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ILLINOIS COMMERCE COMMISSION

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ILLINOIS BELL TELEPHONE COMPANY)	
Application for review of alternative regulation plan.)	Docket No. 98-0252
ILLINOIS BELL TELEPHONE COMPANY)	(Consolidated)
Petition to rebalance Illinois Bell Telephone Company's Carrier Access and Network Access Line Rates.)	Docket No. 98-0335
CITIZENS UTILITY BOARD)	
THE PEOPLE OF THE STATE OF ILLINOIS)	
Verified Complaint for a Reduction in Illinois Bell Telephone Company's Rates and Other Relief.)	Docket No. 00-0764

INITIAL BRIEF
OF THE
COOK COUNTY STATE'S ATTORNEY'S OFFICE

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ORAL ARGUMENT REQUESTED

April 12, 2001

CORRECTED PUBLIC VERSION

TABLE OF CONTENTS

	Page
I. Parties Overall Summary of the Case – Cook County State’s Attorney’s Office’s Position	2
A. Introduction	2
B. Review of Alternative Regulatory Plan	6
C. Statutory Goals	7
D. Public Policy Goals	8
E. Price Cap Formula, X-Factor	9
F. Service Quality Degradation	11
G. LRSIC	15
H. Rate Design	18
I. Depreciation	19
J. Directory Advertising Revenue Imputation	17
K. Intrastate Revenue Requirement, Rate Base, Net Operating Income and Adjustment Summaries	20
L. Conclusion	21
II. Review of the Alternative Regulation Plan/Introduction	23
A. Scope of the Review Proceeding	23
B. Commission Goals for the Plan	26
C. Issues Specified in the 1994 Order	26
D. Meeting the Statutory Criteria	27
1. Just and Reasonable Rates	28
2. Universal Service	30
3. Network Investment and Modernization	31
III. Going Forward Proposal	32
A. Relative to Existing Components	32
1. Price Index Formula	32
2. Price Cap Productivity Factor and Input Price Differential	33
3. GDPPI – Measure for Economy Wide Inflation	35
4. Consumer Productivity Dividend	36
5. Pricing Flexibility and Baskets	37
6. Services Subject to Alternative Regulation	38
7. Calculation of the API and PCI	38
B. Relative to New Components	39
1. Merger Savings	39
C. Reinitialization of Rates	39

D.	Earnings Sharing.....	41
E.	Rate of Return Regulation.....	42
F.	Other.....	43
	1. Basic Residential Rate Price Cap.....	43
	2. Reclassification of Services from Non-competitive to Competitive.....	44
	3. Exogenous Changes.....	46
IV.	Service Quality - Going Forward.....	47
A.	The Legal Standards.....	47
	The Alternative Regulation Plan has failed to Achieve the Commission's Goal of Maintaining an Adequate Level of Service Quality.....	47
B.	Existing and Proposed Measures & Benchmarks.....	50
	Existing Measures and Benchmarks.....	50
	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.....	50
	2. Installation and Repair.....	54
	3. The Plan Carries an Incentive for Ameritech to Invest in Competitive Advanced Services, to the Detriment of non-competitive POTS Services.....	55
	4. Headcount.....	57
	Proposed Measures and Benchmarks.....	60
	Recommended Service Quality Standards.....	60
	Recommended Reporting Requirements.....	61
C.	Existing & Proposed Penalty Structures.....	62
	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.....	63
	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.....	66

3.	If the Commission determines that the SQI will be maintained within the PCI, the Commission should modify the Plan in accordance with Recommendations set forth herein.....	67
V.	Revenue Requirements Analysis.....	69
	Introduction – Revenue Reduction.....	69
A.	Revenue & Expense Adjustments.....	70
1.	Directory Revenues.....	70
2.	Intrastate Depreciation Expense.....	74
3.	Pension Settlement Gain.....	74
4.	Pension Settlement Gain, Ameritech Services.....	76
5.	Pension Settlement Gains, Known 2000 Amount.....	76
6.	Merger Costs Billed in 2000 from SBC.....	77
7.	Accruals for Asset Disposition.....	78
8.	Non-Product “Brand” Advertising.....	79
9.	Sports Team Sponsorship.....	80
10.	Revenue Reduction from Failure to Meet Service Quality Standards.....	80
11.	Uncollectibles.....	81
12.	Software Capitalization.....	82
13.	Reciprocal Compensation Expense.....	83
14.	Accumulated Deferred Income Taxes (ADIT).....	83
15.	Income-Tax Expense Correction.....	84
16.	Revenue Changes from Additional 2000 Tariff Filings.....	84
B.	Rate Base Adjustments.....	85
1.	Interest Synchronization.....	86
2.	Materials and Supplies.....	86
3.	Telephone Plant under Construction and Interest During Construction.....	86
4.	Accumulated Deferred Income Taxes (ADIT) Debit Balance.....	87
C.	Cost of Capital.....	88
D.	Other.....	89
1.	Depreciation.....	89
VI.	Cost of Service.....	95

VII.	Rate Design and Rate Balancing	97
	A. Network Access Lines Prices	97
	B. Residential Order Charge	98
	C. Residential Local Usage Rates	98
	D. Residential Local Usage Calling Plans	98
	E. Residential Call Packs	98
	F. Business Local Usage	99
	G. Vertical Features	99
	H. Business Vertical Features	100
	I. Directory Listings	100
	J. Intrastate Switched Access	101
VIII.	CUB/AG Complaint-(ICC Docket No. 00-0764)	102
IX.	CONCLUSION	103

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 43.08%, 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

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.

modified plan needs meet.

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.