STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION

ILLINOIS BELL TELEPHONE COMPANY	:	
	:	01-0302
Annual Rate Filing for non-competitive services under an alternative form of regulation.	:	

COMMENTS OF THE STAFF OF
THE ILLINOIS COMMERCE COMMISSION

I. AMERITECH ILLINOIS' ALTERNATIVE FORM OF REGULATION

A. Background

On October 11, 1994, pursuant to Section 13-506.1 of the Public Utilities Act ("Act"), the Illinois Commerce Commission ("Commission") entered an Order in Docket 92-0448/93-0239, Consol. ("Order"), approving an alternative form of regulation for Illinois Bell Telephone Company (“Illinois Bell”, "Ameritech Illinois" or "the Company"). Typically referred to as "price caps," this alternative form of regulation ties rates for noncompetitive services to an index and, thereby, supplants the Company's typical rate case with a more streamlined process within which price changes can be approved. This process, as it is applied to Ameritech Illinois, consists of an annual filing made by the Company on or before April 1 of each year and the subsequent approval by the Commission of the proposed Price Cap Index ("PCI"), to be effective on July 1 of the same year.[1]

[1] The Commission's decision to approve tariff changes within the annual filings will be determined based upon the appropriateness of the Company's proposed PCI for the upcoming year, the remaining parameters of the price cap mechanism, the rate design objectives outlined in its Order in ICC docket 92-0448/92-0239 Consol., and the applicable requirements of the PUA.

Most[2] of Ameritech Illinois' noncompetitive services have, for the purpose of price cap regulation, been separated and placed into four distinct customers groups, or service baskets: (1) Residential Basket, (2) Business Basket, (3) Carrier Access Basket and (4) Other Services Basket.[3] The prices for the services within each of these baskets are allowed to fluctuate over time with the restriction that each basket's Actual Price Index ("API") never exceeds the PCI. The PCI is primarily based upon inflation, but includes offsets for productivity, the Company's quality of service and exogenous factors which are beyond the control of the Company.

At the outset of the Plan, the PCI was set equal to 100. Pursuant to the Commission's Order, the PCI must be recalculated once each year according to the following formula:

$$PCI_t = PCI_{t-1}\ [1+ (\%\text{ change in the GDPPI})/100-.043 +/- Z + Q]$$

where:

PCI_t	= price cap index for current year,
PCI_{t-1}	= price cap index for previous year,
GDPPI	= Gross Domestic Product Price Index,
Z	= exogenous change factor, and
Q	= quality of service component<u>, which is negative</u>.

2 Staff notes that all new non-competitive services are excluded from Ameritech Illinois' Alternative Regulation Plan for one year. Further, in its Order in Docket 96-0486/96-0569 Consol. (the TELRIC proceeding), the Commission concluded that, at the present time, Ameritech Illinois' unbundled network elements, interconnection and transport and termination rates should be excluded from the alternative regulation plan currently applicable to the Company's noncompetitive services. For a detailed discussion of the Commission's decision on this issue, please refer to its Order in the TELRIC proceeding at 87.

3 A more detailed list of the services included in each of the service baskets can be found in Appendix A, I.A.2.b, of the Commission's Order in Docket 92-0448/92-0239, Consol.

Similarly, the API of each of the service baskets was set equal to 100 at the outset of the plan. Each basket's API is nothing more than a reflection of the basket's average price once demand and any proposed tariff changes are properly taken into account.[4] The API may change at any time during the year when price changes are made. (Order, Appendix A at 3). The API for an individual basket is calculated as follows:

$$API_t = API_{t-1} * \sum_{i=1}^{n} v_i \frac{P_i(t)}{P_i(t-1)}$$

where:

API_t = actual price index for the current year,
API_{t-1} = actual price index for the previous year,
i = rate element i,
$P_i(t)$ = proposed price for the i_{th} element,
$P_i(t-1)$ = current price for i_{th} element, and
v_i = revenue weight for i_{th} element.

As described in the Commission's Order, "the reasonableness of price changes under the plan is determined by a comparison of the PCI applicable to a given year and the API for each of the four customer categories." (Order, Appendix A at 3). Specifically, each basket's API must be less than or equal to the PCI at all times. This requirement has implicitly placed the emphasis of the Company's annual filings on the calculation of the PCI and the justification of each of its inputs. In addition to determining whether the baskets' APIs are less than the PCI, the Commission must also ensure that any proposed tariff changes are consistent with the requirements of the Act, including Sections 13-505.1 and 13-507.

[4] Under certain circumstances, the basket's API may be recalculated during the year to ensure that it remains less than or equal to the PCI. For example, a price increase in one of the services within a basket would require that basket's API to be recalculated.

B. Filing Requirements

In order to develop a record which the Commission can use to determine whether it should approve Ameritech Illinois' annual rate filings with or without modifications, the Commission has established a very specific set of filing requirements. In its Order, the Commission stated:

> Illinois Bell shall be required to make an annual rate filing no later than April 1 of each year of the plan after 1994. At that time, Illinois Bell shall provide the following information:
>
> (a) the price cap index for the following 12-month period (July to June), with supporting data showing the GDPPI for the previous calendar year and the percent GDPPI change for that 12-month period;
>
> (b) the actual price index ("API") for each service basket, including the effects of proposed rate changes under the price cap index for the following 12-month period (July to June) and adjustments for new services added, existing services withdrawn, and services reclassified as competitive or noncompetitive;
>
> (c) tariff pages to reflect revised rates;
>
> (d) supporting documentation demonstrating that any proposed rate changes are consistent with the requirements of the price index mechanism;
>
> (e) a demonstration that Illinois Bell would be in compliance with Sections 13-507 and 13-505.1 of the Act if the proposed rate changes went into effect;
>
> (f) an identification of any changes to the GDPPI weights and an assessment of the effects of such changes, and any necessary modifications to the PCI;
>
> (g) the current data showing the calculation of Z for the previous calendar year, with the events causing Z to change identified and described;

(h) the current data showing the calculation of Q for the previous calendar year, with the events causing Q to change identified and described.
(Order at 92.)

Furthermore, the Commission stated that "Staff and all of the interested parties will have an opportunity to file written comments in response to each annual filing and the Company will have an opportunity to file reply comments." (Id. at 93).

C. Ameritech Illinois' 2000 Annual Filing

In accordance with the Commission's filing requirements, the Company submitted its sixth annual filing on March 30, 2001. This filing was subsequently revised and resubmitted on April 2, 2001. In its filing, Ameritech Illinois provided: (1) a calculation of the PCI; (2) a demonstration that each of the individual baskets' API would be less than, or equal to, the recalculated PCI (assuming the draft tariff pages are approved by the Commission); and (3) a summary of the analyses that purportedly verify compliance with Sections 13-507 and 13-505.1 of the Act.

A primary issue with Ameritech Illinois' annual filings, while the Company remains under the Plan, is the calculation of the PCI. Exhibit 4 of the Company's filing contains the following calculation for the 2000 - 2001 PCI:

$$PCI_t = 86.68 * [1 + .0264 - .043 - .0025]$$
$$PCI_t = 86.68 * [.9809]$$
$$PCI_t = 85.02$$

Exhibits 1 through 3 contain the calculations of certain inputs to the PCI formula. Specifically, Exhibit 1 contains the Company's annual filing calculations for the percentage change in the GDPPI; Exhibit 2 presents the Company's quality of service results for 2000; and Exhibit 3 presents any proposed exogenous change. There is no exogenous factor for this filing. Based upon the Company's assumptions, the proposed PCI for the period between July 2001 and June 2002 would be 85.02.

II. CALCULATION OF THE PCI

For the reasons set forth below, Staff recommends that Ameritech Illinois has not properly calculated the PCI for the period between July 2000 and June 2001. This is because Ameritech Illinois has applied an incorrect method for determining whether it has satisfied the installation standard for the service quality component of the PCI formula, and as a result of this error has incorrectly identified only one standard that fails to satisfy benchmark requirements. Specifically, Staff believes that an additional .25% reduction in the PCI should be incorporated into the calculation. The remainder of this section of Staff's comments deal with each of the components of the PCI calculation.

A. GDPPI

As the Commission is well aware, the GDPPI is used to measure the annual economy-wide inflationary change that has occurred in a given time period. The GDPPI is very important within the context of the Alt. Reg. Plan because the percent change in GDPPI is used as a direct input in the calculation of the PCI, which, in turn, determines the level to which Ameritech must lower the prices of its services. Ameritech provided its calculation of the percentage change in GDPPI from the 4th

Quarter of 1999 to the 4th Quarter of 2000 in Exhibit 1 to this filing. Exhibit 1 shows that the percentage change in GDPPI is 2.64%. The Bureau of Economic Analysis ("BEA") at the United States Department of Commerce provided the values for the GDPPI used in this calculation. Staff finds the values provided by the BEA, as well as Ameritech's calculation of the percentage change in GDPPI, to be appropriate.

B. Exogenous Factor (Z)

In its annual rate filing, Ameritech Illinois does not seek exogenous change ("Z-Factor") treatment for changes associated with the amendments to Federal Communications Commission's ("FCC") rules, nor does it seek such treatment for any other exogenous change that is quantifiable, outside its control and has not been picked up in the economy-wide inflation factor. Instead, Ameritech relies upon its request for rate re-balancing to address access charge changes ordered by the Commission.

1. ICC Alternative Regulation Order As It Relates to Exogenous Factor Treatment

In addressing the issue of exogenous factor treatment, the Commission concluded that:

> "Exogenous factor treatment should be allowed only for costs which are truly outside the Company's control. Further, the costs should be such that they would not be picked up in the economy-wide inflation factor, to avoid double counting. The financial effects of an exogenous change should be verifiable and quantifiable, to ensure that the effect of the exogenous event can be accurately determined without protracted, controversial regulatory involvement. Positive or negative changes of less than $3 million will not be considered for exogenous factor treatment.
>
> Specific items that would warrant exogenous factor treatment include changes in federal and state tax law to the extent they affect local

> carriers such as IBT disproportionately, mandated jurisdictional separations changes, and changes in Commission approved accounting or cost allocation procedures. Extraordinary costs incurred due to new and unusual regulatory requirements may be considered for exogenous factor treatment. The Company must show that actions taken by the FCC or other federal bodies would affect intrastate cost significantly in the latter case."

(Order at 62-63 (emphasis added); Appendix A at 4).

2. Staff Analysis

Based on its analysis, Staff concludes that Ameritech Illinois' request for no exogenous factor treatment is appropriate and should be granted. Staff reviewed Ameritech Illinois' price cap filings at both the state and federal level as well as additional information provided by Ameritech Illinois personnel at Staff's request. Staff has not identified any change that meets the Commission's criteria for exogenous treatment in this annual filing. Staff believes that Ameritech's intent to seek exogenous change treatment of the access charge reduction in next year's annual filing (*See,* Attachment B, Ameritech response to DR JRM 1.06) would be untimely and, therefore, inappropriate. The issues of rate re-balancing and recovery of access charge reductions will be fully considered in Docket 98-0252, and it is proper to defer this issue to that docket.

C. Quality of Service (Q)

Staff concurs with the Company's observation that a .25% reduction in the formula is appropriate due to reflect the Company's performance relative to the "Out of Service > 24 Hours." However, Staff believes an additional .25% should be deducted from the formula to reflect the Company's performance relative to the installation standard.

Staff believes the Company applied an inappropriate definition of installation performance. The wording in 83 Illinois Administrative Code Part 730.540(a), which is the foundation for the performance benchmarks in the Alternative Regulation Plan, states the following about installation requests:

> The local exchange carrier shall complete 90% of its regular service installations within five working days after the receipt of the application, unless a later date is requested by the applicant.

The term "regular service installations" should not be construed to mean vertical services such as Caller ID or Call Forwarding, and should relate only to the provisioning of regular telephone service, i.e., dial tone. The term "regular service installation" means regular dial tone service, which constitutes either the installation or turning on of telephone service. Vertical features, such as Caller ID, Three-way Calling or Call Forwarding, are supplemental or added features to dial tone service. Staff considers requests for such services to be "change" orders. The Company's tariffs clearly show that vertical services are "optional" or "custom" services and not regular service.[5] Docket No. 98-0252, Tr. 1804 - 1807.

Installation performance was first included as a standard in the Second Amending Order in Docket 55472, which modified General Order 197 (telephone standards) on November 20, 1974, as follows:

[5] In its Annual rate filing, Ameritech "requests that the Commission take administrative notice of the record and Order in Docket Nos. 92-0448/93-0239 for use in reviewing this filing. Staff believes it is more appropriate for the Commission to take notice, and specifically requests that the Commission take notice of, the recently compiled record in Docket Nos. 98-0252/98-0335/00-0764.

Section 611 - Installation Requests

1. The telephone company shall normally complete 90% of its ***regular service (business and residence 1, 2, and 4 party service) installations*** within five working days. The interval commences with the receipt of application unless a later date is requested by the applicant, and when all tariff requirements related thereto have been complied with. Whenever, due to company reasons, the completion rate falls below 82% within five working days for three consecutive months, the company shall report to the Commission. (Emphasis added).

This wording is significant because it provides the basis for the definition for the term "regular service installations." The explanatory reference to "business and residence 1, 2, and 4 party service" indicates that "regular service installations" should be considered to be provisioning business or residential single/party lines. It clearly does not contemplate vertical services.

Somewhere between the advent of vertical services and today, the Company unilaterally and singularly decided to add vertical services to their reporting of "regular service installations" performance data to this Commission. And Staff means "singularly," as Ameritech apparently is the only carrier that includes vertical services in its count of services installed. Staff contacted representatives from Verizon (formerly GTE), Consolidated Communications, and Frontier to learn how they define and report installation orders. None of these other Illinois local exchange companies include vertical features in their installation data compiled and reported to the Illinois Commerce Commission.

Whereas the Company reports that it is successful in meeting the minimum service requirements under Code Part 730 or alternative regulation, the Company, in fact, is failing to meet them. The Company, on average, took longer than five days to complete regular service installation throughout the January 1999 through September 2000 time frame. Moreover, the Company's installation trend has been steadily worsening to the point that September 2000 "dial tone" installations averaged over ten days to complete. Docket 98-0252, Staff Ex. 8.0 at 11. In response to the Illinois Attorney General's Data Request AG-2 in this proceeding, the Company indicated it installed access lines at a rate of only 84% in calendar year 2000.

If the Commission agrees with Staff that Ameritech Illinois' definition of "regular service installation" is inappropriate, the Company has likely missed the "Q" component for installation over the life of the Plan. Had this been reported correctly, Ameritech would have experienced a corresponding -.25% adjustment to the formula over the life of the current Plan. This adjustment would have resulted in a cumulative reduction of $29,578,729 in rates, and is being addressed in Docket 98-0252, the alternative regulation review case.

Testimony in Docket 98-0252 by Ameritech witness Hudzik more clearly delineates the effect of the Company's inclusion of vertical services in its installation reports. Vertical services constitute "80 to 85 percent" of all installation orders. Docket 98-0252, Tr. 1934. The success rate for meeting the Installation within five days requirement for vertical services is probably "99 percent," and, perhaps higher. Docket 98-0252, Tr. 1935. With vertical services removed from installation figures, Ameritech's success rate in 1999 was "between 88 and 90 percent." Docket No. 98-0252, Tr. 1938. For the period of June, July and August, 2000, Ameritech's rate for meeting the installation requirement, including orders for vertical services, was between “96.5 and 98.3” percent. However, with vertical service orders excluded, the Company’s performance “would have been in the 70 percent range.” Docket 98-0252, Tr. 1939. This striking admission makes it clear that Ameritech’s actual performance in relation to this standard has been masked by the inclusion of vertical services statistics.

One result of Ameritech’s service quality failures has been to cause Staff to request the Commission to open Docket 00-0596. That docket is a rulemaking proceeding addressing 83 Illinois Administrative Code Part 730, Standards of Service For Local Exchange Telecommunications Carriers. Among other things, Staff intends to review the definitions of measurements to ascertain that all parties are measuring performance in the same manner. Docket 98-0252, Staff Ex. 8.0 at 11 - 12. Regarding installation specifically, Staff will recommend that the Commission specifically recognize that vertical services should not be included in the installation calculation, and to incorporate the subsequent installation of additional lines as regular installations. The following installation definition represents Staff’s position in Docket 00-0596:

> “Regular service installations” shall be considered to include all installation and move orders of residential and business single lines, including orders for additional lines, and shall exclude orders for the following:
>
> (A) Advanced/Special Services (i.e., WATS, FX, DSL)
> (B) Vertical services
> (C) Payphones
> (D) Company official lines
> (E) Records work only
> (F) Orders impacted by the customer for the following reasons:
> (i) Hold for payment
> (ii) Customer will advise

(iii) Customer requested later due date
(iv) No access

It would be incorrect to view this proposed definition as an admission by Staff that vertical services could have ever been legitimately added to the "regular service installation" calculation under the current language of Part 730. Docket 98-0252, Staff Ex. 22.0 at 13 - 14.

D. Staff's Alternative PCI Calculation

Based on Staff's proposed modification to Ameritech Illinois' quality of service component, the PCI for 2000-2001 must be recalculated. Staff's calculation differs from Ameritech's only in that the service quality component of the formula include a .5% reduction in the PCI rather than a .25% reduction. The revised PCI for 2000-2001 is calculated as follows:

$PCI_t = 86.68 * [1 + .0264 - .043 - .005]$
$PCI_t = 86.68 * [.9784]$
$PCI_t = 84.81$

III. CALCULATION OF THE API OF EACH BASKET

The API of each of the service baskets was set equal to 100 at the outset of the plan. Each basket's API is nothing more than a reflection of the basket's average price once demand and any proposed tariff changes are properly accounted.[6] The API may change at any time during the year when price changes

[6] Under certain circumstances, the basket's API may be recalculated during the year to ensure that it remains less than or equal to the PCI. For example, a price increase in one of the services within a basket would require that basket's API to be recalculated.

are made. (Order, Appendix A at 3). The API for an individual basket is calculated as follows:

$$API_t = API_{t-1} \times \sum_{i=1}^{n} v_i \frac{P_i(t)}{P_i(t-1)}$$

where:

API_t = actual price index for the current year (2001),
API_{t-1} = actual price index for the previous year (2000),
i = rate element i,
$P_i(t)$ = proposed price for the i_{th} element,
$P_i(t-1)$ = current price for i_{th} element, and
v_i = revenue weight for i_{th} element.

As has been the practice in previous filings, the formula has been simplified for performing the actual calculation:

$$API_t = API_{t-1} * \frac{\text{Proposed Revenue}}{\text{Current Revenue}}$$

where:

$$\text{Proposed Revenue} = \sum_{i=1}^{n} P_i(t) * Q_i(t-1),$$

$$\text{Current Revenue} = \sum_{i=1}^{n} P_i(t-1) * Q_i(t-1), \text{ and}$$

Q_i (t-1) = the actual demand for the i_{th} element in the previous year (2000 demand in this filing).

Thus, the API for each basket has been calculated by multiplying the previous year's API by the revenue for the current year that would result from the proposed price changes and then dividing this by the revenue for the current year that would result if no price changes were to take effect. Since the current year's demand is unknown, the previous year's demand is used in order to produce both the proposed and current revenue figures.

As described in the Commission's Order, "the reasonableness of price changes under the plan is determined by a comparison of the PCI applicable to a given year and the API for each of the four customer categories." (Order, Appendix A at 3). Specifically, each basket's API must be less than or equal to the PCI at all times. This requirement has implicitly placed the emphasis of the Company's annual filings on the calculation of the PCI and the justification of each of its inputs.

The Company has provided information in this filing to calculate the new API values for each basket. The table below shows the old API, the proposed revenue, the current revenue, and new API for each basket. According to these calculations, each basket’s API is less than the PCI of 85.02 for this filing.

	Old API	Proposed Rev	Current Rev	New API
Residence Services	86.5393	$X	$X	85.0197
Business Services	74.8294	$X	$X	74.8294
Carrier Basket	57.7264	$X	$X	57.6025
Other Services	86.6782	$X	$X	85.0181

As shown above, Staff recalculated the PCI based on its determination that Ameritech Illinois failed to meet two service quality benchmarks, and not just the single benchmark failure to which Ameritech admits. As a result, the API for the Residence Services basket and the Other Services basket both exceed the new PCI of 84.81. Therefore, Ameritech Illinois must make additional rate reductions in the Residence Services basket totaling at least $1.45 million, and at least $1.68 million in the Business Services basket, in order to reduce the API for each of these baskets below the 84.81 level.

IV. Residential Usage Reductions and Discounts

Ameritech Illinois' residential usage tariffs contain discounts which indirectly determine customer prices. For example, in the absence of an optional calling plan an Ameritech Illinois residential customer in MSA 1 receives volume discounts on cumulative Band A and Band B usage. Currently, such customers receive discounts on Band A and B spending for each month equal to 0% for spending up to $2.60, equal to 15% for spending in the range of $2.61 to $5.20, equal to 20% for spending in the range of $5.21 to $10.40, equal to 26.8% for spending in the range of $10.41 to $26.00, and equal to 33% for spending above $26.00. *See* Illinois Residence Services Category, April 1, 2001 Illinois Price Cap Filing (No Rate Rebalancing) at Page 1 of 2. As a result of such discounts, the average rates per minute of use paid by Ameritech Illinois' customers vary with customer usage patterns and typically depart from the undiscounted usage prices.

Price reductions resulting from volume discounts can significantly impact price cap adjustments. For example, the price reductions proposed by Ameritech for residential Band B additional minutes of use result in a reduction in Ameritech revenue of $XXX, based on year 2000 annual demand. *See Id.* However, these reductions are offset for customers by lost usage discounts which amount to $XXX, according to Ameritech's calculations. Consequently, as a result of discounts lost by consumers, Ameritech estimates that the reduction in total local usage revenue for the Illinois Residential Services Category reported by Ameritech Illinois equals

$XXX rather than $XXX.[7] *See Id.* Therefore, local service volume discounts play an important role in Ameritech's ability to meet price constraint obligations consistent with its existing alternative regulation plan.

Staff requested from Ameritech Illinois an explanation of how proposed volume discount revenue is calculated in the Annual Price Cap Filing. *See* Illinois Commerce Commission Data Request, ICC Docket No. 01-0302, JZ 1.5; Attachment C to these Comments. Ameritech responded as follows:

> Proposed Revenue for Residential Volume Discounts in Ameritech's Annual Rate Filing is calculated based on the following formula:
>
> > (Annual Demand*Proposed Price)*(Sum of all MSA 1's Usage Proposed Revenue/Sum of all MSA 1's Usage Current Revenue)
>
> The same principle is used in calculating MSA 2's Proposed Revenue. The formula applies to both embedded and marginal discounts. *See* Response Staff Data Request JZ 1.5 (Attachment C).

The methodology employed by Ameritech to compute proposed volume discount revenue results in a proxy that does not reflect the actual proposed volume discounts that would occur given year 2000 demand and proposed prices. In fact, the methodology employed by Ameritech systematically over-states the impact that rate reductions have on average rates paid by Ameritech Illinois' customers. A hypothetical example demonstrates this systematic bias.

Assume that Ameritech Illinois has a single MSA 1 residential customer that makes 100 Band A peak period calls in a month. Under current rates that customer would be charged a rate of $.05 per call. The customer would thus have a

7 Without other changes, Ameritech Illinois' changes in discounts for usage spending in the

cumulative usage bill, absent discounts, equal to $5.00. The fist $2.60 of this usage bill would not be eligible for volume discounts under Ameritech's current discount schedule. The remaining $2.40 would, however, receive a discount of 15% or $0.36. Therefore, the customers' usage bill would equal $4.64 ($5.00 less the $0.36 discount).

Now suppose Ameritech proposes to reduce its Band A peak period call rate to $0.04 per call. Based on the same usage, the customers usage bill, absent discounts, will be $4.00. Again, the first $2.60 of this usage bill would not be eligible for volume discounts under Ameritech's current discount schedule. The remaining $1.40 would receive a discount of 15% or $0.21. Therefore, the customers usage bill would equal $3.79 ($4.00 less the $0.21 discount). The proposed rate results in an 18.3% reduction in total customer usage charges.

The customer's usage bill, absent discounts, under the current rates would be $5.00. The customer's usage bill, absent discounts, under the proposed rates would be $4.00. **$**2.60 would be the base demand eligible for the 0% discount and $2.40 would be the base demand eligible for the 15% discount. By employing the Ameritech methodology described above for calculating proposed discount revenue, the discount revenue reported for a price cap filing by Ameritech would equal (4.00/5.00)*2.60*0.00+(4.00/5.00)*2.40*0.15=$0.288, which exceeds the $0.21 the customer would actually receive if usage were to remain constant. According to Ameritech's methodology the customer's usage bill would be reported as $3.712 ($4.00 less a discount of $0.288). Therefore, Ameritech's methodology

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range of $10.41 to $26.00 would reduce revenue by $XXX. See Id.

would portray the rate decrease as causing a 20.0% reduction in rates, when in fact, as demonstrated above, the actual reduction would be only 18.3%.

This example generally applies to all reductions in undiscounted usage prices. Ameritech systematically over-states the reductions in revenue created by its proposed price reductions. As a result, Ameritech Illinois' customers -- in particular customers purchasing services that are subject to volume discounts -- do not receive all of the benefits of price reductions prescribed by the Plan and the Act. In addition, Staff is of the opinion that, unless corrected, Ameritech's proposed price reductions do not satisfy the requirements of the price cap system and are therefore not compliant with the current Alternative Regulation Plan. Staff recommends that Ameritech correct this error by computing proposed revenue based on actual customer usage patterns for 2000.

In the event Ameritech is unable to make a correction based on actual customer usage patterns for year 2000, Staff recommends that the Commission require Ameritech to produce an alternative proxy that does not result in systematic over-statement of rate reductions, a proxy that also must insure that all required rate reductions are made by the company. If the company is unable to present a proxy that has no systematic bias, Staff recommends that the Commission require Ameritech to assume that revenue reductions resulting from all reductions in direct usage charges result in maximum reductions in consumer discounts. For example, Band B additional minute charge reductions in MSA-2 reduce undiscounted MSA-2 revenue by $XXX. Such reductions could result in all MSA-2 residential customers spending less than $XXX since total revenue from spending over $104.00 equaled only $XXX. *See* Illinois Residence Services Category, April 1, 2001 Illinois Price Cap Filing (No Rate Rebalancing) at Page 1 of 2. The lost discounts on the $XXX for the over $104.00 category would equal $XXX. In addition, marginal spending between $52.01 and $104.00 could be reduced by $XXX ($XXX-$XXX). This would result in lost discounts in the $52.01 to $104.00 category of $XXX. In sum, consumers could lose a total of $XXX in discounts in MSA-2. Employing the same methodology in MSA-1 implies that, in total, residential consumers could lose a total of $XXX in discount revenue ($XXX in MSA-1 and $XXX in MSA-2). This is well above the $XXX implied by Ameritech Illinois' proxy methodology and indicates that Ameritech fails to meet required revenue reductions in the Illinois Residence Services Category by $1,774,517. *See* Attachment D to these Comments for details of these calculations. If Ameritech fails to correctly calculate the revenue impacts associated with volume discounts then, in order to ensure that consumers receive all of the price reductions consistent with the alternative regulation plan, Staff recommends that the Commission require Ameritech to adopt this methodology and calculate the revenue reductions resulting from all reductions in direct usage charges as if those reductions were the maximum reductions possible.

V. <u>AGGREGATE REVENUE TEST AND IMPUTATION</u>

In addition to determining whether the baskets' APIs are less than or equal to the PCI, the Commission must also ensure that any proposed tariff changes are consistent with the requirements of the Act, including Sections 13-505.1 and 13-507. As required by the Commission's Order, the Company provided an Aggregate

Revenue Test with its annual filing pursuant to Section 13-507 of the Act. The test demonstrates that Ameritech Illinois will remain in compliance with Section 13-507 of the Act if its proposed tariff changes are approved. (Ameritech Illinois Exhibit 6A). Also, the Company has provided an Imputation Test for those services affected by price changes pursuant to Section 13-505.1 of the Act. The test demonstrates that Ameritech Illinois will also remain in compliance with the Act's imputation requirements. (Ameritech Illinois Exhibit 6A).

VI. Intrastate Net Merger Savings

Ameritech provided its calculation of Intrastate Net Merger Savings as Proprietary Exhibit 9 to its Annual Price Cap Filing. That calculation reports intrastate net merger savings of $X million during calendar 2000. Ameritech's calculation reduces this amount by net merger costs reported in 1999 and allocates 50% of the balance to Illinois ratepayers. In response to DR JRM 1.05, Ameritech states that none of the amount of calendar 2000 intrastate net merger savings is passed to ratepayers in this annual filing, noting that these amounts are subject to future audit.

Staff believes that the Commission's Order in Docket 98-0555 requires Ameritech to reduce rates in this annual filing to reflect its net merger costs and savings. This rate adjustment or credit should not be delayed indefinitely, pending the outcome of a future audit, although adjustments to that amount may be required in the future, based upon the outcome of the audit. Staff also disagrees with inclusion of costs that have produced no savings and net costs reported for calendar 1999 in the calendar 2000 calculation required to be reflected in this filing.

Staff has provided a corrected calculation of calendar 2000 intrastate net merger savings as Attachment A to these comments.

Specifically, the Commission's Order in Docket 98-0555 states in pertinent part:

> "To the extent that costs are incurred to produce savings and are shown to be both reasonable and directly related, we agree with the Joint Applicants that netting is appropriate. As a matter of logic, the only savings that can be experienced are net savings. Moreover, our reading of Section 7-204(c) indicates that just such a result is contemplated. We further conclude on the arguments presented, that 50% of the net merger savings allocable to AI should be allocated to consumers using Staff's distribution methodology. This strikes a fair balance considering the commitment, performance and benchmark costs which will be incurred post-merger."…
>
> "To be specific, Ameritech Illinois is required to track its share of all actual merger-related savings and all merger-related costs, as herein defined, separately for the period beginning on the date that the merger is consummated and ending on March 15, 2000. AI shall submit that information as part of its annual Alt. Reg. filing on April 1, 2000. Furthermore, this information will continue to be provided in Ameritech's annual price cap filings until such time as an updated price cap formula has been developed in Docket 98-0252. In the annual price cap filings, AI is required to flow-through merger savings net of reasonable costs in the manner here described until such time as an updated price cap formula has been developed." …
>
> "It is the ruling of this Commission that the net merger-related savings should be allocated to Ameritech Illinois' customers as follows:
>
> (1) Carriers purchasing AI's UNEs, interconnection, and transport and termination services will benefit from merger-related savings through updated rates resulting from modification of its TELRIC, shared and common costs.
>
> (2) Once the share of the merger-related savings allocable to UNEs, interconnection, transport and termination purchasers have been identified, the remaining balance of savings will be allocated to interexchange, wholesale and retail customers. This will be done by dividing the remaining merger-related savings between IXCs on the one hand and end users

> (whether served via retail or wholesale) on the other, based on the relative gross revenues of each of these two groups.

> As per Staff's recommendations, which we find to be reasonable, IXCs' share of the merger-related savings should be allocated to those customers through reductions in access charges, including the intrastate PICC. End users' share of the merger-related savings should be allocated as a credit on a per network access line basis to ensure that business customers do not receive a larger portion of the merger-related savings than residential customers.
> (Order at 146-150).

In Staff's opinion, no adjustment to calendar 2000 reported intrastate net savings should be made related to the calendar 1999 data. Each year's annual price filing should reflect only data related to the current year. Staff notes that, although Ameritech reported net merger related costs (or costs in excess of savings) for calendar 1999, the 3rd party auditor reported net merger related savings in excess of costs. (See BWG Final Confidential Report, p. VII-42, Table RCS-37). Costs and Savings related to calendar 1999 are currently being litigated in Docket 01-0128 and the Commission can order any necessary adjustment or credit related to calendar 1999 in that Order. The scope of this annual filing should be limited to consideration of calendar year 2000 data as reported by Ameritech.

As noted above, the Commission's Order in Docket 98-0555 requires that only "costs are incurred to produce savings and are shown to be both reasonable and directly related" are appropriately netted against savings. Staff issued Data Request JRM 1.03 to obtain Ameritech's rationale for its inclusion of costs in Exhibit 9 that don't appear to have produced any savings. Ameritech provided no rationale for, or explanation of these costs. Therefore, Staff's calculation of intrastate net merger savings includes costs for those accounts where savings were produced but eliminates costs which have not been shown to produce any savings whatsoever.

To date, Ameritech has not shared any merger related savings with any purchaser of AI's UNEs, interconnection, and transport and termination services through updated rates resulting from modification of its TELRIC, shared and common cost studies. Ameritech should be ordered to properly calculate a revised shared and common cost study and file revised tariffs reflecting all net merger savings. This is a topic of Staff testimony in Docket 00-0700 and appropriate parameters for that study can be determined based upon the evidentiary record in that case.

Because year 2000 net savings have not benefited purchasers of UNE's, interconnection and termination services and it is unlikely that such benefits will flow to these purchasers before late 2001, it is appropriate that the entire 50% of calendar 2000 intrastate net merger savings of $23.2 million should be allocated to IXC, business and residential customers in accordance with the Commission's Order. To do otherwise would result in a multi-million dollar windfall to Ameritech, in essence rewarding it for failing to follow the Commission's Order in Docket 98-0555. The Commission should Order Ameritech to return $11.6 million to its customers to reflect calendar 2000 intrastate net merger savings in this docket.

VII. Impact of Other Pending Proceedings

Staff notes that there are other docketed cases currently before the Commission that could impact this case significantly. Namely, there are several issues before the Commission in Dockets 98-0252/98-0335/00-0764 (Consolidated) and Docket 98-0860 that could alter the structure of the alternative regulation plan considerably. It is possible that an Order could be issued in either one of the above mentioned cases before this proceeding is completed.

One of the issues in Dockets 98-0252/98-0335/00-0764 (Consolidated) is Ameritech Illinois' proposal for rate rebalancing. Due to the significant impact that rate rebalancing would have on this annual filing, the Company has chosen to produce two variations of its rate proposals in this filing. Staff is of the opinion that rate rebalancing is only one of several issues from that proceeding that would have significant impacts on the annual filing, and that it is neither appropriate nor practical to address any of these possible outcomes here. It is certainly not appropriate to address only one of these issues without considering the impacts of all such issues that could alter the nature of the underlying Plan. It is Staff's position that the current proceeding must advance according to the alternative regulation plan as it exists currently. Appendix A of the Order makes it clear that this annual review of the Plan is limited to determining whether Ameritech's rates should be adjusted within the constraints of the PCI as set in that Order. Changes to the Plan itself (such as rate rebalancing) are being properly considered in Docket 98-0252 and should remain within the bounds of that proceeding.

VIII. CONCLUSION

Staff recommends that the Commission order Ameritech Illinois to file tariff changes consistent with the recommendations contained herein which demonstrate that the Company is in full compliance the Commission's price cap Order and all of the Commission's rules.

Respectfully submitted,

____

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