nos. 92-0448/93-0239 (Consol.) (October 11, 1994), Order at 36. Ameritech Illinois notes that “The GDPPI is a widely-accepted measure of economy-wide inflation.” Ameritech Illinois Ex. 2.0 at 5 (Meitzen). Ameritech witness Meitzen notes:

...Therefore, the “official” government measurement of economy-wide inflation and productivity are now performed on a chain-weighted basis. The measurement of economy-wide input price changes is also on a chain-weighted basis, because the change in input prices for the economy is calculated as the change in output prices plus the change in TFP.

The Commission may wish to consider these changes in the official economy-wide measurement of inflation, productivity and input prices. However, to use a chain-weighted GDPPI in Ameritech Illinois' price index formula, the Commission would have to completely recalculate the price index formula, as all components of the X factor would have to be measured on a chain-weighted basis. Ameritech Illinois Ex. 2.0 at 7 (Meitzen).

Ameritech Illinois proposes that a chain weight GDPPI should replace the current fixed weighted GDPPI.

35 (Selwyn) for details of the “implicit X-factor” calculation.

Substantial record evidence indicates that the fixed weight GDPPI should be replaced with the chain weighted GDPPI. GCI Ex. 3.0 at 12 (Selwyn). Dr. Selwyn agreed with Ameritech's proposal that the fixed weighted GDP-PI should be replaced with the chain weighted GDP-PI. GCI Ex. 3.0 at 12 (Selwyn). Dr. Selwyn testified that: "The chain-weighted GDP-PI, published by the BEA, is generally viewed as the most appropriate measure of economy wide output price inflation for purposes of a price cap plan. GCI Ex. 3.0 at 12 (Selwyn). The Commission should adopt the chain weighted GDPPI.

4. Consumer Productivity Dividend

The X-factor includes a component called the consumer productivity dividend which "represents an advance commitment by the regulated utility to flow through to consumers a portion of the benefits that will result from adoption of the incentive regulatory mechanism." GCI Ex. 3.0 at 9 (Selwyn). The Commission provided for a 1.0 % consumer productivity dividend as part of the plan. ICC Docket No. 92-0448/93-0239 (Consol.), Order at 39 (October 11, 1994). The Commission noted that:

"Section 13-506.1 of the Act requires that an alternative plan of regulation identify specifically: how ratepayers will benefit from any efficiency gains; cost savings arising out of the regulatory change; and improvements in productivity due to technological change. We are persuaded that the adoption of an additional increment to the price regulation formula is the most direct and appropriate way to achieve these goals." ICC Docket No. 92-0448/93-0239 (Consol.), Order at 39 (October 11, 1994).

The Commission should reject Ameritech Illinois' request to eliminate the consumer dividend.¹² Without the consumer dividend, it is difficult to see how consumers would benefit under the plan. Dr. Selwyn testified that the consumer productivity dividend has proven to be

¹²See Ameritech Illinois Ex. 3.0 at 8 (O'Brien).

inadequate. Dr. Selwyn generally recommended that “...the ICC conform its price cap formula to the FCC’s 6.5% X factor, which includes a CPD of 0.5%. However, if the ICC were to adopt an X-factor below the 6.5% that I recommend, then I would urge the ICC to retain the existing 1.0% CPD in Illinois.” GCI Ex. 13.0 at 26 (Selwyn); *See also* GCI Ex. 13.0 at 28 (Selwyn). He also indicates that sharing should be included in any future alternative regulation plan. GCI Ex. 3.0 at 43 (Selwyn).

5. Pricing Flexibility and Baskets

The Alternative Regulation Plan provided for four baskets: residential, business, carrier, and other. 92-0448/93-0239 (Consol.), Order at 66-71. Ameritech Illinois is proposing that the baskets be consolidated into a single basket. Ameritech Illinois Ex. 3.0 at 16 (O’Brien).

The Commission should reject consolidating the four baskets into one. As stated by witness TerKeurst “Ameritech Illinois’ proposal elevates the objectives of price flexibility over the welfare of ratepayers and should be rejected. In approving the four basket structure, the Commission correctly recognized that such a structure is needed to help ensure that telecommunications services will be available to *all* Illinois citizens at just, reasonable, and affordable rates, consistent with the goals identified in the PUA.” GCI Ex. 1.0 at 45 (TerKeurst).¹³ Further, consolidation would provide an opportunity to utilize Ramsey pricing among customer classes and would increase the incentives to prematurely classify services as competitive. GCI Ex. 1.0 at 46 (TerKeurst). The baskets provide safeguards to ratepayers and Ameritech Illinois’ consolidating them into one should be rejected.

¹³See also 92-0448/93-0239 (Consol.), Order at 69.

The Alternative Regulation Order provided for 2% pricing flexibility. ICC Docket No. 92-0448/93-0239 (Consol.), Order at 70. Ameritech proposed that this be changed to 15% increase per year. Ameritech Illinois Ex. 3.0 at 16 (O'Brien). The Commission should reject this change. As noted by Charlotte TerKeurst, "Ameritech Illinois' proposed pricing flexibility far exceeds any reasonable limit." GCI Ex. 1.0 at 46-47 (TerKeurst).

6. Services Subject to Alternative Regulation

The Commission should adopt the approach of GCI witness TerKeurst and include switched and nonswitched access services, UNEs, interconnection, and transport and termination services in the carrier basket. See GCI Ex. 1.0 at 48-61 (TerKeurst). Further, pursuant to TerKeurst testimony, wholesale services should continue to be included in the alternative regulation mechanism and should be removed from the carrier basket and placed in the same basket as their companion retail services. GCI Ex. 1.0 at 59-60 (TerKeurst). Also, the Commission should reject excluding 911 services and should include E911 services in the alternative regulation mechanism and they should be in the other basket. GCI Ex. 1.0 at 61 (TerKeurst). As stated by TerKeurst: "Further, given the importance of affordable emergency services, every effort should be made to ensure that the rates for those services receive the benefit of Ameritech Illinois' ongoing efficiency gains. Additionally, E911 and 911 services should receive a financial benefit if Ameritech Illinois fails to meet the standards established in the service quality incentive mechanism." GCI Ex. 1.0 at 60-61 (TerKeurst).

7. Calculation of the API and PCI

The Commission should adopt the various recommendations of Charlotte TerKeurst with respect to the PCI and API. The PCI and API should be reinitialized as discussed in the testimony of GCI witness TerKeurst. GCI Ex. 1.0 at 61(TerKeurst). The Commission should

also close the loophole and provide that “the API formula should be applied in a manner that would measure any changes in *effective* rates that may occur as a result of modifications to discount calling plans or other factors.” GCI Ex. 1.0 at 64 (TerKeurst).

The Commission should adopt TerKeurst’s approach and clearly define the term “new service” to exclude the bundling or reconfigurations of existing services. Also the Commission should adopt the approach of TerKeurst where she provides: “Further, the terms of the alternative regulation plan should specify that, if Ameritech Illinois bundles or otherwise reconfigures existing services to create a new offering, each noncompetitive portion of the bundled offering should be priced subject to the price cap mechanism and included in the same basket as that in which the noncompetitive service is included when offered on an unbundled basis.” GCI Ex. 1.0 at 67 (TerKeurst).

B. Relative to New Components

1. Merger Savings

The Commission needs to ensure that savings are flowed through to ratepayers.¹⁴ The Commission should utilize Dr. Selwyn’s approach and should introduce a new variable into the price cap formula and adopt an “M-factor” to reflect merger savings. Dr. Selwyn indicated the M-factor would initially be set at 4.8%. GCI Ex. 3.0 at 40 (Selwyn). Dr. Selwyn noted that the PCI can be adjusted if the Commission determines that a different M-factor should be applied after the Commission investigation of merger savings. GCI Ex. 3.0 at 40 (Selwyn).

C. Reinitialization of Rates

The Commission needs to reduce Ameritech Illinois rates to a just and reasonable level. The Commission in approving the Alternative Regulation Plan provided for this review. In order

to conduct a meaningful review, the Commission needs to analyze Ameritech Illinois' earnings and order rate reductions as warranted by the evidence. Whether one views the result of this proceeding as a new or a modified plan, we urge the Commission to undertake the same comprehensive analysis that it undertook to ensure compliance with the Public Utilities Act when approving the original alternative regulation plan.

Smith noted that: "Before the Commission establishes a new regulatory plan for IBT, alternative or otherwise, the Company's going in rates must be recalibrated to reflect a just and reasonable level. The excess intrastate return indicates that the Company is due for a significant intrastate rate reduction." GCI Ex. 6.0 at 4 (Smith).

The Commission needs to reinitialize rates consistent with the testimony of Dr. Selwyn who indicated:

Specifically, the Commission should re-establish the "going-in" rate levels, as it did in Docket 92-0448, so as to permit Ameritech Illinois to earn only its authorized return on equity at the outset of the plan. As the Company improves its efficiency over time, increases the volume of services it furnishes to consumers, and takes other measures aimed at increasing its overall profitability (subject, of course, to service quality and other constraints that the Commission may properly impose), it will then be able to once again enjoy earnings growth. It makes no sense for the going-in rates to be excessive at the very outset, and reinitialization is thus essential to assure that rates under the revised alternative regulation meet the statutory requirement of being "just and reasonable." GCI Ex. 3.0 at 45 (Selwyn).

As noted by Dunkel: "The rate design proposals contained herein are based upon a change in Ameritech's annual revenue requirement, as discussed in the Direct Testimony of Mr. Ralph Smith. As discussed in Mr. Smith's testimony, Ameritech is significantly over-earning. Therefore, a corresponding significant reduction in Ameritech's overall revenues would be

¹⁴See ICC Docket 98-0555 for a discussion of the treatment of merger savings.

appropriate to establish the “reinitialized” rates under an alternative regulation structure.” GCI Ex. 8.0 at 11 (Dunkel).

Dunkel points out that: “The reinitialized rates that come out of this proceeding should be designed to improve universal service, not to make it worse or to continue it at its present, unsatisfactory level. GCI Ex. 9.0 at 10 (Dunkel). Dr. Selwyn testified that “I am recommending that Ameritech Illinois’ rates be *reinitialized* to produce no more than the 11.36% rate of return that the Commission had utilized in setting the “going-in” rates for the current price cap regulation plan, and that the ROI be used to set going-in rates for any extension of the current alternative regulation plan or for reinstatement of rate of return regulation.” Chicago Ex. 1.0 at 75 (Selwyn).

Rates under the plan need to be just and reasonable. 220 ILCS 5/13-506.1 (b)(2); 220 ILCS 5/13-506.1(a)(6). The Commission should adopt reinitialized rates under any new or revised alternative regulation plan.

D. Earnings Sharing

The Public Utilities Act provides for earnings sharing as an option. 220 ILCS 5/13-506.1(a). The Commission should provide for earnings sharing as part of any alternative regulation plan approved in this docket.

Charlotte TerKeurst testified that “Earnings sharing would provide a degree of protection to customers by requiring Ameritech Illinois to share excessive earnings. It would also lessen somewhat Ameritech Illinois’ incentives to inflate earnings improperly through cost-cutting measures that harm customers.” GCI Exhibit 1.0 at 67 (TerKeurst).

The Commission declined to adopt earnings sharing in the original alternative regulation plan. The Commission stated: “Whether to adopt a sharing provision as a component of an

alternative form of regulation of noncompetitive services is one of the most significant decisions the Commission will make in this proceeding.” ICC Docket No. 92-0448/93-0239 (Consol.), Order at 49. The Commission stated:

The Commission’s decision to exclude express earnings sharing from the alternative regulation plan approved in this proceeding is not to be construed as a rejection of all earnings sharing mechanisms for the future. This is the initial alternative regulatory plan for telecommunications in Illinois. The Commission will, in its future review proceedings, entertain evidence and argument of policy considerations for the provision of some forms of earnings sharing in a revised plan. ICC Docket No. 92-0448/93-0239 (Consol.) (October 11, 1994), Order at 51.

The Commission seemingly left the door open for it being appropriate at another time, and we urge the Commission to conclude with respect to earning sharing that its time has come and adopt earnings sharing as part of any new order. The Commission should adopt Charlotte TerKeurst’s approach to earnings sharing as described in her testimony. GCI Exhibit 1.0 at 67-72 (TerKeurst).

E. Rate of Return Regulation

The Commission should allow Ameritech Illinois to continue under a new or modified alternative regulation plan. The original alternative regulation plan expired at the end of the first five years. The Commission in its Order stated “We conclude that it is appropriate to impose the statutorily mandated cap on residential basic services (Access and Band A) for the full five-year period of the alternative regulation plan.” ICC Docket No. 92-0448/93-0239 (Consol.), Order at 64 (October 11, 1994). The Commission also required Illinois Bell to submit an application for review of the adopted alternative regulation mechanism by March 31, 1998 when it submits its annual report for 1997. ICC Docket No. 92-0448/93-0239 (Consol.), Order at 94 (October 11, 1994). At the conclusion of the five years, the plan expired, and this docket is a new alternative

regulation plan.

Whether one views the plan as expired or continuing, the Commission is ultimately faced with the choice of whether to allow Illinois Bell to be regulated under an alternative form of regulation or to return it to rate of return regulation. The Commission should put in place a new/modified alternative form of regulation plan. The Commission needs to make a variety of modifications in order to bring the current plan, even with Ameritech Illinois' proposed modifications, into compliance with Illinois law. Those modifications are discussed throughout this brief. If the Commission does not bring the Alternative Regulation plan into compliance with Illinois law, then the Commission should return Ameritech Illinois to rate of return regulation.

F. Other

1. Basic Residential Rate Price Cap

One of the key provisions to ensuring compliance with Section 13-506.1(b) was the basic residential price cap. The Commission had the foresight to ensure that residential consumers were protected throughout the plan by capping prices for the five-year period of the plan.

The Commission needs to determine whether as a result of this proceeding we have a new plan or a modified plan. The Illinois Public Utilities Act provides in part:

An alternative regulation plan approved under this Section shall provide, as a condition for Commission approval of the plan, that for the first 3 years the plan is in effect, basic residential rates shall be no higher than those rates in effect 180 days before the filing of the plan. 220 ILCS 5/13-506.1 (c).

The current alternative regulation plan is expired. The Public Utilities Act in Section 5/13-506.1(c) provides for the Commission to cap basic residential rates. The Commission should provide for a cap on residential rates throughout the plan. It is unclear whether a modified plan

would be subject to Section 5/13-506.1(c). However, even if the Commission does not view the plan as a new one, the Commission can choose on its own to impose a cap on basic residential rates. The Commission noted in the original order that it had the authority to extend the term of the basic residential rate cap if they concluded it was necessary to ensure conditions in Section 13-506.1(b) are met. ICC Docket No. 92-0448/93-0239 (Consol.) (October 11, 1994), Order at 64.

The original alternative regulation order provided:

We conclude that it is appropriate to impose the statutorily mandated cap on residential basic services (Access and Band A) for the full five-year period of the alternative regulation plan. ICC Docket No. 92-0448/93-0239 (Consol.)(October 11, 1994), Order at 64.

In its rate rebalancing discussion, Ameritech Illinois contends that “Both the statutory 3-year cap on basic residence rates and the Commission’s five- year cap on rates in the residence basket have expired.” Ameritech Illinois Ex. 1.2 at 30 (Gebhardt). Whatever ones view, the Commission should adopt a cap as part of any new or modified plan.

2. Reclassification of Services from Non-competitive to Competitive

The current Alternative Regulation plan should be modified in order to reduce the incentives for Ameritech Illinois to prematurely classify services as competitive and raise rates. GCI Ex. 1.0 at 31 (TerKeurst). TerKeurst recommended that where the Commission overturns competitive reclassifications, there should be a financial consequence of \$10,000 per day under the alternative regulation plan. GCI Ex. 1.0 at 32 (TerKeurst). TerKeurst also recommended that “...the manner in which Ameritech Illinois reclassifies services as noncompetitive and

provides refunds following a Commission rejection of a competitive reclassification should be streamlined to speed the refunds to customers.” GCI Ex. 1.0 at 33 (TerKeurst).

Another of the recommendations made by witness TerKeurst calling for earnings sharing should be adopted. “An earning sharing mechanism would reduce Ameritech Illinois’ incentive to prematurely reclassify services as competitive and raise their rates, because Ameritech Illinois would be obligated to share those revenues with customers.” GCI Ex. 1.0 at 33 (TerKeurst).

Competition in the local exchange area is extremely limited and is likely to remain that way in the near future. GCI Ex. 1.0 at 20 (TerKeurst). Charlotte TerKeurst testified that: “As I explain in this section, alternative regulation provides incentives for Ameritech Illinois to stymie local competition, prematurely reclassify services as competitive, and then use its market power to raise rates. Ameritech Illinois’ actions are the very antithesis of the workings of a competitive market and demonstrate quite clearly that competition has not developed in local markets to the extent needed so that it can function as a substitute for regulation.” GCI Ex. 1.0 at 20 (TerKeurst).

Charlotte TerKeurst pointed out that she believes that Ameritech Illinois has prematurely classified services as competitive and then increased rates for the reclassified services. GCI Ex. 1.0 at 26-27 (TerKeurst). TerKeurst points out that Ameritech Illinois has conducted a massive reclassification of business and residential services since early 1997. TerKeurst states: “Ameritech Illinois has already increased rates for some of the reclassified business services. While it has not increased rates for the reclassified residential services to date, this reprieve appears to have occurred only because Ameritech Illinois’ billing systems are not currently capable of charging different rates for residential services on an exchange-by-exchange basis.” GCI Ex. 1.0 at 28 (TerKeurst).

3. Exogenous Changes

Ameritech Illinois' proposal on the treatment of exogenous costs should be denied. As noted by witness TerKeurst "Ameritech Illinois' proposal to allow automatic offsets for *all* Commission-mandated rate changes would circumvent the Commission's discretion to determine whether the price regulation formula is just and reasonable absent the offset." GCI Ex. 1.0 at 38 (TerKeurst).¹⁵

The original alternative regulation order adopted Staff's approach for the treatment of exogenous costs and indicated that the Company would identify them on an annual basis. ICC Docket No. 92-0448/93-0239 (Consol.) (October 11, 1994), Order at 61-62. The exogenous events, either positive or negative must be verifiable and quantifiable and no less than a \$3 million change. ICC Docket No. 92-0448/93-0239 (Consol.) (October 11, 1994), Order Appendix at 4.

Ameritech Illinois is recommending changes in the treatment of exogenous costs. Ameritech Illinois requested that "...the exogenous change provision should be modified to: (1) expressly allow offsets to Commission-mandated rate changes; and (2) to allow those offsets to take place immediately, without waiting for the next annual filing under the Plan." Ameritech Illinois Ex. 1.1 at 37 (Gebhardt). The change Ameritech proposed "...would allow the Company to implement exogenous changes immediately in externally imposed circumstances..." Ameritech Illinois Ex. 3.0 at 10 (O'Brien). Ameritech Illinois proposed the Company be allowed to file within 30 days. Ameritech Illinois Ex. 3.0 at 11 (O'Brien).

The Commission should reject Ameritech Illinois' proposed changes.

¹⁵See also GCI Exhibit 1.0 at 38-40 (TerKeurst) (re: exogenous factor treatment).

IV. Service Quality – Going Forward

A. The Legal Standards

Ameritech Illinois has not met its burden of proof to demonstrate that the alternative regulation plan has met the statutory and regulatory goals set forth by the general assembly and by the Commission. The plan has not maintained the quality of telecommunications services, rather POTS provisioning has declined during the alternative regulation. In addition, the plan unduly prejudices residential customers because the plan provides incentives for AI to focus on business customers and advanced services to the detriment of POTS. The plan did not ensure that service quality relating to POTS provisioning was maintained in past years and provides little assurance that adequate service quality will be maintained going forward. The alternative regulation plan may have provided incentives for AI to dedicate extensive investments to advanced services and other business services, but the benefits that enured to business customers resulted in a detrimental impact on residential services such as POTS. Because of the disparate level of service relating to business and advanced services as compared to POTS that has resulted during the alternative regulation period, the plan would not be in the public interest as proposed by AI.

The Alternative Regulation Plan has Failed to Achieve the Commission’s Goal of Maintaining an Adequate Level of Service Quality

At a minimum, “adequate” means that consumers can expect Ameritech Illinois to meet all service quality benchmarks on a consistent basis. Alternative Regulation has provided incentives to Ameritech to let basic service decline, while it will reap billions annually, in new

revenue from its investment in competitive services. GCI 11.0 at 8,13, 69-70 (TerKeurst). The statute does not require the Commission to rubber stamp the alternative regulation plan. Rather, AI has a burden of proof to show the Plan is in the public interest. Evidence shows that POTS service has deteriorated since alternative regulation was initiated. Undisputed evidence of AI's failure to meet the OOS>24 benchmark every year except 1999, the year the companies desperately needed to be in the Commission's good graces so that it would approve the merger, counsels against accepting Ameritech's claim that alternative regulation has been good for Illinois consumers.

Further, an examination of Ameritech Illinois' reporting methods demonstrates that the service consumers have received was even worse than the poor level of service reflected in AI's consistent failure to meet the benchmarks. But for AI's creative reporting methods, it likely would have failed to meet the standards even in 1999. And the *degree* of failure would have been more pronounced. The GCI parties need not "prove" that alternative regulation has failed, but *Ameritech* must "prove" it has not. Ameritech has not met this difficult burden.

The alternative regulation plan has failed because rather than maintaining adequate service quality, AI allowed POTS service to decline substantially since the plan has been in force. The plan carries with it incentives for AI to slash costs to the detriment of service quality. While it may provide incentives for AI to invest in lucrative competitive services, such as those services associated with Project Pronto, there is no evidence that the alternative regulation plan has incited AI to invest in provisioning POTS. Without meaningful incentives to safeguard POTS and basic phone service, it cannot be reasonably argued that the plan is in the public interest.

Statutory Requirements

The Commission may approve the plan or modified plan . . . if it finds . . . that the plan . . . at a minimum:

- (1) is in the public interest; . . . (6) will maintain the quality and availability of telecommunications services; and (7) will not unduly or unreasonably prejudice or disadvantage any particular customer class, including telecommunications carriers. . .” 220 ILCS 5/13-506.1(b).

Regulatory Objectives

In its 1994 alternative regulation order the Commission concluded:

. . . that it will adopt a service quality component in the price cap formula. We recognize that one of the theoretical risks of price regulation is that the company may, while seeking to maximize its income, reduce expenditures in certain areas in such a manner as to impact service quality adversely. This is especially true for residential services which are the most inelastic services and are unlikely to be exposed to competitive pressures in the near term.

Section 5/13-506.1(b)(6) requires the Commission to find that an alternative regulation plan will maintain the quality and availability of telecommunications services (emphasis in original).

Illinois Bell Telephone Company, Petition to Regulate Rates and Charges of Noncompetitive Services Under An Alternative Form of Regulation. Citizens Utility Board vs. Illinois Bell

Telephone Company, Complaint for an investigation and reduction of Illinois Bell Telephone

Company’s rates under Article IX of the Public Utilities Act, Order at p. 58, ICC Docket 92-

0448, 93-0239 (consol.) (Oct. 11, 1994). To that end, the Commission directed AI to file an

application for review of the plan, in which AI is required to address *inter alia* “Whether, and the

extent to which, the adopted regulatory framework has met each of the established statutory and

regulatory goals.” Order at 10,11, appendix A.

B. Existing and Proposed Measures and Benchmarks

Existing Measures and Benchmarks

1. **Ameritech's Service quality deteriorated in several material respects since the Inception of the Alternative Regulation Plan in 1994 and therefore AI has failed to meet the statutory and regulatory objectives set forth above**

Ameritech Illinois has not maintained adequate quality of telecommunications services, rather POTS provisioning has declined during the alternative regulation period. The plan unduly prejudices residential customers because it provides the incentive for AI to focus on business customers and advanced services to the detriment of POTS. The plan has not ensured that service quality relating to POTS provisioning has been maintained. However, extensive investments in advanced services and better service have enured to the benefit of *business* customers. For example, during the alternative regulation period, calls to business centers have been answered much more promptly than calls to residential or repair call centers. GCI Ex. 2.0 at 43 (TerKeurst), see also, GCI Ex. 2.1. Another example of disparate treatment is seen in AI's average installation intervals. GCI 2.0 at 47 (TerKeurst). Average installation intervals for POTS service *only* have been significantly longer than average installation intervals for *all* services (about 8 days for POTS only compared to about 2.4 for all services). *Id.*¹⁶ Thus, the plan has resulted in disparate levels of quality of service relating to business and advanced services, on the one hand, and service relating to residential and POTS, on the other. The plan is therefore not in the public interest because it unduly and unreasonably prejudices residential customers.

The record demonstrates that there was a general decline in several aspects of Ameritech

¹⁶ The 2.4 day average reflects data collected from 1996-1999, while the 8 day average for

Illinois' performance following the inception of alternative regulation, as evidenced by the following:

- Ameritech Illinois' performance in restoring service to customers within 24 hours of a reported outage (i.e., the OOS>24 measure) has declined dramatically. Contrary to Mr. Gebhardt's assertion that Ameritech Illinois' service has not deteriorated under alternative regulation,¹⁷ Ameritech Illinois' rate of failure in correcting out of service situations within 24 hours averaged about 14.1 percent between 1995 and 1998 – over twice the average rate of failure in 1990 through 1994.¹⁸
- Ameritech Illinois' performance in answering calls from residential customers declined significantly between 1997 (the earliest year for which data is available) and mid-1999. The average speed at which Ameritech Illinois answers residential customer calls (as captured by the Average Speed of Answer – Residential Customer Call Centers measure) increased from 38.2 seconds in January 1997 to 413.1 seconds in June 1999. The percent of residential customer calls answered (as captured by the % Calls Answered - Residential Customer Call Centers measure) declined dramatically, from 93.2 percent in January 1997 to 59.5 percent in June 1999.¹⁹
- The number of Ameritech Illinois consumer complaints that were escalated to higher levels of Ameritech management, the so-called executive appeals complaints process,²⁰ increased dramatically for billing (a 35 percent increase), construction (a 37 percent increase), customer provisioning (a 45 percent increase), directories (a 26 percent increase), product (a 38 percent increase), and other (a 6 percent increase) complaints between 1997 (the earliest year for which data is available) and 1999.²¹

Service quality has declined even further since the SBC/Ameritech merger, as the following indicate:

POTS reflects data in 2000 (through September 2000). GCI Ex. 2.0 at 47 (TerKeurst).

¹⁷Ameritech Illinois Ex. 1.1 at 39-40 (Gebhardt).

¹⁸ GCI Ex. 2.0 at 10, Ameritech Illinois response to CUB data request 4.27(b).

¹⁹ GCI Ex. 2.0 at 11, Ameritech Illinois response to CUB data request 11.8.

²⁰ Id., Ameritech Illinois response to CUB data request 4.29.

²¹ Id., Ameritech Illinois response to CUB data request 11.8.

- The number of lines that were out of service almost doubled between late 1999 and mid-2000.²²
- Since early 1999, the average number of days needed to install a new access line (as captured by the POTS Mean Installation Interval measure) has more than doubled for residential customers.²³
- While Ameritech Illinois had reported some progress in 1999 in restoring out of service situations, its OOS>24 performance declined again in 2000, reaching 15.2 percent in August 2000.²⁴
- Between December 1999 and June 2000, the speed at which customer calls are answered (as captured by the Average speed of Answer measure) declined in the residential and repair call centers and the percent of customer calls answered in those call centers (as captured by the % Calls Answered measure) also declined.²⁵
- The average time taken to repair service, whether for all telecommunications service troubles as a whole (as captured by the Mean Time to Repair measure) or for POTS trouble on a stand-alone basis (as captured by the POTS Mean Time to Repair measure) has sharply increased since the SBC/Ameritech merger, with Ameritech Illinois reporting 77.7 hours of repair POTS in September 2000.²⁶
- Between 1999 and 2000, repair complaints increased by 71 percent, installation complaints increased by 190 percent, and construction and engineering complaints increased by 119 percent.²⁷
- By August 2000, the number of consumer complaints to Ameritech Illinois as tabulated through the executive appeals complaints process increased

²² Id., NARUC Company Service Quality Reports July 1999 - June 2000.

²³ Id., Ameritech Illinois response to CUB data request 4.12.

²⁴ GCI Ex. 2.0 at 12, Ameritech Illinois response to CUB data request 4.31.

²⁵ Id., Ameritech Illinois response to CUB data request 11.8.

²⁶ Id., Ameritech Illinois responses to CUB data requests 4.5 and 11.8; NARUC Company Service Quality Reports June 1999-June 2000.

²⁷ Id., Ameritech Illinois response to CUB data requests 11.8.

compared to 1999. Consumer complaint levels increased by 28 percent, 51 percent, 56 percent and 92 percent for maintenance, network, construction, and customer provisioning complaints, respectively.²⁸

- The percent of customers assigning Ameritech Illinois a low score of 0 to 5 (out of 10 points) for service quality in Ameritech Illinois customer surveys increased by 20 percent from January 1999 to August 2000.²⁹
- Variations in state requirements have resulted in discriminatory treatment of Ameritech Illinois customers. Specifically, calls to Ameritech/SBC's collection offices by customers in other states are currently routed ahead of Illinois customer calls to meet other states' service quality standards.³⁰

According to Ameritech's records, during June through August 1999, the company restricted overtime for technicians. GCI Ex. 2.0 at 13 (TerKeurst), AI Response to CUB DR 4.39. During that same period, Ameritech's records show that OOS>24hr in Illinois increased from 2.8% to as high as 6.1%. *Id.* Again, in August 2000, Ameritech restricted overtime, and this time the OOS>24hr performance declined even more dramatically from 4.4% to 15.2%. *Id.* The latter drop in service quality represents a nearly 250% decline, a performance level almost four (4) times worse. Ameritech's performance relating to POTS installation shows a similar decline during the same periods that Ameritech slashed technician overtime. GCI 2.0 at 13,14 (TerKeurst), AI Response to CUB DR 4.12.

²⁸ *Id.* at 13.

²⁹ *Id.*

³⁰ GCI Ex. 2.0 at 13, Ameritech Illinois response to CUB data request 4.47.

It is noteworthy that Ameritech reported that installation intervals increased overall, i.e., for both residential and business access lines in the aggregate, during the periods covering June through August 1999 and June through August 2000. Yet, the installation intervals for *business* access lines, alone, during the same periods, improved slightly. See, AI Response to CUB DR 4.12. The disparity is quite telling. When you examine the evidence closely, the data reveals where AI's priorities lie in terms of which class of customers receive the best treatment from Ameritech. From a business perspective, it may be advantageous to treat those customers from which a company receives the most revenue better than others. But from a regulatory perspective, the result seems perverse, and in any event, violates 220 ILCS 5/13-506.1(b)(7) requirement that the Plan must not “. . . *unduly or unreasonably prejudice or disadvantage any particular customer class, . . .*” (emphasis added). The bottom line: those classes of customers who primarily use only POTS, demand for which is the most inelastic of Ameritech's services, get left behind in favor of those customers to whom the benefits of competition are most available.³¹

2. Installation and Repair

The evidence demonstrates that Ameritech's service quality especially relating to installations and repair has likely been far worse than Ameritech has reported it. Ameritech's method of computing its installation performance disguises the real performance. Ms. TerKeurst's testimony explains that in reporting its performance for % installation within 5 days, AI commingled its installation performance for POTS and other services, including vertical

³¹ Demand for POTS service is less elastic than other telecommunications services offered by Ameritech Illinois. POTS service is also a prerequisite to access any other telecommunications service by a customer, including access to emergency services, usage, and toll services, as well as advanced services. POTS service is therefore qualitatively different than other services, and

features. GCI Ex. 2.0 at 27. *“However, commingling POTS and other services, including vertical features, to demonstrate compliance with this service quality standard is inconsistent with the practice of other carriers and . . . inconsistent with the Commission’s intent. Commingling the data allows POTS installation intervals to worsen while being masked by other service installations [such as vertical services] which are executed with minimal time and effort.”* Id. The evidence demonstrates that the growth in sales of vertical services has exploded during the time alternative regulation has been in place, resulting in significantly increased earnings for AI but requiring much less work than provisioning POTS. GCI Ex. 2.0 at 38, Tr. 1814-15.³² The adverse effect on POTS service quality is dramatic: installation intervals for residential and businesses have been two (2) to three (3) times longer than Ameritech’s reported aggregated results, and worsens over time. Id. AI trumpets the claim that it met the standard 95% every year since alternative regulation began, but the claim is based on grossly skewed calculations. The actual performance for POTS has likely been much worse than AI’s figures suggest.

3. The Plan Carries an Incentive for Ameritech to Invest in Competitive Advanced Services, to the Detriment of non-competitive POTS Services

Not only has the alternative regulation plan failed to maintain an adequate level of service quality, but, in fact, it has provided an incentive to let service decline. Mr. Gebhardt claims that the alternative regulation plan “created an environment which incited Ameritech to invest in its

worthy of special treatment. GCI Ex. 2.0 at 38-39.

³² Installation of vertical features do not require a field visit to customer premises “in almost every case.” No work is required on Ameritech’s outside plant or central office associated with installing vertical features. In fact, a simple computer entry by a customer service representative is all the work required to fill the vertical service install orders. Cross examination of Mr. Hudzik, Tr. 1814-15.

network.” and cites “Project Pronto” in support. AI Ex. 1.1 at 14 (Gebhardt), Tr.451-453. First, the Alt Reg Plan did not “cause” Ameritech to invest in Project Pronto, as Mr. Gebhardt admitted. Id. at 453. SBC/Ameritech would likely have launched Project Pronto whether or not Alt Reg was in place. Second, Project Pronto does little, if anything, to support POTS provisioning and certainly the Pronto investments do not reflect an actual *incentive* for AI to invest in POTS facilities. On the contrary, as the foregoing discussion of the misleading effect of AI’s reporting method illustrates, the plan has provided an incentive to invest in competitive services to the detriment of POTS.

The \$3.7 billion which AI claims it has “committed” to invest in its network is “committed” to providing advanced services, all of which are competitive. See AI Ex. 1.1 at 14 (Gebhardt), Tr. 459,460. Mr. Jacob’s testimony relating to Project Pronto is consistent with Mr. Gebhardt’s. Jacobs Rebuttal, AI Ex. 5.1 (Jacobs), p. 5-6. Mr. Gebhardt describes, at length, the advanced services that AI allegedly will bring to Illinois through “Project Pronto” including SS7 technology, Ameritech Intelligent Network (AIN) platform, 2-PIC capabilities, collocation facilities, UNE’s, Ameritech Advanced Data Service (AADS), DSL, ATM and the ever-important marketing talent from “*companies which sell [these] products in highly competitive markets.*” Id. at 16-17, Tr.457-460. Mr. Gebhardt readily informs the Commission that all these services are competitive, and he tacks a \$3.7 billion price tag on them with approximately \$900 million allocated to Illinois. Tr. 440,457,460. What is noticeably absent from Mr. Gebhardt and Mr. Jacob’s testimony is the price tag for maintaining or improving *POTS*.

On cross examination, Mr. Gebhardt said that “some” of the Project Pronto funds would go toward provisioning POTS, but he could not articulate how much. Tr. 461. Mr. Jacobs also admitted that the Project Pronto investments are primarily for competitive, advanced services.

AI Ex. 5.1 at 5 (Jacobs). Jacobs alludes to potential, ancillary benefits of Project Pronto to POTS, but fails to articulate to what extent in any concrete terms or numbers. *Id.* at 5, 6. In fact, none of the Ameritech testimony relating to network investments made during the alternative regulation period delineates how much went to POTS or other non-competitive services.

This would not be so alarming were it not for, at least, two things: 1) the service quality failures that have resulted during the same period (discussed *supra*, see also, Tr. 480); and 2) that the company insists that all its investments in advanced services, including Project Pronto allocations, should count toward its network investment commitment under the merger order. AI Ex. 3.1 at 20 (O'Brien), AI Ex. 5.1 at 6, GCI Ex. 11.0 at 68 (TerKeurst). The company admitted that “. . . Ameritech *severely underspent* on its network, in particular on outside plant vs. switching or trunking . . .” See, GCI Ex. 11.0 at 69, *quoting* Salomon Smith Barney's analysts' report, Dec. 19, 2000. (emphasis added). The foregoing discussion sheds an interesting light on how it is that AI is now able to allege that “. . . Ameritech Illinois' noncompetitive service rates are lower today by hundreds of millions of dollars than they would have been if [the Alt Reg Plan] had not been adopted.” AI Ex. 1.1 at 12.

4. Headcount

Ameritech Illinois blamed its service quality problems on a number of factors, foremost of which, was allegedly “unanticipated retirements of network personnel.” But the evidence contradicts this assertion. It appears that the mass retirements were not the product of an error in forecasting attrition, as Mr. Hudzik claims (Tr. 1954), but rather the product of calculated decisions by Ameritech executives to cut costs post-merger. In fact, AI offered early retirement packages and other incentives to retire to some of its most experienced managers and technicians prior to the “unanticipated” exodus. See Ameritech Illinois Ex. 12.1 at 12 (Hudzik), Ameritech

Illinois Ex. 12.0 at 7 (Hudzik), Tr.1884-1894 (Hudzik). In the face of actually providing incentives for network employees to retire sooner, and the clear evidence that an abnormally high number did in fact retire, incredibly, AI claims that the mass exodus was: (1) “unanticipated;” and (2) “outside the control of SBC and Ameritech.” Tr. 1882, Attachment A at 35, 37, AI response to Chairman Mathias data request (September 28, 2000) from GCI 2.2.(“Attachment A,” hereinafter).

Mr. Hudzik claims that, beginning in 1999, unanticipated retirements of network personnel led to a ten percent (10%) reduction in non-management headcount by January 2000. Ameritech Illinois Ex. 12.0 at 7-8 (Hudzik). Yet AI offered early retirement incentives, including Supplemental Income Protection Program (SIPP) benefits, to network technicians who retired during that same period. SAO Cross Exhibits 40, 41; see also, Attachment A at 30-32. The SIPP retirement incentive was offered to technicians who, as of November 1999, were within two (2) to four (4) years of retirement eligibility, but AI claims that it took “additional measures in 1999 to incent non-management employees to remain [on the Ameritech payroll].” See SAO Hudzik Cross Ex. 40 and 41, Attachment A at 33-34. (emphasis added). The “incentive” Ameritech identifies was: an option for employees to receive the pension they already had earned in the form of a lump sum benefit calculated as of 12/31/99 increased by one year’s interest, or their benefits calculated under regular provisions of the pension plan, if the employee remained on the payroll through calendar year 2000. Id.

First, nowhere in AI’s Response to Chairman does Ameritech support the claim that these “additional measures” were meaningful incentives to keep employees on the payroll. Second, the “incentive” was only offered to a small group of employees; to wit: employees who were service pension eligible as of December 31, 1999. Id., see also, SAO Cross Ex. 40, 41. Others,

outside this group were offered incentives to retire. Ameritech admits that it offered the latter group of non-management network employees separation packages, bonuses, payments, or other incentives, including SIPPs, in addition to said employees' regular compensation. see, Hudzik Cross Ex. 40, 41, Tr. 1892.

Approximately 762 network non-management employees ultimately retired from the company post-merger. Attachment A, at 30-34 (50 during May 10, 1998 to December 31, 1998; 556 in 1999; and 156 in 2000), see also, Tr.1958. The record is unclear as to how many network non-management employees would have continued to work absent the above incentives, but the fact that so many retired during the same period that these incentives were offered, contradicts mere coincidence as an explanation. Clearly, the mass exodus was, at least, foreseeable. More than likely, the exodus was anticipated by Ameritech and indeed calculated to cut costs.

In addition, AI provided its network *managers* incentives to retire early. Three-hundred and sixty four (364) Network Services managers who worked in Illinois have retired since May 10, 1998, the date of the Merger Agreement. SAO Hudzik Cross Ex. 38, Tr. 1870. Of those managers, at least 56 retired pursuant to AI's Enhanced Pension and Retirement (EPR) program that provides for an additional five years of age and five years of service to be applied to all pension benefits calculations for eligible employees. Tr. 1871. Mr. Hudzik admits that the EPR program can be characterized as an early retirement offer or as an inducement to retire. Tr. 1871-1872, 1887, see also, SAO Hudzik Cross Ex. 38. Others retired due to the merger of SBC and Ameritech. Id. Nowhere in the record does AI explain why it did not provide incentives for all or most of its experienced network personnel to remain with the company longer. This would not be so alarming were it not for the fact that Ameritech Illinois knew, at least, by 1999, that its dispatched orders, wholesale, and DSL orders would increase dramatically requiring far more

work by network technicians. Hudzik Rebuttal, 7-8., see also Tr. 1895,1896, 1899-1890. All this refutes Mr. Hudzik's remarkable denial that alternative regulation or price-cap regulation in combination with additional incentives to reduce costs post merger "could provide an incentive for Ameritech to reduce expenditure in certain areas while seeking to maximize its income." See Tr. 1862, 1865, 1896-1897.

Proposed Measures And Benchmarks

Alt Reg has failed to maintain service quality. Therefore, the plan should be either rejected or higher standards, increased reporting requirements, consumer credits, cellular phone loan programs, and harsher penalties should be imposed.

Recommended Service Quality Standards (See GCI Ex. 2.0 (TerKeurst))

One of the eight service quality measures that are in the current service quality incentive mechanism should be removed, ten measures should be added, and modifications should be made in the way certain of the measures are calculated in accordance with the method described below. Ameritech Illinois has provided only limited information regarding how some of the measures are calculated, and the recommendations below have been developed on the basis of that information. The measurements and associated standards proposed by Ms. TerKeurst in GCI Ex. 2.0, pages 27-65, and recommended herein include the following:

TABLE 2

Service Quality Measures and Standards
in the Proposed Service Quality Incentive Mechanism

<u>Measure</u>	<u>Explained at</u>	<u>Standard</u>	<u>Ex. 2.0</u>
	<u>Pages:</u>		
POTS % Installations Within 5 Days		95.44%	27-30
Trouble Report Rate per 100 Access Lines		2.66	30-32
POTS % Out of Service Over 24 Hours		5.0%	32-36
Operator Average Speed of Answer—Toll and Assistance		3.6 seconds	
Operator Average Speed of Answer—Information		5.9 seconds	
Operator Average Speed of Answer—Intercept		6.2 seconds	
Trunk Groups Below Objective		4.5/year	37
Average Speed of Answer			
Residential Customer Call Centers		80% w/in 20 seconds	43
Business Customer Call Centers		80% w/in 20 seconds	43
Repair Centers		80% w/in 20 seconds	43
% of Calls Answered			
Residential Customer Call Centers		95 %	46
Business Customer Call Centers		95 %	46
Repair Centers		95 %	46
POTS Mean Installation Interval		4 business days	46-48
POTS Mean Time to Repair		21 hours	49-52
POTS % Installation Trouble Report Rate (7 days)		5%	52-54
POTS % Repeat Trouble Report Rate (30 days)		10%	54-57
POTS % Missed Installation Commitments--Company Reasons		1%	57-54
POTS % Missed Repair Commitments – Company Reasons		1%	59-61
POTS % Missed Installation Appointments – Company Reasons		1%	61-62
POTS % Missed Repair Appointments– Company Reasons		1%	63-65

Recommended Reporting Requirements

(See GCI Ex. 2.0, p. 89-93 (TerKeurst))

In order to ensure adequate monitoring and early detection of problems with Ameritech Illinois' service quality, the Commission should require Ameritech Illinois to provide monthly reports regarding its quality of service that are more extensive than are currently made available. First, Ameritech Illinois should provide monthly performance data for each of the service quality measures in Table 2, above. Additionally, Ameritech Illinois should be required to report, on a

monthly basis and for each of its twelve geographic areas in Illinois,³³ its performance regarding the following service quality measures. Results should be reported separately for business and residential customers and also separately for initial and second or additional lines. In addition, several measures should be reported separately for single line orders and multiple line orders, as indicated below:

- POTS % installations within 5 days, for single and multiple orders separately
- Trouble reports per 100 access lines
- Trouble rate per 100 access lines
- POTS % out of service over 24 hours
- POTS mean installation interval, for single and multiple line orders separately
- POTS mean time to repair
- POTS % installation trouble report rate (7 days), for single and multiple line orders separately
- POTS % installation trouble rate (7 days), for single and multiple line orders separately
- POTS % repeat trouble rate (30 days)
- POTS % repeat rate (30 days)
- POTS % missed installation commitments--company reasons, for single and multiple line orders separately
- POTS % missed repair commitments—company reasons
- POTS % missed installation appointments—company reasons for single and multiple line orders separately
- POTS % missed repair appointments

C. Existing And Proposed Penalty Structures and Equitable Remedies

The service quality incentive (SQI) mechanism should be divorced from the price cap mechanism so that financial consequences of degrading service quality are not diminished as services are reclassified as competitive and so that compensation remains available for all customer classes. In addition to financial consequences, equitable remedies such as individual customer credits and cellular phone loaner programs should be adopted to directly compensate

³³ Ameritech Illinois monitors its service quality performance internally for each of the following twelve geographic areas: Metro Southeast, Metro West, Chicago North, Chicago South, Chicago Central, Metro North, Illinois Valley, Illinois North, Illinois South, Northshore and Fox Valley.

customers who have been inconvenienced or otherwise harmed by poor service quality. If the Commission determines that the SQI will be maintained within the PCI, the Commission should modify the Plan in accordance with the recommendations set forth in subsection C(3) below.

- 1. The service quality incentive (SQI) mechanism should be divorced from the price cap mechanism, so that financial consequences of degrading service quality are not diminished as services are reclassified as competitive and so that compensation remains available for all customer classes.**

Financial incentives related to service quality should be applied separate from the price cap formula. This is necessary to ensure that penalties for poor service are disassociated with non-competitive service revenues. As Ameritech reclassifies more services as competitive, less revenue is captured under the category of non-competitive services revenue. Consequently, the penalties associated with poor performance decrease accordingly and become less and less effective as a deterrent. GCI 2.0 at 66 (TerKeurst). As Mr. Gebhardt has admitted, AI has demonstrated a willingness to incur penalties through a PCI adjustment if the penalty is less than the cost to actually meet a given standard. GCI 2.0 at 67 (TerKeurst), Tr. 1844. The \$30 million penalty from AI's failure to meet OOS>24 benchmark in 2000 is just one glaring example. Tr. 1844. The Commission must put some teeth into its penalty provisions if it wishes to deter Ameritech from continuing with its slash/cut approach to meeting its bottom line to the detriment of basic telephone service quality.

The existing PCI credits should be replaced with larger customer credits returned directly to all customers regardless of whether the services they purchase are competitive. GCI 2.0 at 67. The credits should be calculated beginning with a base credit level for each standard missed. The amount of the credit should be increased to reflect the degree by which AI misses the

benchmark. The customer credits should escalate if AI fails to meet one or more of the benchmarks in two or more consecutive years. Id.

The Commission should adopt Ms. TerKeurst’s recommendations that the original \$4 million annual credit under the price cap mechanism should be tripled to a base customer credit of \$12 million for the first year a service quality standard is missed. (GCI Ex. 2.0 at 70).

Tripling that amount to \$12 million, coupled with the post-merger credit that applies for the OOS>24 measure would strengthen Ameritech Illinois’ incentive to maintain its service quality at acceptable levels. Id.

Customer credits should increase with the severity of service quality deterioration. The base customer credit should be multiplied by the severity related escalation factors so that, for example, a customer credit would be increased by 50% if the standard is missed by 100%. The mathematical formulae that would yield these results is generally represented as follows:

$$\text{Total customer credit} = \text{base customer credit} * \text{severity} - \text{related escalation factor (SREF)}, \text{ where } \text{SREF} = 1 + ((\text{performance-standard}) / (2 * \text{standard}))$$

(see GCI Ex. 2.5 for proposed SREF’s labeled “Attachment B” affixed to this brief, see also GCI 2.0 at 70-76 for customer credit escalation examples).

As discussed above, the Commission should escalate customer credits for failure to meet service benchmarks in accordance with the recommendations Charlotte TerKeurst sets forth generally at pages 67-75 of her Direct Testimony. GCI Ex. 2.0 (TerKeurst). Any customer credits assessed due to AI’s failure to meet a benchmark should be returned to the customer through a one-month credit to all customers, regardless of whether the services they purchase are classified as competitive or noncompetitive. GCI 2.0 at 68 (TerKeurst). The credit provisions should apply to both competitive and noncompetitive services because a “pure” price cap

mechanism for noncompetitive services coupled with broad pricing flexibility for services classified as competitive provides equally adverse incentives for the company to reduce service quality related to both classes. *Id.* at 69. The total credit should be allocated and returned as follows: first, the credit amount would be allocated among retail customers, carriers purchasing wholesale, UNE, interconnection, and transport and termination services; and allocated amounts would be returned to retail and wholesale customers as an equal credit per network access line, and to interexchange carriers and to carriers purchasing UNEs, interconnection, and transport and termination services through a percentage credit on one month's bill. GCI Ex. 2.0 at 69 (TerKeurst).

Customer credits should be applied on a monthly, not yearly basis. The penalty amount should be commensurate with the degree of degradation in quality, i.e., the margin by which AI misses the benchmark. In business, as in life, the effectiveness of punishment decreases as the gap between the time of the wrong, and the moment of retribution widens. The Commission should require monthly credits so that AI immediately feels the sting of a penalty when it fails to meet a benchmark. Likewise, customers should be afforded immediate relief when they have been inconvenienced by poor service performance. Swift, meaningful relief encourages public confidence that the regulatory scheme aimed at protecting public rights delivers what it promises.

2. In addition to financial consequences, equitable remedies such as individual customer credits and cellular phone loaner programs should be adopted to directly compensate customers who have been inconvenienced or otherwise harmed by poor service quality

Remedies in addition to financial consequences should be adopted. They should go directly to the specific customers who suffer particularly adverse impacts as a result of poor service performance, including those experiencing out-of-service situations, installation delays, or missed commitments or appointments. GCI Ex. 2.0 at 81. In addition to monetary remedies (bill credits), the Commission's Order should include temporary service-restoring solutions (cellular phones).Id. A tough customer credit program and a cellular phone loaner program should be adopted so that the actual customers inconvenienced by AI's poor service quality are directly compensated and access to basic phone services afforded to them. The Commission should reject AI's annual credit proposal because annual credits may not compensate the customers who were directly injured, nor would it provide a continuous deterrent to allowing basic phone service quality to decline. See, Tr.1830 (Hudzik).

Competitive LEC customers, like retail customers, served through resale of AI's services suffer adverse impacts when AI's service is interrupted. GCI Ex. 2.0 at 83. Therefore, LECs should receive credits as well so they can pass it through to their customers. Billing credits should be issued automatically, without requiring the customer to request available credits. Credits should be provided for all service interruptions exceeding 24 hours as opposed to 48 hours under the current plan. Id. at 84. If the Commission adopts a credit for installation intervals exceeding seven (7) calendar days, as proposed by AI, the credit provision should be strengthened in accordance with Ms. Terkeurst's recommendations at page 85 of Exhibit 2.0. Id. at 85.

In addition to strengthening and expanding credit provisions currently offered by Ameritech Illinois, additional customer compensation should be required for other failures to provide service. Specifically, a \$50 dollar customer credit should be instituted to cover AI's failure to meet a repair commitment or a due date, or if AI fails to notify the customer, at least, 24 hours in advance that it will not meet a repair or installation appointment. *Id.* at 86.

Ameritech Illinois should also be required to establish a cellular telephone loaner program covering customers inconvenienced by OOS>24 hours and installation delays beyond seven (7) calendar days after the customer's service order. *Id.* at 87. Finally, the Commission should make resellers eligible for the loaner program in accordance with the terms Ms. TerKeurst recommends in her testimony. *Id.* at 88.

3. If the Commission determines that the SQI will be maintained within the PCI, the Commission should modify the Plan in accordance with the Recommendations set forth herein

In the alternative, if the Commission maintains the SQI incentive within the price cap index, PCI credits should be increased and escalation provisions adopted for the same reasons described in the previous section. GCI Ex. 2.0 at 76. To that end, the Commission should adopt Ms. TerKeurst's recommendations at pages 76-78 of GCI Exhibit 2.0 and require the PCI credit for missing a standard to be increased from .25 percent assessment against the PCI to a base 1.25 percent assessment. GCI Ex. 2.0 at 76. The PCI credit would be structured to increase with the degree of deterioration in service quality using the same escalation factors shown in GCI Ex. 2.5, attached. (see, Attachment B) . The mathematical formulae would be generally:

Total PCI credit = base PCI credit * severity-related escalation factor ("SREF"), where SREF = 1 + ((performance - standard) / (2 * standard)). *Id.* at 77.

In conclusion, the Alt Reg plan should be rejected unless the additional safeguards recommended by Ms. TerKeurst and set forth herein are adopted in the new plan. The Plan has provided the incentive for AI to slash costs to the detriment of service quality, and AI has done just that during the period that the Plan has been in place.(see, Ameritech Illinois Ex. 1.1 at 31-33 (Gebhardt), Ameritech Illinois Ex. 8.0 at 18 (Avera). The merger of SBC and Ameritech has exacerbated the problem. The poor performance relating to POTS as discussed above is the result of those incentives. AI's assertions that the mass retirements were unanticipated lacks credibility. Likewise AI's assurance that it will fix the problem by hiring new personnel and increased training lacks credibility. While the incentives to slash costs remain, the Commission should not be persuaded that AI will depart from its previous course. The company has little monetary incentive to change its ways in the face of record earnings and the high price attached to its shares in the financial markets.(see, Ameritech Illinois Ex. 8.0 at 17-18 (Avera), Ameritech Illinois Response to AG DR 1.2) Thus to ensure that service quality will not continue to decline or linger at its current unacceptable level, the Commission must either reject the Plan entirely or modify it in accordance with Ms. TerKeurst's recommendations adopted herein.

V. Revenue Requirements Analysis

Introduction – Revenue Reduction

The Commission should reduce Ameritech Illinois' rates to a just and reasonable level. The Commission needs to insure that the rates charged by Illinois Bell Telephone Company will produce fair, just and reasonable rates for telecommunications services. 220 ILCS 5/13-506.1 (b)(2). Ralph Smith in this case has stated:

This information indicates that the company is earning very substantial returns on intrastate investment and on equity. Before the Commission establishes a new regulatory plan for IBT, alternative or otherwise, the Company's going-in rates must be recalibrated to reflect a just and reasonable level. The excess intrastate return indicates that the company is due for a significant intrastate rate reduction. GCI Exhibit 6.0 at 4 (Smith).

Ralph Smith presented various issues including intrastate revenue requirement, rate base, net operating income and adjustment summaries. GCI Ex. 6.0 at 1 (Smith). GCI Exhibit 6.2 at 1 (Smith). Ralph Smith showed at the time of rebuttal "...revenue excess of approximately \$956 million for IBT's Illinois intrastate operations:..." GCI Ex. 6.2 at 3 (Smith)³⁴. Smith concludes that IBT is earning on its Illinois intrastate operations substantially in excess of the rate of return used by the Commission in the last proceeding, ICC Docket No. 92-0448/93-0239 (Consol.). GCI Ex. 6.2 at 3-4 (Smith).

The Commission should use the information presented by Smith to evaluate the alternative regulation plans and as a tool in setting just and reasonable rates. One way to evaluate Illinois Bell under the alternative regulation plan is to look at the various financial components and see how they would measure up under a more traditional rate of return analysis. This information can serve as a guide for the Commission to use in determining what

³⁴ Updated number.

adjustments need to be made to the alternative regulation plan in order to bring about compliance with the Illinois Public Utilities Act.

The determination of a revenue requirement in this docket is one of the keys to performing a rate design.

A. Revenue and Expense Adjustments

1. Directory Revenues

There are a number of companies involved in the publishing of yellow pages. DonTech is a partnership between Ameritech Publishing, Inc, (“API”) and the Reuben H. Donnelley Corporation (“Donnelley”). Ameritech Illinois Ex. 11.0 at 4 (Barry). Ameritech Publishing of Illinois, Inc. (“APII”) is a wholly owned subsidiary of API created in 1983 to conduct directory operations in Illinois. Ameritech Illinois Ex. 11.0 at 3 (Barry). Since Docket 92-0488 the directory contract between IBT and its affiliates, API and DonTech, has expired as of December 31, 1999. GCI Ex. 6.0 at 22 (Smith). Also, “Section 222(e) of the Telecommunications Act of 1996 (“TA 96”) requires IBT to provide non-affiliated directory publishers with listing information in a fair, impartial and nondiscriminatory manner, and limits IBT to charging such publishers \$0.04 per directory listing and \$0.06 per listing for updates.” GCI Ex. 6.0 at 22 (Smith).

The Company is arguing that the Commission should not include directory advertising revenues when analyzing Ameritech Illinois’s revenue requirement. There are two main arguments for this conclusion set forth by the Company.

First, the Company argues that with the expiration of the contract between IBT and its affiliates (in December of 1999) the basis for including revenues from the Yellow Pages advertising in the calculation of the Company’s revenue requirements also expired. The

reasoning here is that “Donnelley had owned and published the Yellow Pages for over 70 years prior to 1984 and had never been regulated by the Commission. Donnelley’s (and after 1984, Donnelley/API’s) Yellow Pages revenues or profits had never been included in calculating Ameritech Illinois’ revenue requirement. Rather, what had been included in calculating Ameritech Illinois’ revenue requirement was the contract revenues Ameritech Illinois received from the directory publisher in exchange for providing listing information and billing and collection services.” Ameritech Illinois 1.3 at 119 (Gebhardt). In Docket 92-0448/93-0239 “the Commission believed that Donnelley gave API additional benefits in exchange for the contract renewal that should have been paid to Ameritech Illinois.” Ameritech Illinois Ex. 1.3 at 109 (Gebhardt). This imbalanced negotiation (i.e., not an arms length negotiation) was the cause for an additional imputation, not that profits from the Yellow Pages could, per se, be imputed. Thus, with the current situation, imputation is not proper because there is no underlying activity to correct, the contract is expired and TA 96 mandates what can be paid for listing information, therefore there is no improper contract revenue to impute.

Second, that the Commission does not have jurisdiction over this particular issue. Specifically, that “Section 7-102(2) [of the Public Utilities Act] does not grant the Commission plenary authority over affiliated interest to the utility . . . [it] merely grants the Commission access to the affiliated interest’s accounts and records to the extent necessary to permit the Commission to determine the reasonableness of transactions between the utility and the affiliated interest.” Ameritech Illinois Ex. 1.5 at 34 (Gebhardt). Mr. Gebhart goes on to argue that the appellate court in *Illinois Bell Telephone Company v. Illinois Commerce Commission*³⁵, “upheld

³⁵Illinois Bell Telephone Company v. Illinois Commerce Commission, 283 Ill. App. 3d 188, 669 N.E. 2d 919 (1st Dist. 1996).

the imputation in that case because of an improper transaction that allegedly disadvantaged ratepayers . . . However, the appellate court did not hold that the Commission had jurisdiction over API or the yellow pages.” Ameritech Illinois Ex. 1.5 at 35 (Gebhardt). Thus, Ameritech’s argument seems to be that some type of improper transaction must exist for the Commission to have jurisdiction over the Yellow Pages.

Both of the arguments set forth by Ameritech have a similar theme, the Company has done nothing wrong, so nothing should be imputed to their intrastate revenue requirement. API and Ameritech Illinois are totally separate companies and Ameritech Illinois has not given anything to API to the detriment of the ratepayers. Therefore, it would stand to reason, that if the Company has done something to the detriment of the ratepayers that the Commission would have the jurisdiction and a reason to include revenues from the Yellow Pages advertising in the calculation of the Company’s revenue requirements.

One reason that the Commission should include directory advertising revenues when analyzing Ameritech Illinois’ revenue requirement is explained by GCI witness Dunkel: “The high revenues generated by the LEC [Local Exchange Carrier] “endorsed” directory are a by-product of the provision of basic local exchange service. As a by-product of providing basic local exchange service, the local LEC becomes the known “expert” on the telephone numbers they serve. Because it is the recognized expert on local telephone numbers, the LEC’s “endorsement” of a local directory has great value. The high profits of the local LEC “endorsed” directory are directly related to the provision of local exchange service . . .” GCI Ex. 7.0 at 2 (Dunkel). In a competitive market, the “by-product” revenues have the effect of lowering the price of the primary product. GCI Ex. 7.0 at 5 (Dunkel). Thus, “directory advertising does not “subsidize” residential basic, but its existence does reduce the amount by which other services

must be priced above their TSLRICs, since directory advertising covers a portion of the Ameritech common costs.” GCI Ex. 7.0 at 7-8 (Dunkel).

A similar issue is the existence of the Ameritech name and logo printed on the actual directories. So, “even though the cost of non-product and corporate image building advertising has and should be excluded from IBT’s operating expenses for determining customer rates, Ameritech Illinois’ customers have nevertheless been paying for product advertising expenses which include and reinforce the Ameritech name and “brand.” The use of the Ameritech name (and now the SBC name as well) in Ameritech Illinois product advertising that is paid for by customers reinforces and promotes the recognition of that name.” GCI Ex. 6.2 at 37-8 (Smith).

The main issue involves the diversion of directory revenue away from IBT and into a non-regulated affiliate, API. API, an affiliate of Ameritech Illinois, is publishing a Yellow Pages Directory in Illinois and is obtaining revenue from the publication. It is Cook County’s position that “Ameritech has attempted in its filing to divert all such revenue to API, so that none of it is reflected in assessing the intrastate revenue requirement for IBT, the regulated telephone company. Determining the amount of revenue from directory advertising which should count toward IBT’s intrastate revenue requirement therefore is an issue which must be addressed in the current proceeding.” GCI Ex. 6.0 at 22 (Smith).

For the above stated reasons, a revenue adjustment of \$126 million for the annual amount of Directory Revenue is required. See Smith Schedule E Revised and Schedule E-1 Revised; GCI Ex. 6.2 at 31 (Smith). Staff witness Everson concurs with Mr. Smith that the amount of the imputed directory revenue is \$126,000,000. Staff Ex. 32.0 at 4 (Everson).

2. Intrastate Depreciation Expense

Mr. Dunkel calculated the 1999 intrastate depreciation expense as follows:

Using FCC Approved Parameters **	Using ICC Approved Parameters **	Claimed by Ameritech **
**	**	**

GCI Ex. 8.0 at 100 (Dunkel).

Dunkel has recommended that the Commission use the FCC approved parameters which results in an annual intrastate depreciation expense of ** **. GCI Ex. 8.0 at 102 (Dunkel). Ameritech first recommended an amount of ** **, however a number of additional adjustments were made during the course of testimony which resulted in the Company changing its recommendation to ** **. GCI Ex. 9.9 at 1 (Dunkel). The difference between GCI's recommendation and Ameritech's current recommendation is **

** . GCI Ex. 9.9 at 1 (Dunkel). Cook County argues that the Commission should use the figures recommended by Dunkel and used by Mr. Smith.

3. Pension Settlement Gain

The Company recorded a net pension settlement gain of \$98.6 million in 1999. This amount relates to the work force reduction that occurred after the merger with SBC. GCI Exhibit 6.0 at 30 (Smith). The Company attempted to remove the \$98.6 million as part of its adjustment where it adds \$117.902 million to the 1999 Corporate Operation Expense. The 98.6 million should not be removed in this manner. Rather, it should be amortized over a five-year period. GCI Exhibit 6.0 at 30 (Smith). Amortizing the pension settlement gains in this way would be consistent with the Commission Order in ICC Docket 92-0448/93-0239 at 109, where the Commission concluded that amortizing IBT's work force re-sizing expenses over a five-year

period would be appropriate. Amortization in this case would result in a reduction of the Company's proposed intrastate operating expense by \$52.951 million. GCI Exhibit 6.0 at 30 (Smith).

The Company claims that "the level of pension settlement gains experienced in 1999 represents a non-recurring, prior period event and, therefore, should be eliminated entirely in presenting a normalized 1999 operating income statement." Ameritech Illinois Exhibit 7.2 at 13 (Dominak). However, it has not been "...demonstrated that the settlement gains IBT recorded in 1999 relate entirely to prior periods. [In addition], just because the current period pension cost recorded pursuant to FAS 87 includes both current components . . . and a net amortization component does not mean that the pension settlement gains recorded by IBT during the test year should be totally ignored as if they did not occur." GCI Exhibit 6.2 at 26 (Smith). Staff Witness Hathhorn also recommends a five-year amortization. Staff Exhibit 6.0 at 8 (Hathhorn).

The Company has also not provided any evidence that the 1999 settlement gain was not caused by, or related to, the force loss that occurred at Ameritech after the SBC/Ameritech merger was announced. As Mr. Smith states "it is unrealistic to expect that the significant or "abnormal" level of retirements experienced by Ameritech concurrent with and/or following the SBC/Ameritech merger had nothing to do with the merger." GCI Exhibit 6.2 at 29 (Smith). The Company claims that ratepayers have not been funding 100% of the Company's pension expenses. Rather, that "as a result of the alternative regulation plan adopted in docket #92-0448/93-0239, the rates charged by the Company for non-competitive service have been subject to a price cap formula, pursuant to which the overall level of rates declined each year without reference to a 'revenue requirement.'" Ameritech Illinois Ex. 7.1 at 34 (Dominak). Hathhorn responds to this argument by stating: "The Company has not identified how pension expense is excluded from the price cap formula in any way. [cites omitted] While it is true that the revenue requirement in the original Alternative Regulation case, Docket Nos. 92-0448/93-0239 (Consol.) . . . did not contain a provision for pension expense, the reasoning was due to the fact the

Company had negative pension expense at the time. Ameritech Illinois Ex. 7.1 at 34 (Dominak). Neither the revenue requirement in that proceeding, nor the inputs for the price cap formula used today, contain any factors or adjustments to exclude pension expense from the cost of service to ratepayers. Therefore, pension expense, and any related settlement gains, should be treated as an above the line item and not be disallowed because the historical level of pension expense was negative at the time of the last revenue requirement determination.” Staff Exhibit 20.0 at 4 (Hathhorn).

4. Pension Settlement Gain, Ameritech Services

The Ameritech Services 1999 pension settlement gains should also be amortized over a five-year period, rather than being excluded entirely from the test year results, as the Company witness recommends. GCI Ex. 6.2 at 14 (Smith). This adjustment increases intrastate operating expense. GCI Ex. 6.5. The Company rejects this amortization for basically the same reasons it rejects the amortization of the pension settlement gain. Ameritech Illinois Ex. 7.2 at 16 (Dominak).

5. Pension Settlement Gains, Known 2000 Amount

The impact of known pension settlement gains recorded by IBT in 2000 should be amortized over a five-year period as described in Schedule E-19 of GCI witness Smith’s testimony. It will decrease the intrastate expense by \$13.169 million. GCI Exhibit 6.2 at 22 (Smith). The Company states that this would “double-count” an income statement item by including adjustments for both the 1999 and 2000 pension settlement gains credits. Ameritech Illinois Exhibit 7.2 at 17 (Dominak). Staff witness Hathhorn opines that the year 2000 pension settlement gains is outside the test year and should not be included and no adjustment should be made. Staff Ex. 31.0 at 4 (Hathhorn).

6. Merger Costs Billed in 2000 from SBC

\$13.874 million for merger costs should be removed from the 1999 test year results. The merger costs were not booked nor billed to IBT until 2000 and therefore it is not a 1999 expense. GCI Ex. 6.0 at 32 (Smith). The adjustment in the intrastate operating expense uses the 13% nonregulated factor for Corporate Operations Expense, however the Company has attempted to decrease the 13% to 4.63%, thereby allocating more expense to regulated operations. This is not a correct adjustment.

Description	Amount	Proposed Change
Merger costs from SBC	\$ 13,784	\$ 13,784
non-regulated portion	13%	4.63%
regulated portion	87%	95.37%
intrastate factor	0.7716101	0.771601
intrastate amount	\$ 9,253	\$ 9,253
adjustment to intrastate amount	\$ 9,253	\$ 9,253

The lower percentage is internally inconsistent with the attempted revision of the nonregulated factor by Mr. Dominak on IBT Ex. 7.1, Schedule 3. A consistent calculation of those amounts would require either: (1) rejecting the expense increase associated with IBT's belated attempt to revise the nonregulated factor on its Exhibit 7.1, Schedule 3; or (2) recalculating the merger expense adjustment to reflect the consistent use of a 4.63%. Recalculating the merger expense using the 4.63% nonregulated factor, would increase the \$9.253 million amount to \$10.143 million. GCI Ex. 6.2 at 9 (Smith).

Changing the percentage from 13% to 4.63 % would also change calculations for the components of the \$117.902 million "prior period" expense additions in IBT Exhibit 7.0, Schedule 1, Column B. The "prior period" amount is a summation of: (1) the net pension

settlement gain; (2) merger costs from SBC; (3) and the accruals for asset disposition. Specifically, the adjustments on GCI Ex. 6.1, Schedule E-4, for the merger costs billed in 2000 by SBC and Schedule E-5, for the amortization of asset disposition accrual amounts. The use of a lower nonregulated allocation factor would increase the amount of each of those adjustments by a similar ratio to the merger cost adjustment (approximately 9.62%). GCI Ex. 6.2 at 10 (Smith).

Staff witness Hathhorn agrees that the costs from SBC to the Company related to planning and implementation of the SBC/AI merger should be disallowed. These costs are included in the Company's "prior period" adjustment and were a one-time expense of the merger between AI and SBC and therefore need to be excluded from the revenue requirement in order to present a normal, on-going level of expenses for the future. Staff Ex. 6.0 at 4 (Hathhorn).

The Company claims that these costs are more appropriately addressed in the Commission-mandated tracking of merger costs and savings. The use of the "proper" nonregulated factor, 4.63%, increases the intrastate adjustment from \$9.253 million to \$10.143 million. The Company does not agree that either the amortization of pension settlement gains nor the amortization of asset disposition accrual credit amounts is appropriate, therefore no further adjustments are necessary. Ameritech Illinois Ex. 7.2 at 31 (Dominak).

7. Accruals for Asset Disposition

The "prior period" amount is a summation of: (1) the net pension settlement gain; (2) merger costs from SBC; (3) and the accruals for asset disposition. The third item, accruals for asset disposition, is \$5.518 million of the total \$117.902 million.

The Company states that the accruals were made for costs associated with the sale of several properties in 1994 and that, in this case, the accruals were higher than the actual costs and the original transactions occurred in 1994, a time when the alternative regulation was underway in Illinois. Therefore, rates were not impacted by the estimated accruals that were booked as the corporate expenses in 1994. The Company made a reconciling adjustment in the

amount of \$5.518 million as a credit to the Corporate Operations expense in 1999 to remove the balance of the accrual. Ameritech Illinois Ex. 7.1, 37-38, 7.2, 33-4 (Dominak).

However, while the Company has identified the \$5.518 million as the amount it credited to Corporate Operations Expense during 1999, it is unclear how much expense Ameritech charged for this in 1999 and prior years. If the \$5.518 million is to reverse expense over-accruals that built up over a period of several years, then a more appropriate rate making treatment would be to amortize it over a similar period. Based on the information provided by the Company, the \$5.518 million is apparently related to the costs it accrued over a number of years related to the sale of land and buildings. Consequently, GCI witness Smith reflected an adjustment to amortize \$5.518 million over a representative period of five years. The adjustment reduces Ameritech's proposed intrastate operating expense by \$2.963 million. See GCI Ex. 6.0 at 33; E-5 (Smith)

The basis for reflecting this credit in 1999 results is that the Company actually recorded it in its 1999 results. The basis for amortizing the 1999-recorded amount over five years is that it relates back to 1994, approximately a five-year period, and the Commission has used a five-year period, and the Commission had used a five-year amortization period for other costs where the impact on the test year of an item is being normalized. GCI Ex. 6.0 at 31 (Smith).

8. Non-Product "Brand" Advertising

The purpose of non-product advertising is to promote the image of Ameritech, now SBC, and is not an attempt to sell specific products to ratepayers. The link between non-product advertising and the increased sales of regulated services in Illinois is remote and not quantifiable, thus the intrastate amount of \$6.807 million should be removed from the test year revenue requirement as recommended by GCI witness Smith. GCI Ex. 6.0 at 35; E-6 (Smith).

The Company states that Non-product advertising "does not focus directly on the promotion of a specific product, it is intended to create positive images of the Company in the mind of consumers, thereby promoting sales of all of the Company's products and services."

Thus, this type of “brand” advertising is an integral part of promoting Ameritech’s products and services, especially to large businesses and institutions. Ameritech Illinois Ex. 7.2 at 35 (Dominak).

However, the Commission, in its Order Docket Nos. 92-0488/93-0239, agreed that the purpose of this type of advertising “is to promote the Company’s corporate image and goodwill. Accordingly, the Commission does not find this advertising to be a reasonable expense for the ratepayers to bear.” Order 106-7 at 107.

9. Sports Team Sponsorship

The intrastate expense amount of \$96,000 for sports team sponsorship should be removed from the 1999 test year expense. The sponsorship of a sports team is not a cost of providing telephone service, but rather is another example of promoting the Company’s goodwill and corporate image, thus it is an expense ratepayers should not bear. GCI Ex. 6.0 at 36; E-7 (Smith). Ameritech “is willing to accept the proposed adjustment of \$96,000 to intrastate Customer Operations Marketing Expenses for sports team sponsorships.” Ameritech Illinois Ex. 7.1 at 6-7 (Dominak).

10. Revenue Reduction from Failure to Meet Service Quality Standards

The revenue reduction resulting from the Company’s failure to meet service quality standards should be added to the recorded amount of 1999 test year revenues. GCI Exhibit 6.0 at 36 (Smith). This reduction is necessary because “the revenues that IBT has lost because it failed to provide adequate service are similar to a penalty or fine. It is necessary to remove the impact of such penalties from the test year. Failure to impute these foregone revenues lowers the Company’s reported level of revenues, and causes the Company to report a lower earned return.” GCI Ex. 6.2 at 45 (Smith).

The way to remove this impact is to restore, or impute, the revenues to the test year as if IBT had been providing minimally acceptable service. GCI Ex. 6.2 at 45 (Smith). The Company claims that the customers have already received the benefit of the service quality penalties in the year the penalty was incurred and in each year thereafter. Ameritech Illinois Ex. 7.2 at 34-35 (Dominak). However, the reality is that without imputing the reduced revenue recorded by the company due to its failure to fully meet the quality of service standards it is the ratepayers that would be forced to pay extra. Therefore, the amounts in GCI witness Smith's Schedule E-8 should be used, adding \$29.579 million of foregone revenue to the test year for the cumulative impact on the 1999 test year for IBT's failure to provide adequate service. GCI Ex. 6.2 at 46 (Smith).

11. Uncollectibles

The SBC method of estimating uncollectibles applied different, generally higher, percentages to over-due account balances, compared to the previous method used by IBT. The entry for \$18.685 million on October 1999 is a one time catch-up item, therefore, should be removed. GCI Ex. 6.0 at 39 (Smith). The impact on IBT's revenue adjustment must also be considered. The appropriate uncollectible factor of 1.67% must be used to calculate the increase to uncollectible associated with this adjustment. Using 1.67%, the adjustment is \$639,000 ($\$38.272 \text{ million} \times 1.67\% = \$639,000$). GCI Ex. 6.2 at 18; E-9; E-16 (Smith).

The October 1999 adjustment is a one-time occurrence; the effects of this one-time adjustment should not affect the revenue requirement. The test year uncollectible percentage of 1.67% should be used. The Company's uncollectible experience in the first nine months of 2000, with an uncollectible percentage of 1.16%, shows that a lower uncollectible percentage is appropriate. Staff Ex. 5.0 at 10; 19.0 at 6-7 (Voss)

Ameritech Illinois accepts the \$18.7 million adjustment for uncollectible expense. Ameritech Illinois Exhibit 7.2 at 7 (Dominak). And the Company accepts the uncollectible rate of 1.67% as calculated on page 2 of Staff Ex. 5.0. Ameritech Illinois Ex. 7.2 at 2 (Dominak).

12. Software Capitalization

The American Institute of Certified Public Accountants issued a Statement of Position No. 98-1 (SOP 98-1) which requires that software costs be capitalized. The intrastate allocation factor for Plant Specific Operations should be used for calculating the capitalized software adjustment, which produces a reduction to intrastate expense of \$1.306 million, as shown on GCI exhibit 6.3, Schedule E-10 Revised. GCI Ex. 6.2 at 12; E-10 (Smith).

The Company agrees that the correct adjustment for Plant Specific Operations should be \$1.306 million, this is reflected in Ex. 7.2, Schedule 1, Column D. Ameritech Illinois Ex. 7.2 at 3 (Dominak).

Staff witness Hathhorn notes that the Company and GCI have reached agreement on the need for this adjustment. Staff Ex. 20.0 at 9 (Hathhorn). Mr. Smith's revised adjustment corrects an error of \$13,000 which has been agreed to by the Company and is reflected in GCI Ex. 6.2, Schedule E-10 Revised. Staff has not updated the revenue requirement for this minor correction. Staff Ex. 31.0 at 6 (Hathhorn).

13. Reciprocal Compensation Expense

Reciprocal Compensation refers to the revenue received by the telephone company from other carriers and payments by the telephone company to other carriers associated with traffic generated by customers of a local carrier that relies upon the facilities of another carrier for completion of the call. GCI Ex. 6.2 at 20 (Smith). Some portion of these credits recorded in 2000 by IBT for reciprocal compensation expense apparently relate to the disputed amounts of reciprocal compensation expense that IBT recorded in 1999. GCI Ex. 6.2 at 21; E-18 (Smith).

An adjustment is necessary to reflect a normal level and/or to remove amounts being paid under protest by IBT. A more normal level can be achieved by averaging the available 1999 and 2000 monthly expense levels. This adjustment reduces IBT's intrastate expense by \$33.322 million. GCI Ex. 6.2 at 22; E-18 (Smith).

IBT's reciprocal compensation expense in 2000 is considerably lower than the expense it had recorded in 1999, which is reflected in its 1999 test year filing. GCI Ex. 6.2 at 21 (Smith). However, the internet minutes of use, one reason cited by the Company for the higher compensation expense in 1999, are relatively equal in 1999 and 2000. The settlement of disputed amounts (a payment to CLECs under protest, credits for the settlement of disputed reciprocal compensation billings, and a credit to reverse an accrual for reciprocal compensation expense) contributed to the decrease in IBT's recorded reciprocal compensation expense in 2000 versus 1999. GCI Ex. 6.2 at 21 (Smith).

After reviewing Mr. Smith's rebuttal testimony, the Company discovered that some of the information provided to the data request CUB 5.30 was in error. The level of reciprocal compensation expense in Exhibit 7.0, Schedule 1 was \$170.8 million, however the correct amount is \$128.3 million (\$42.5 million less of contingent liability associated with the recording of reciprocal compensation expense). Mr. Smith's adjustment assumes a normalized level of reciprocal compensation expense of \$128.7 million, very close to the \$128.3 million amount the Company reaches after its correction. Therefore, the Company believes that no further adjustment is required. Ameritech Illinois Ex. 7.2 at 31 (Dominak). Therefore the adjustment recommended by GCI witness Smith should be followed.

14. Accumulated Deferred Income Taxes (ADIT)

In 1999 IBT subtracted \$97.616 million for "Merger Issues" from the ADIT balance used as a rate base. There are two major components to this item: (1) \$60 million relating to a "competitive declaration;" and (2) \$21 million for a methodology change in the way the Company estimated uncollectibles. GCI Ex. 6.2 at 18-19 (Smith). The \$60 million was removed by IBT in the derivation of its intrastate rate base, however the other \$21 million was not removed. GCI Ex. 6.2 at 19 (Smith).

The Company agrees that the ADIT needs to be adjusted for the uncollectibles, however they claim that the uncollectible expense adjustment is only the tax effect of the Company

accepted adjustment that would impact the ADIT balance. Thus, the amount should be based upon the uncollectible expense adjustment of \$18.685 million thereby making the adjustment \$7.412 million. Ameritech Ex. 7.2 at 3 (Dominak).

However, as GCI witness Smith argues, the impact of the uncollectibles methodology change should be removed from the test year. The Company has already agreed to remove the \$18.7 million impact, as reflected in IBT Ex. 7.1, Schedule 1, thus it stands to reason that the related ADIT debit balance item of approximately \$19 to \$20 million for uncollectibles should also be removed from rate base. The adjustment should be \$19 million from rate base for the ADIT debit balance relating to the Uncollectibles change. This decreases the intrastate rate base by \$19 million. GCI Ex. 6.2 at 19; E-17 (Smith).

15. Income-tax Expense Correction

An omission in the calculation of federal income tax on Ameritech Illinois Exhibit 7.0, Schedule 1 has been re-computed, which results in an adjustment of \$2,189,000 on Exhibit 7.1, Schedule 3, Column B. Ameritech Illinois Ex. 7.1 at 6 (Dominak). The correction to income tax expense shown on Ex. 7.1, Schedule 3 (which is incorporated in the “Prior Period” Taxes & Nonregulated” amount in Mr. Dominak’s Ex. 7.1, Schedule 1, Column B) has been reflected in Mr. Smith’s Schedule E-24, GCI Exhibit 6.3. GCI Ex. 6.2 at 13; E-14 (Smith).

16. Revenues Changes from Additional 2000 Tariff Filings

GCI witness Smith reflected the \$38.272 million adjustment to IBT Exhibit 7.1, Schedule 1, Column F on GCI Ex. 6.3, Schedule E-16, for intrastate revenue increase. However, Mr. Smith is not satisfied that the ongoing levels of intrastate revenue are being adequately reflected by the Company. GCI Ex. 6.2 at 16 (Smith).

The adjustments made by the Company for local service revenue does not reflect the actual growth in local service revenue that IBT has experienced. The growth in local service revenue from 1999 to 2000 September has been approximately \$200 million. The growth rate for the same category in 1998 to 1999 was approximately \$246 million. GCI Ex. 6.2 at 16 (Smith).

In addition, the Company's pro forma adjustments reflect a significant net pro forma *decrease* in intrastate access revenue, whereas a response to data request BLV-031(a) shows that intrastate access revenue has *increased* by over \$6 million in 1999 and 2000. Thus, the concern is that the known and ongoing levels of local service revenue and intrastate access revenue have been understated. GCI Ex. 6.2 at 16; E-16 (Smith).

Initially Mr. Voss also recommended an adjustment increasing test year revenues based upon increased operating revenues in the year 2000. Staff Ex. 5.0 at 13 (Voss). However, after evaluating Mr. Dominak's rebuttal testimony, Mr. Voss withdrew his recommendation for the adjustment without any explanation as to why his opinion had changed. Staff Ex. 19.0 at 13 (Voss).

In response to Mr. Smith's arguments the Company states that a complete twelve-month analysis indicates that there is almost no increase in local revenues as a result of fourth quarter adjustments. Also, the Company's adjustments to 1999 operating revenues reflect the annualized effects of known and measurable changes in the rate levels for various services as a result of the 1999 and 2000 price cap filings and the tariff filings during the 1999 and 2000. The Company's adjustments do not reflect a change in the level of revenues associated with a change in 1999 levels of expenses and investment, thus the level of revenues reflected in the Company's proposed operating statement are properly matched with the 1999 operating expenses and investment. Ameritech Illinois Ex. 7.1 at 24 and 7.2 at 36 (Dominak).

B. Rate Base Adjustments

1. Interest Synchronization

"The interest synchronization adjustment synchronized the rate base and cost of capital with the tax calculation. It is calculated by applying the weighted cost of debt to the

recommended rate base to obtain a synchronized interest deduction for use in the calculation of test year income tax expense.” GCI Ex. 6.0 at 41 (Smith). The Commission in determining revenue requirements has consistently used this method. Schedule E-11 Revised shows the updated adjustment. GCI Ex. 6.2 at 53 (Smith).

The Company does not use an interest synchronization adjustment because it “strongly disagrees with the concept and methodology of attempting to “estimate” interest expense when those costs are already available and truly represented by the actual expense amount incurred during the year under report here.” Ameritech Illinois Ex. 7.1 at 10 (Dominak). However, the Company does admit “the Commission has historically adopted such adjustments in the context of rate cases.” Ameritech Illinois Ex. 7.1 at 11 (Dominak).

Staff witness Voss explains that “since the ratepayers are responsible for the interest expense, the ratepayers are entitled to the tax benefits generated by that interest expense. As AI’s rate base is adjusted, the interest expense and the associated tax benefit must also be adjusted.” Staff Ex. 19 at 9 (Voss). Therefore, the interest synchronization adjustment in this proceeding is appropriate.

2. Materials and Supplies

The Company agrees with GCI witness Smith that the adjustment of \$1,242,000 to materials and supplies is appropriate. The adjustment is shown on Ex. 7.1, Schedule 2, Column B and increases the intrastate Net Original Cost by \$924,000. Ameritech Illinois Ex. 7.1 at 8 (Dominak). The GCI adjustment can be found on Schedule E-12.

3. Telephone Plant under Construction and Interest During Construction

The amount used for Telephone Plant Under Construction (TPUC) exceeds the twelve-month average TPCU balance significantly. Therefore, “to reflect a more normal level of TPUC,

[Smith] used a 36-month average balance for the period ending August 31, 2000, of \$61.838 million.” GCI Ex. 6.0 at 44 (Smith). This will decrease intrastate rate base by \$13.130 million. The Company accepted Mr. Smith’s methodology for TPUC. Ameritech Illinois Ex. 7.2 at 18 (Dominak). However, the Company does not believe that the 36-month average balance of TPUC should be used. Ameritech Illinois Ex. 7.2 at 20 (Dominak).

GCI witness Smith’s recommended adjustment for Interest During Construction (IDC) is linked with his recommended amount for TPUC. The “recommended TPUC amount is based upon the use of a 36-month average to derive a normal level of TPUC...to correspond with the use of the \$2.244 million intrastate IDC amount in the income statement, the appropriate intrastate TPUC amount is the \$45,883 million shown on GCI Exhibit 6.1, Schedules E-13 and E-13.2. The Company’s TPUC amount of \$59,034 million should be reduced by \$13,151 million.” GCI Ex. 6.2 at 8 (Smith).

4. Accumulated Deferred Income Taxes (ADIT) Debit Balance

“For 1999, IBT has subtracted \$97.616 million for “Merger Issues” from the ADIT balance used as a rate base offset . . . the two major components of this item are (1) approximately \$60 million relating to a “competitive declaration” and (2) approximately \$21 million for a methodology change in the way Ameritech Illinois estimated Uncollectibles.” GCI Exhibit 6.2 at 18-9 (Smith). The first part was removed by IBT in the derivation of its intrastate rate base because the services were not competitive. GCI Exhibit 6.2 at 19 (Smith). For part two, the Uncollectibles, “The Company has agreed that the approximately \$18.7 million impact on Uncollectibles expense should be removed, as recommended by myself and Staff, and IBT has reflected that adjustment on IBT Ex. 7.1, Schedule 1, Column L. The related ADIT debit

balance item of approximately \$19 to \$20 million for Uncollectibles should also be removed from rate base.” GCI Exhibit 6.2 at 19 (Smith). Mr. Smith recommends an adjustment of \$19 million from rate base, as shown on Schedule E-17. GCI Exhibit 6.2 at 19 (Smith) The Company agrees with “. . . the premise of Mr. Smith’s proposal to adjust ADIT for the Uncollectibles. . .” Ameritech Illinois Ex. 7.2 (Dominak).

C. Cost of Capital

Previously, as shown on “Page 175 of the Commission’s Order in Docket Nos. 92-0488/93-0239 shows that the Commission used a cost of common equity of 11.36% and an overall cost of capital of 9.64%. GCI Ex. 6.0 at 7 (Smith). GCI witness Smith “. . . performed a calculation of the earned return on equity using the capital structure and weighted cost of capital presented by the Company in its Exhibit 6.0, on Schedule 13” GCI Ex. 6.0 at 8 (Smith). Mr. Smith’s calculations show “. . .that the Company is significantly over-earning on its Illinois intrastate rate base and that IBT’s rates should be reduced significantly before any new regulatory plan - alternative or otherwise - is established by the Commission.”GCI Ex. 6.0 at 7 (Smith). Therefore, Mr. Smith’s recommendation on “Schedule D shows the cost of capital structure and debt costs recommended by Staff, and an 11.8% cost of equity, which is the low end of Staff’s recommendation.” GCI Ex. 6.0 at 14 (Smith).

As Staff witness Pregozen explains, “A thorough analysis of the required rate of return on common equity requires both the application of financial models and the analyst’s informed judgment. An estimate of the required rate of return on common equity based solely on judgment is inappropriate. Nevertheless, because techniques to measure the required rate of return on common equity necessarily employ proxies for investor expectations, judgment remains necessary to evaluate the results of such analysis. Based on my analysis, in my

judgment, the investor required rate of return for AI's common equity ranges from 11.80% to 14.40%." Staff Ex. 11.0 at 29 (Pregozen).

D. Other

1. Depreciation

The Commission provided Illinois Bell with depreciation flexibility in the Alternative Regulation Plan. 92-0448/93-0239 (Consol.)(October 11, 1994), Order at 55. However, the Commission stated:

As stated in a later section of this Order, however, the Commission will monitor IBT's formulation and application of depreciation rates, and places the Company on notice that detection of any abuses will result in a reevaluation of the alternative regulatory plan pursuant to Section 13-506.1(e) of the Act. 98-0448/98-0252 Order at 55 (October 11, 1994).

The evidence demonstrates abuses, therefore the Commission should reevaluate the depreciation freedom granted to Ameritech Illinois.

Before rate design can be performed, the desired revenue requirement must be established, since the rates in total are designed to cover the full revenue requirement of the Company, including a reasonable return on investment for shareholders. GCI Ex. 8.0 at 89 (Dunkel) The rate design proposals are all based on a specific revenue requirement. The largest expense that Ameritech has claimed is the depreciation expense. Depreciation rates directly affect consumers because depreciation rates are used to calculate the depreciation expense, and this expense is recovered in the prices charged to customers. GCI Ex. 8.0 at 91 (Dunkel)

The Uniform System of Accounts (USOA) for telecommunications defines depreciation as:

Depreciation means the loss not restored by current maintenance, incurred in connection with the consumption or prospective retirement of telecommunications plant in the course of service from causes which are known to be in current operation, against which the company is not protected by insurance, and the effect of which can be forecast with a reasonable approach to accuracy.

Among the causes to be given consideration are wear and tear, decay, action of the elements, inadequacy, obsolescence, changes in technology, changes in demand and requirements of public authorities. (47 CFR Ch. 1, Uniform Systems of Accounts Section 32.9000)

The USOA also states,

...the loss in service value of the property...be disturbed... under the straight-line method during the service life of the property. (Section 32.2000(g) and (i))

“Service life” and “remaining life” end when the investment is retired from the USOA “plant in service” accounts. (USOA Part 32.2000(d)) GCI Ex. 8.0 at 90 (Dunkel)

In the case at hand, there is an obvious problem with the company’s claimed intrastate depreciation and amortization expense. That is, the Company is claiming depreciation and amortization expense on accounts that are already fully depreciated. For example, the investment in the Analog Switching Account was already over depreciated at the start of 1999. In spite of that, in 1999 Ameritech claimed another **

** of depreciation/amortization expense in that Account, as shown on GCI Ex. 8.9 in the “depreciation expense” column. The ** ** of claimed 1999 expense is a purely fictional expense. When an investment is fully depreciated, one cannot properly continue to depreciate or amortize that investment further. GCI Ex. 8.0 at 93-4 (Dunkel)

Further, discovery indicates that Ameritech is still claiming additional depreciation/amortization expense in the Analog Switching Account for the years 2000 and 2001, and will be claiming additional depreciation/amortization expense at least through the end of year 2002 for this Account. GCI Ex. 8.0 at 97 (Dunkel)

While the Analog Switching Account is the largest account in which the Company is claiming depreciation on a fully depreciated investment, there are other accounts that were fully depreciated for which the Company booking claimed depreciation/amortization expense in 1999 (as can be determined from GCI Ex. 8.10).GCI Ex. 8.0 at 96-7 (Dunkel)

Claiming a depreciation expense on an investment that is already fully depreciated violates the FCC's Uniform System of Accounts (USOA) definition of depreciation, which is used by the ICC. USOA Part 32.2000(g)(2)(ii) requires:

(ii) Companies... shall apply such depreciation rate...as will ratably distribute on a straight line basis the difference between the net book cost of a class or subclass of plant and its estimated net salvage during the known or estimated remaining service life of the plant.

The "net book" cost is the plant in service less the depreciation reserve. When the depreciation reserve equals the book cost, there is no longer any "net book" cost. In accounts which have a zero net salvage, the depreciation expense and depreciation rate is zero, when the depreciation reserve equals the book cost. In accounts where the future net salvage is different than zero, when the depreciation reserve equals the plant in service adjusted for the net salvage, the proper depreciation rate and depreciation expense at that point is zero.

When the investment has been fully depreciated, and therefore the loss of value has been fully recovered, no additional recovery of the investment or loss is allowable. The purpose of depreciation is to recover the loss of the investment over the service life of that investment. Once the investment has been fully depreciated, there is no longer any valid way to record a so-called depreciation or amortization expense. GCI Ex. 8.0 at 95 (Dunkel) The so-called depreciation expense for Analog Switching that the Company is booking does not meet the definition of depreciation or amortization expense.

When asked for the depreciation parameters (such as the lives and net salvage) Ameritech used to calculate the intrastate depreciation rates it was booking, Ameritech responded:

Ameritech response:

Ameritech Illinois does not use the federal telecommunications historic conventions, such as projection life, curve shape, and other parameters in setting its depreciation rates. (See Ameritech response to City of Chicago Request 39)

Ameritech has not provided any details as to how it determined the intrastate depreciation rates it is booking. GCI Ex. 8.0 at 96 (Dunkel)

In the Alternative Regulation Order, ICC gave Ameritech the freedom to choose its own intrastate depreciation rates for booking purposes. While this is true, this proceeding requires that the Commission look at whether the alternative regulation plan has been fair to consumers and the Company, and how to “reinitialize” rates as a new starting point. In order to properly evaluate the success of the plan and to reinitialize rates, it is necessary to examine the reasonableness of Ameritech’s depreciation expense and determine what the true depreciation expense should be. Depreciation is the largest claimed expense of Ameritech Illinois. It would be improper to determine the reinitialized customers rates based simply on whatever unexplained numbers Ameritech has chosen as its claimed intrastate depreciation and amortization expense. GCI Ex. 8.0 at 98 (Dunkel)

Even in many accounts that are not already over depreciated, the Ameritech claimed intrastate depreciation expense vastly exceeds the reasonable depreciation expense calculated using either the FCC or the ICC approved parameters. The lives and other parameters in the Alt Reg Order were used by the ICC in the process of establishing the initial alternative regulation rates. The ICC order that those lives and other parameters should be used in the future for determining the depreciation expense in the LRSIC studies, although Ameritech had been given freedom pertaining to the depreciation rates it booked. GCI Ex. 8.0 at 100 (Dunkel) Since those lives were adopted, Ameritech Illinois has actually been keeping the equipment in service longer than was anticipated in those FCC and ICC projection lives. GCI Ex. 8.0 at 101 (Dunkel)

The Commission should apply the same principle to Ameritech’s conduct in this proceeding as it did in its Interconnection Order. In that Order, the Commission stated:

We are unwilling to adopt Ameritech Illinois’ ill-defined and largely judgmental calculations of economic lives and abandon the traditional engineering and economic principles which we have utilized in the past. The specifics of the Company’s proposal are

not supported by a sufficient quantum of evidence. Although it asserts that service lives must be shortened in order to ensure that they are consistent with the new competitive environment, it provided very little hard evidence justifying either the range prepared by Mr. Marsh or the actual depreciation economic lives. Mr. Palmer selected. For example, Ameritech Illinois proposes an economic life of 30 years for poles, which is down from 39 years in current LRSIC studies. It provides no explanation for this change which we can evaluate. Have there been exciting new developments in telephone pole technology? Does it expect its poles to break under the weight of its competitors' attachments? GCI Ex. 8.0 at 97 (Dunkel)

This Commission decision was correct. Indeed the depreciation expense that the Company is claiming in this proceeding is even worse than "judgmental." As previously discussed, the Company is depreciating investments that are already over depreciated. In addition, the Company refuses to provide the lives, net salvage, or other parameters it used to calculate its claimed depreciation expense. Therefore, the Commission cannot evaluate what "judgments" the Company made. GCI Ex. 8.0 at 98 (Dunkel)

In February, 1998 Interconnection Order, the ICC adopted the FCC parameters for calculating the depreciation costs in that proceeding:

We believe that the projections lives and net salvage percentages underlying the depreciation rates prescribed for Ameritech Illinois by the FCC as set forth in the FCC's annual update of depreciation rates should be used in the TELRIC calculations. (Citation omitted) They reflect the most recent credible and comprehensive evaluation of depreciation in the record. GCI Ex. 8.0 at 102-103 (Dunkel)

While the FCC does not have jurisdiction over the intrastate depreciation rates, they do have expertise in determining depreciation rates. The FCC's opinion can be considered by depreciation experts. Although they have independent jurisdictions, it is traditional for the state and federal regulators to consider each other views. Traditionally, telephone depreciation rates

have been set in a “Three Way Meeting”, which involves the Company, the FCC Staff, and the State commission Staff. Many times, the depreciation parameters that the state commission use as a result of those meetings are the same parameters that the FCC utilizes, although they have separate jurisdictions. In addition, it should be recognized that the FCC depreciation approval process examines the identical telephone plant as is examined in the intrastate jurisdiction. GCI Ex. 8.0 at 103 (Dunkel)

Ameritech initially claimed a 1999 intrastate depreciation expenses of ** **. GCI Ex. 8.0 at 10 (Dunkel) This amount was later adjusted by the Company to **

** . GCI Ex. 9.9 at 1 (Dunkel) It is clear, by the Company’s own adjustments, that the Commission needs to take a closer look at the issue of depreciation.

For all these reasons, the intrastate depreciation expense should be calculated utilizing the FCC approved parameters. This results in an intrastate depreciation expense of ** **. These FCC parameters produce a result that is similar to the result using the ICC approved parameters. The proposed parameters are forward looking, and include a large allowance for the possibility that technological change, competition or other future events will significantly shorten the lives as compared to the lives that have actually occurred in Illinois in the recent past and produce a depreciation expense that is reasonable GCI Ex. 8.0 at 111-12 (Dunkel)

VI. Cost of Service

The Commission is urged to review how it treats loop costs. William Dunkel noted that: “As Ameritech admitted in discovery, Ameritech’s claimed cost of Residence Local Exchange Service includes 100% of the unseparated loop facility costs and 100% of the NTS-COE facilities costs.” [footnotes omitted] GCI Ex. 8.0 at 74 (Dunkel).

As noted by witness Dunkel, “It is an undeniable physical fact that the loop facilities are utilized by both competitive and non-competitive services.” GCI Ex. 8.0 at 81 (Dunkel).

Dunkel goes on to state that:

The loop facility cost is a shared cost. Therefore, this Commission’s rules and proper economic principles require that shared cost not be included in the LRSIC in any one of the services that share that facility. The proper treatment of a shared cost is to exclude it from the LRSIC. The cost of the shared loop facility should not be included in the LRSIC of basic exchange service, just as it is not included in the LRSIC of toll service, or of any other service that shares the loop facility. GCI Ex. 8.0 at 82-83 (Dunkel).

Dunkel notes that “The proper treatment is to properly calculate the LRSIC for each service. GCI Ex. 8.0 at 83 (Dunkel). GCI Exhibit 8.20 shows the facilities that are needed to provide various major services. GCI Ex. 8.0 at 66 (Dunkel).

Dunkel testified that the fundamental issue in analyzing telecommunications LRSIC cost studies is the treatment of the shared costs. GCI Ex. 8.0 at 73 (Dunkel). Dunkel noted: “The largest shared facility cost is the cost of the “common line” or “loop”.”[footnote omitted] GCI Ex. 8.0 (Dunkel) at 73. Dunkel pointed out that Ameritech’s claimed cost of Residence Local Exchange Service includes 100% of the unseparated loop facility costs and 100% of the NTS-COE facilities costs. GCI Ex. 8.0 at 74 (Dunkel). Dunkel noted that the loop is shared by a number of major services. GCI Ex. 8.0 at 66 (Dunkel). Part 791.20 of the Commission’s cost of

service rule indicates that “Long-run service incremental cost excludes any costs, including common costs, that would be incurred if the service is not produced.” See GCI Ex. 8.0 at 67-68 (Dunkel). The costs of the loop would be incurred even if basic exchange service were not provided as the loop would still be needed to provide toll service, for line sharing, ADSL, vertical features and intrastate services. Therefore, it should not be included in the LRSIC of basic exchange/NAL service. See GCI Ex. 8.0 at 68 (Dunkel). Further Ameritech Illinois’ current approach to violates Section 254(k) of the telecommunications act of 1996. The Commission also needs to bring it into compliance with Section 13-507 of the Illinois Public Utilities Act. See GCI Ex. 8.0 (Dunkel) at 79-81.

Dunkel testified that “The loop facility is a shared cost.” GCI Ex. 8.0 at 82 (Dunkel). The Commission should require that shared costs not be included in the LRSIC in any one of the services that share that facility. Further, Dunkel noted that his proposed \$1.30 NAL reduction did not adjust for the fact that the loop facility is shared and therefore his proposed NAL reduction is very conservative. See GCI Ex. 8.0 at 83 (Dunkel).

The Commission should adopt Dunkel’s recommendation “that the Commission expressly conclude that loop and port facility cost should not be included in the LRSIC for the NAL service...” GCI Ex. 8.0 (Dunkel) at 112.

VII. Rate Design and Rate Rebalancing

Ameritech Illinois filed a petition to rebalance rates. 98-0335. That case has been consolidated with the Alternative regulation review docket in 98-0252. Ameritech Illinois is proposing a \$2.00 increase for monthly rates for residential network access lines. Ameritech Illinois Ex. 1.2 (Gebhardt) at 24. As noted by Dunkel, the changes proposed by Ameritech would produce a net increase in revenues. GCI Ex. 9.0 (Dunkel) at 9. Ameritech's request to increase rates for monthly network access lines should be denied.

William Dunkel provided testimony on various rate proposals. Dunkel stated:

GCI Ex. 8.5 summarizes the revenue impacts of the specific rate changes that I recommend in this proceeding. The specific rate changes I have proposed produce a total annual revenue reduction of ** ***. In addition, I have allowed the ** ** of future switched access reduction that Ameritech anticipates. The total annual revenue reduction being proposed by GCI in this proceeding is \$966 million, as discussed in GCI Ex. 6.0 (Smith Direct). Therefore, while I have not set forth any specific rate changes to produce the additional ** ** of annual reductions, I recommend the NAL be reduced by more than \$1.30. GCI Ex. 8.0P (Dunkel) at 37.

A. Network Access Lines Prices

William Dunkel testified that "Ameritech's proposal to increase NAL rates by \$2 per line per month should be denied. The current NAL rates are well above their long run incremental costs (LRSIC)." GCI Ex. 8.0 (Dunkel) at 4.

Dunkel goes on to propose that residential and business NAL rates be reduced by \$1.30 per line. GCI Ex. 3.0 (Dunkel) at 4. Dunkel later went on to recommend that the residential NAL be reduced by no less than \$1.30. GCI Ex. 8.0 at 13 (Dunkel). Dunkel notes that after the \$1.30 per line per month reduction, the rates would provide a contribution that would still support over 100% of the loop and port costs. GCI Ex. 9.0 (Dunkel) at 18. Dunkel also

proposed that the business NAL rates be reduced by \$1.30 per line per month. GCI Ex. 8.0 (Dunkel) at 14.

B. Residential Order Charge

Dunkel testified that he supports Ameritech’s proposal to reduce the residential order charge for a new service from \$33.05 to \$20 and a reduction in the line connection charge from \$20.50 to \$5.00. GCI Ex. 8.0 at 14-15 (Dunkel). In response to Ameritech witness Van Lieshout, Dunkel points out that under the Ameritech’s reduction in order charges and the \$2 per line increase, Ameritech customers do not come out better. Dunkel shows by way of example that the customers would pay more over time than they would have saved with the reduction in the non recurring charge. GCI Ex. 8.0 at 15 (Dunkel).

C. Residential Local Usage Rates

William Dunkel testified that Ameritech’s proposal to reduce Band B additional minutes rates by 50% in MSA 1 should be adopted. GCI Ex. 8.0 at 22 (Dunkel). However, Dunkel goes on to “...recommend that essentially all residential local usage rates reduced.” GCI Ex. 8.0 at 23 (Dunkel). Contrary to Ameritech’s claims, Dunkel’s proposed \$0.03 per call rate does not lower the Band A call rate below LRSIC. GCI Ex. 9.0 at 11 (Dunkel).

D. Residential Local Usage Calling Plans

William Dunkel notes in his testimony that SimpliFive is currently providing ** contribution in excess of LRSIC. He recommends that the Band A and B rates for Ameritech’s residential SimpliFive be reduced from \$0.05 to \$0.02. He notes that this would still provide a ** contribution above LRSIC. GCI Ex. 8.0P at 24 (Dunkel).

E. Residential Call Packs

William Dunkel proposed reducing the call pack plan rates. Dunkel noted: “Under Ameritech’s “Call Pack” plans, the residence Local Calling Plan Call Allowance Per Line rates

are generating a contribution of ** ** above LRSIC and the per-call (over the call allowance) rates are making a contribution of ** ** above LRSIC, as shown on page 2 of GCI Ex. 8.23.” GCI Ex. 8.0 at 25 (Dunkel). For example, William Dunkel proposed that the 100 allowance call pack with a current price of \$10.00 be reduced to \$3.00. GCI Ex. 8.0 at 25 (Dunkel). See GCI Ex. 8.23 (Dunkel).

F. Business Local Usage

William Dunkel testified: “I propose reductions in essentially all of the business local usage services.” He suggested that Band A business be reduced from \$0.04 to \$0.01 for the initial minute and from \$0.015 to \$0.005 for each additional minute. He also proposed that Band B be reduced from \$0.08 to \$0.02 for the initial minute and from \$0.04 to \$0.01 for each additional minute. GCI Ex. 8.0 at 26 (Dunkel). See GCI Ex. 8.24.

G. Vertical Features

William Dunkel testified that “Many of Ameritech’s residential vertical features rates contain extremely large contribution in excess of their LRSIC costs. GCI Ex. 8.0 at 28 (Dunkel). Dunkel went on to propose reductions for a number of Ameritech’s major per line residence vertical features. Some of the ones Dunkel proposed:

Residential Vertical Features			
	LRSIC (per Ameritech)	Present Rate	GCI Proposed Rate
Call Waiting	** **	\$2.25	\$1.00
Caller ID	** **	\$5.00	\$1.50
Add Name to Caller ID	** **	\$0.95	\$0.25
Automatic Call Back - Pay per Use	** **	\$0.70	\$0.25

GCI Ex. 8.0P at 29 (Dunkel). See GCI Exhibit 8.25 for the various proposed rates for these and other vertical features. Substantial evidence demonstrates that the Commission should reduce residential vertical features as proposed by Dunkel. Dunkel notes: “Under the GCI proposed rates, these services are still producing an overall contribution of ** ** over LRSIC, as shown on GCI Ex. 8.25.” GCI Ex. 8.0 (Dunkel) at 29.

H. Business Vertical Features

William Dunkel also testified that “Similar to the situation with residence vertical features, many of Ameritech’s business features contain extremely large contribution in excess of their LRSICs. GCI Ex. 8.0 at 30 (Dunkel).

Business Vertical Features			
	LRSIC (per Ameritech)	Present Rate	GCI Proposed Rate
Call Waiting	** **	\$5.00	\$2.00
Call Forwarding Variable	** **	\$5.00	\$2.00
Caller ID	** **	\$7.50	\$2.25
Automatic Call Back - per call	** **	\$0.75	\$0.50

GCI Ex. 8.0 (Dunkel) at 30. See GCI Exhibit 8.26 for the various proposed rates for these and other vertical features. We urge the Commission to adopt the business vertical feature reductions proposed by Dunkel.

I. Directory Listings

William Dunkel testified and proposed eliminating the charge for business and residential privacy listing rates. Dunkel noted: “Customers should be free to choose not to have their personal information published, without incurring a financial penalty for doing so.” GCI Ex. 8.0

(Dunkel) at 32. The Commission should act, and put a stop to this practice. It is unfair to allow Ameritech to benefit here at the expense of consumers privacy. As noted by Dunkel, Ameritech's Sorenson does not deny that there is ** ** cost basis for the privacy listings charges. GCI Ex. 9.0 at 24 (Dunkel).

Dunkel also proposed "...reducing the rates for the business and residence additional listing rates, the residence enterprise listing rate and business and residence Custom Number Service rates." GCI Ex. 8.0 at 31 (Dunkel). Dunkel proposed reducing the residential additional listings from \$0.82 per month to \$0.50 per month for Chicago exchanges and from \$0.58 to \$0.35 per month for other exchanges. Dunkel proposed reducing additional business listings from \$5.00 to \$3.00 per month. Dunkel went on to recommend reducing the residence and business Custom Number Service rates from \$38.00 to \$25.00 and the Enterprise listing service rate from \$8.63 to \$4.00 per month. GCI Ex. 8.0 at 33-34 (Dunkel). Dunkel's recommendations should be adopted by the Commission. See GCI Ex. 8.27.

J. Intrastate Switched Access

With respect to intrastate switched access services Dunkel stated: "...I have included the full ** ** claimed switched access revenue reduction, which occurred in June, 2000. I have also shown the Ameritech claimed additional future reduction amount of ** ** as a possible future reduction, as shown on GCI Ex. 8.5." GCI Ex. 8.0 (Dunkel) at 36.

VIII. CUB/AG Complaint – (ICC Docket No. 00-0764)

On December 4, 2000 the Illinois Attorney General's Office and the Citizens Utility Board filed a complaint against Illinois Bell Telephone Company. The case is Illinois Commerce Commission docket number 00-0764 and also on December 4, 2000, AG/CUB filed a motion to consolidate 00-0764 with 98-0252/98-0335. The AG/CUB case requests a rate reduction. On December 22, 2000 Ameritech Illinois responded to the AG/CUB motion to consolidate and in addition to that response, filed a motion to dismiss the AG/CUB complaint.

Consistent with the discussions made in this brief, the Commission should grant a rate reduction and reduce rates to a just and reasonable level.

IX. CONCLUSION

For the above stated reasons:

- (i) the Commission should adopt a new Alternative Regulation Plan consistent with the positions taken in this brief;
- (ii) If, however, the Commission does not make the appropriate modifications to the original Alternative Regulation Plan, then the Commission should place Ameritech Illinois under rate of return regulation

Respectfully submitted,

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