

**STATE OF ILLINOIS**  
**ILLINOIS COMMERCE COMMISSION**

ILLINOIS INDEPENDENT TELEPHONE	)	
ASSOCIATION	)	
	)	Docket No. 00-0233
Petition for initiation of an investigation	)	
of the necessity of and the establishment	)	
of a Universal Service Support Fund in	)	
accordance with Section 13-301(d) of	)	
the Public Utilities Act	)	
	)	Consol.
ILLINOIS COMMERCE COMMISSION	)	
On Its Own Motion	)	
	)	Docket No. 00-0335
Investigation into the necessity of and,	)	
if appropriate, the establishment of a	)	
universal support fund pursuant to	)	
Section 13-301(d) of the Public Utilities	)	
Act.	)	

**PHASE II REPLY BRIEF OF**  
**VERIZON NORTH INC. AND VERIZON SOUTH INC.**

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Verizon North Inc. (f/k/a GTE North Incorporated) and Verizon South Inc. (f/k/a GTE South Incorporated) (collectively referred to as “Verizon”), through its attorneys, hereby submit to the Illinois Commerce Commission (“Commission”) this Reply Brief for Phase II of this proceeding. This Reply Brief is filed in accordance with the procedural schedule established by the Administrative Law Judge on March 22, 2001.

**I.**  
**EXECUTIVE SUMMARY**

Verizon has demonstrated through its Initial Brief that there may be no need for an intrastate universal service fund (“USF”) after the Commission establishes a reasonable “affordable rate,” accounts for all appropriate federal funding that the members of the Illinois Independent Telephone Association (“IITA”) receive, and ensures that no funds are being used to offset the under-recovery of switched access costs. These adjustments are required by, and

consistent with, Section 13-301(d) of the Public Utilities Act (“the Act”). 220 ILCS 5/13-301(d). No party has presented compelling argument or evidence to rebut Verizon’s arguments addressing the need for, or size of, an intrastate USF. In fact, the Initial Briefs of the various IITA members now call into question whether there is a reliable cost study upon which an intrastate USF can be established under Section 13-301(d).

On March 23, 2001, the IITA filed the testimony of Robert C. Schoonmaker proposing the use of the HAI 5.0a cost model in order to meet the requirements of Section 13-301(d). (Schoonmaker Dir., IITA Ex. 2.0). Mr. Schoonmaker proposed the use of this HAI model for all IITA members. Indeed, all IITA members benefited from the use of the HAI model when the IITA first proposed its use during Phase I of this proceeding, which resulted in an extension of existing funding for all of the IITA members. (Schoonmaker Dir. (Phase I), IITA Ex. 1.0) Now, however, after realizing that their current level of subsidization may be reduced substantially as a result of proposed adjustments from the Staff and AT&T Communications of Illinois, Inc. (“AT&T”), 15 IITA members have completely abandoned their reliance on the HAI model and strain to advocate for the use of an embedded cost model in order to maintain an amount approximating their existing levels of funding<sup>1</sup> (collectively “the 15 Companies”). In fact, certain of the 15 Companies have gone so far as to state that the HAI is “Pie in the Sky”. (Brief of Leaf River Telephone Company, *et al.* (“Leaf River”), p. 34). Consequently, almost 1/3 of the IITA’s own members now question the use of an adjusted HAI cost study and the reliability of its results. There can be no question that the disintegration of the IITA’s membership’s

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<sup>1</sup> These 15 companies are: Grafton Telephone Company, Gridley Telephone Company, Harrisonville Telephone Company, Home Telephone Company, Metamora Telephone Company, Tonica Telephone Company, Leaf River Telephone Company, Alhambra-Grantfork Telephone Company, The Crossville Telephone Company, Glasford Telephone Company, Montrose Mutual Telephone Company, New Windsor Telephone Company, Oneida Telephone Exchange, Viola Home Telephone Company, and Woodhull Telephone Company.

position on the HAI cost model and its results casts doubt on whether the cost model can be used in order to satisfy Section 13-301(d). At a minimum, without the 15 Companies presenting any reliable cost study, the Commission cannot create an intrastate USF for the 15 Companies under Section 13-301(d) of the Act.

In an effort to support the use of an embedded cost approach to establish costs for the list of supported services, the 15 Companies raise a number of legal and factual arguments. These arguments are wrong as a matter of law, or contrary to the evidentiary record developed in this proceeding. Moreover, these 15 Companies once again seek to include in the record the inappropriate embedded cost testimony that was stricken by the Administrative Law Judge and his decision later affirmed by the Commission. Their arguments on this point are equally unpersuasive now, as they were several weeks ago.

Turning to Staff's Initial Brief, Verizon generally agrees with many of Staff's positions, particularly its positions concerning the appropriate affordable rate and the proper funding methodology to be employed, if the Commission were to determine that the creation of an intrastate USF was required. Verizon, however, believes that Staff did not go far enough in two respects. First, it appears that Staff's proposal for an intrastate USF does not reduce the fund to reflect all appropriate federal funding received by the IITA member companies. Second, Staff proposes a phase-in of the affordable rate and delay of a detailed review of the rate of return for some companies until 2002, which is inconsistent with Section 13-301(d) and results in the improper imposition of a greater funding burden on other ratepayers within the State. These issues are discussed in detail further in this brief.

It is imperative for the Commission to remember that the establishment of any intrastate USF will impact ratepayers around the State. As Staff noted in its Brief, it would be inequitable

to require ratepayers around the State to provide a subsidy in order to subsidize a company that does not require such a subsidy. (Staff Init. Br. (Phase II), p. 4). Consequently, the Commission must consider carefully all issues related to the possible establishment and size of any intrastate USF and ensure that the fund complies with Section 13-301(d).

Finally, AT&T and MCI WorldCom, Inc. (“MCI”) (collectively “the IXCs”) continue to claim that a universal service funding methodology should be retroactively imposed for true-up purposes related the DEM Weighting Fund. The Commission’s conclusion in its First Interim Order in this proceeding, relying on an extensive evidentiary record, demonstrates that the IXCs claim is wrong. The DEM Weighting Fund is an access charge revenue replacement, not a universal service fund, and “that access revenue replacements are not tantamount to universal service subsidies.” (Docket No. 00-0233/00-0235, Consol., First Interim Order, p. 7) Given that contributions to the DEM Weighting Fund were made based upon a carrier’s proportionate share of intrastate toll minutes of use, which relates directly to the purpose of the fund, there is no need to conduct a true-up of the DEM Weighting Fund. Accordingly, the Commission should find that the existing funding methodology for the DEM Weighting Fund should also be deemed the permanent funding methodology.

## **II.** **ARGUMENT**

### **A. Section 13-301(d) Requirements**

#### **1. Introduction**

Prior to the establishment of an intrastate USF under Section 13-301(d), the burden of proof is on the IITA member companies, as the requesting carriers, to show that their proposal

complies with the Act. Among the requirements of Section 13-301(d) is the need to demonstrate:

...that the economic costs of providing services for which universal service support may be made available exceed the affordable rate established by the Commission for such services may be eligible to receive support, less any federal universal service support received for the same or similar costs of providing the supported services;....

220 ILCS 5/ 13-301(d). These requirements relate directly to the positions Verizon identified in its Initial Brief, and also were subject to discussion in the Briefs of the IITA, the 15 Companies, the Frontier Companies, and Moultrie Independent Telephone Company. The arguments of these parties concerning Section 13-301(d) are addressed in turn.

**2. The Requirement To Demonstrate Economic Costs Through A Reliable Cost Study**

**a. Section 13-301(d) Requires The IITA Members To Present A Forward-Looking Cost Study**

Section 13-301(d) requires a carrier to demonstrate “the economic costs of providing services” eligible for support under an intrastate USF. (*Id.*) As explained in the testimony of IITA witness Schoonmaker:

The IITA recognizes that state statutes (Section 13-301(d)) specifically require the use of “economic costs” and have undertaken an effort to develop those costs using tools readily available in the industry.

(Schoonmaker Dir, IITA Ex. 2.0, p. 13). For purposes of meeting the statute’s requirement to use economic costs, then, the IITA proposed the use of the HAI 5.0a cost model. In doing so, Mr. Schoonmaker explicitly recognized that the IITA could not use an embedded cost model approach. (*Id.* at p. 3-4; Schoonmaker, Tr. 618). Staff also concurred that the term “economic costs” requires the use of a forward-looking cost methodology. (Koch, Tr. 721, Hoagg, Tr. 868 (“as used by economists...economic cost is understood to be pretty much equivalent to the phrase forward-looking cost...”).

Despite the testimony of various expert witnesses declaring that the term “economic costs” equates to a forward-looking cost methodology, the 15 Companies claim that the term allows for the use of an embedded cost methodology under the Act. (Initial. Br. Of Grafton Telephone Company, *et al.*(“Grafton”), pp. 43; Leaf River Init. Br., p. 1). There is absolutely no evidentiary support for this interpretation of the Act. Instead, the 15 Companies resort to a contorted legal argument in an effort to have their embedded cost approach adopted. Of course, the 15 Companies have turned to the embedded cost methodology only after it became apparent that existing levels of subsidization would be reduced. (The 15 Companies were part of the IITA when it filed a forward-looking cost methodology on March 23, 2001. *See*, IITA Ex. 2.0). In short, their arguments are unavailing.

An aggregate cost study based on embedded costs does not allow for the identification of either subsidies or support flows between and among the services provided out of shared plant. The identification of these support and subsidy flows must be identified by a forward-looking cost study, as called for by the Act by requiring the use of a study based upon economic costs.

The statute provides that a party must demonstrate its “economic costs” of providing service. As explained by a number of witnesses who are economists or have a background in the development of cost studies, the only reasonable interpretation of the term is the need to demonstrate a company’s forward-looking costs. There is no evidence to the contrary. Because the Commission is an agency charged with the administration and oversight of the Act, including Section 13-301(d), its interpretation of Section 13-301(d) will be accorded great deference. *Illinois Bell Telephone Company v. Illinois Commerce Commission*, 282 Ill.App.3d 672, at 676 (1996). In this instance the evidence, including that of IITA witness Schoonmaker, demonstrates that the term “economic costs” requires the use of a forward-looking cost methodology.

Moreover, an embedded cost approach is inconsistent with the concept of economic costs. (Hoagg Tr. 868). Given these facts, the only reasonable interpretation of Section 13-301(d) requires the use of a forward-looking cost methodology. Consequently, the 15 Companies' efforts at statutory re-construction should be rejected.

**b. Without An Appropriate Cost Study Upon Which To Rely, The 15 Companies Have Not Complied With Section 13-301(d) Of The Act**

The 15 Companies now have chosen to disavow their earlier support for the HAI 5.0a cost model, which has been the foundation for the IITA's request for an intrastate USF under Section 13-301(d). (Leaf River Init. Br., p. 34; Grafton Init. Br., p. 37). Prior to the improper attempt to file embedded cost rebuttal testimony on June 12, 2001 by certain of the 15 Companies, the IITA members supported the use of the HAI 5.0a model and, in fact, benefited from its use in Phase I of this proceeding by virtue of the Commission's extension of the DEM Weighting Fund until September 30, 2001. (IITA Exs. 1.0 & 2.0; First Interim Order at 9). Proposed adjustments to the IITA cost model, particularly those proposed by Staff, has now led to the 15 Companies abandoning the HAI 5.0a cost model. In light of their position, and absent record evidence supporting any other appropriate forward-looking cost model, the 15 Companies have no cost model upon which to meet the requirements of Section 13-301(d) of the Act.

The HAI 5.0a cost model served, in part, for the Commission's extension of the DEM Weighting Fund in Phase I of this proceeding. (Schoonmaker Dir., IITA Ex. 1.0). As the evidence suggested in Phase I, various parties had concerns about the use of the model, including IITA witness Schoonmaker. (Schoonmaker Dir., IITA Ex. 1, pp. 18-19) Despite these concerns, the IITA continued to employ the use of the HAI model again in this Phase of the proceeding. (Schoonmaker Dir., IITA Ex. 2.0). In this phase of the proceeding, which explored the IITA's use of the model in detail, it became apparent that various parties and Staff had concerns about

the inputs in the model and the model's results. (*See*, Staff Init. Br., pp. 34-35; Schoonmaker Dir, IITA Ex. 2.0, pp. 19-21; AT&T Init. Br., pp. 8-17; Ameritech Init. Br., pp. 7-9). Now, only when faced with the prospect of losing substantial subsidies do the 15 Companies take issue with the HAI 5.0a model.

The 15 Companies cannot have it both ways. On one hand, the 15 Companies have enjoyed the benefits of remaining with the IITA and its use of the HAI 5.0a cost model for the first 14 months of this proceeding where, as an example, they have continued to receive DEM Weighting Fund subsidies this year. (*See e.g.*, Whitcher Tr. 223). Now, though, as they face the very real prospect of losing this outside source of funding do they claim the HAI model is no good. In order to maintain their historic level of subsidization the 15 Companies apparently are unconcerned about this patent inconsistency in position. The Commission should not share this attitude.

Any intrastate USF will require other ratepayers around the State to pay for such a fund. It is Verizon's position that an intrastate USF should be established only if all the requirements of Section 13-301(d) are met. The Commission should not, and legally cannot, establish a fund simply to maintain the 15 Companies' historic level of subsidization.

The 15 Companies were fully aware of this proceeding and had the opportunity to present their own cost study testimony pursuant to the schedule established in this proceeding: they chose not to do so. (*See e.g.*, Whitcher, Tr. pp. 215-216, 222-223). Given that the 15 Companies have not presented an alternative forward-looking cost study in evidence, and now assert that the HAI model is flawed (Grafton Init. Br., p. 37), these Companies have presented no reliable cost study to demonstrate their economic costs related to the list of supported services.

Section 13-301(d) requires a company to demonstrate that its economic costs exceed the affordable rate for that service. In light of the above discussion, the 15 Companies have failed to present a cost study that identifies their economic costs in order to meet the requirements of Section 13-301(d). Accordingly, the Commission cannot legally find that these Companies are eligible to receive support from an intrastate USF.

**c. The Record Does Not Contain A Reliable Forward-Looking Cost Study**

To date, Verizon has not taken a position with respect to the IITA's use of the HAI 5.0a for purposes of trying to establish its forward-looking costs of providing basic local exchange service. Indeed, Verizon has remained silent on the choice of model and the various inputs to the model utilized by the IITA. Despite Verizon's silence, the record contains substantial evidence detailing the various concerns that the Staff and parties have, including IITA witness Schoonmaker, about the use of the HAI 5.0a cost model. (*See*, Staff Init. Br., pp. 34-35; Schoonmaker Dir, IITA Ex. 2.0, pp. 19-21; AT&T Init. Br., pp. 8-17; Ameritech Init. Br., pp. 7-9). Now, as described in the preceding arguments, even various IITA members assert that the HAI 5.0a model is flawed (Grafton Init. Br., p. 33) and that the "HAI is Pie in the Sky". (Leaf River Init. Br., p. 34).

Absent a reliable forward-looking cost study, the Commission cannot establish an intrastate USF under Section 13-301(d). The purpose of such a cost study is two-fold: 1) to assist the Commission in determining whether such a fund is necessary; and, if necessary, 2) to ensure that the size of the fund is proper. Consequently, it is imperative for the Commission to assess whether this record contains a reliable cost study. At present, however, Staff, AT&T, Mr. Schoonmaker, and almost 1/3 of the IITA members raise varying degrees of concern about the model or the results of the model. Given these facts, it is Verizon's position that there is a

serious evidentiary question as to whether the model and its results are reliable. Accordingly, without a reliable cost study that meets the requirements of Section 13-301(d), the Commission cannot establish an intrastate USF.

**d. The Requirement To Use A Forward-Looking Cost Methodology Is Not Pre-empted By The Recent Order Of The Federal Communications Commission (“FCC”)**

The 15 Companies assertion that the Commission is pre-empted from using a forward-looking cost methodology in assessing whether to create an intrastate USF is complete nonsense. (Grafton Init. Br., pp. 50-53; Leaf River Init. Br., pp. 15-22). In its recent Order addressing rural carriers and federal universal service issues, the FCC determined not to use one particular forward-looking methodology. (*Fourteenth Report and Order and Twenty-Second Order on Reconsideration, Federal-State Joint Board on Universal Service and Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers* (CC Docket Nos. 96-45 and 00-256, Par. 177, released May 23, 2001)(“FCC Order”). The FCC Order did not, however, conclusively determine that forward-looking cost methodologies are inappropriate. In fact, the FCC Order explicitly reserved the right to consider forward-looking cost methodologies in the future. (*Id.* at Par. 174).

The clear language of the FCC Order notwithstanding, the 15 Companies claim that the Commission is somehow precluded under the preemption doctrine from using a forward-looking cost methodology. The 15 Companies’ argument completely misapprehends the FCC Order, ignores the fact that the other IITA members continue to advocate the use of a forward-looking cost methodology, and ignores the Commission’s obligation to enforce the law in Illinois.

The FCC Order did not determine the issue of the appropriate cost model approach to use in Illinois. The FCC Order addresses a federal universal service fund for rural carriers, not an intrastate USF for Illinois, as contemplated under Section 13-301(d) of the Act. (*Id.*) The FCC

Order contains no language, explicit or implicit, to suggest that a State is precluded from using a forward-looking cost methodology in establishing an intrastate USF. (*Id.*) In fact, despite the urging of rural carriers for the FCC to reject the use of forward-looking cost methodologies in perpetuity, the FCC expressly reserved the right to use such a methodology. (*Id.*) Consequently, the FCC Order does not preempt, in any way, the Commission from using a forward-looking cost methodology. Accordingly, the 15 Companies lengthy discussion of the preemption doctrine is irrelevant to this proceeding.

The 15 Companies arguments on this point also ignore the position of the other IITA member companies. The IITA does not, and cannot, claim that the FCC Order somehow requires the Commission to use an embedded cost methodology. To date, since the release of the FCC Order the IITA has had at least two opportunities to make such a claim: in rebuttal testimony filed June 12, 2001, and in its Initial Brief. To the contrary, the IITA continues to propose the use of a forward-looking cost methodology, albeit reluctantly. (IITA Init. Br., pp. 4-8). The reason is simple: there is no reasonable basis to claim that the FCC Order preempts the Commission's use of a forward-looking cost methodology. Otherwise, as IITA witness Schoonmaker stated, the IITA would rather use an embedded cost methodology. (Schoonmaker Dir., IITA Ex. 2.0, pp. 12-13).

Finally, assuming, *arguendo*, that the Commission was somehow preempted from using a forward-looking cost methodology, the Commission still could not employ the use of an embedded cost methodology under Section 13-301(d). As discussed in preceding arguments, the only reasonable interpretation of Section 13-301(d) requires the use of a forward-looking cost methodology. Given that the Commission only has those powers granted to it by the legislature, (*Board of Education of Community Consolidated School Dist. No. 59 v. Illinois State Board of*

*Education*, 317 Ill.App.3d 790, 794, 740 N.E.2d 428, 432 (1<sup>st</sup> Dist. 2000); *City of Chicago v. Illinois Commerce Commission*, 294 Ill.App.3d 129, 136, 689 N.E.2d 241, 246), the Commission cannot use an embedded cost approach. Instead, the 15 Companies would need to go to the General Assembly and seek to have Section 13-301(d) amended. The Commission, cannot act outside of its statutorily mandated authority. Therefore, even under the 15 Companies argument, the Commission cannot use an embedded cost approach.

The 15 Companies' preemption argument is wholly without merit. The FCC Order did not preclude a State from employing the use of a forward-looking cost methodology for purposes of assessing the need to create an intrastate USF. The 15 Companies claim is further undercut by the fact that other IITA members continue to advocate for the use of a forward-looking cost model. In conclusion, the Commission must reject this unfounded preemption argument.

### **3. The Requirement To Establish An Affordable Rate**

#### **a. Verizon's Proposed Minimum Affordable Rate Is Reasonable**

Verizon has presented testimony and argument to support a minimum affordable rate of \$22.23 per month, excluding taxes and other surcharges. (Verizon Init. Br., pp. 6-7). The reasons for using this figure as the minimum affordable rate are compelling. First, Verizon's affordable rate proposal is based upon a Verizon service territory that is substantially similar to that of the IITA members (i.e., population density). (Beauvais Reb., Verizon Ex. 5.0, pp. 3-4). Verizon demonstrated that its customers are paying this rate today. Meanwhile, none of the IITA members presented evidence that would distinguish the economic demographics of their customers from the similarly situated Verizon customers. Second, no IITA member presented reasonable evidence or argument as to why a similarly situated Verizon customer should pay a higher rate for basic local exchange service and pay a surcharge to help support companies that are charging their customers a lower rate for basic service. (Beauvais Reb., Verizon Ex. 4.0,

p. 8). In sum, Verizon's proposed affordable rate is reasonable and is based upon a rate customers within the State are paying today.

Staff and MCI each have proposed a minimum affordable rate to be utilized in assessing the need for an intrastate USF. (Staff Init. Br., pp. 26-30; MCI Init Br., pp. 8-12). Staff generally concurs with Verizon's proposal. (Staff Init. Br., pp. 28-29). Like Verizon witness Dr. Beauvais, Staff also is concerned with making other similarly situated ratepayers pay a surcharge to support companies whose customers are paying a lower rate for basic service. (Staff Init. Br., p. 29). Consequently, while the amount of the affordable rate proposed by Staff and MCI also may be reasonable, the Commission should adopt Verizon's proposal as the minimum affordable rate for purposes of determining whether an intrastate USF is necessary and, if so, the size of the fund. This is because Verizon's proposal is based upon rates already in effect, which are being charged to similarly situated customers.

The IITA members whose existing rate is below \$22.23 oppose Verizon's proposal. The reason for this opposition is that Verizon's proposal will reduce the amount of funding they will receive from an intrastate USF. These IITA members, however, have presented no compelling evidence to rebut Verizon's affordable rate proposal.

**b. Establishing A Minimum Affordable Rate Below \$22.23 Is Unreasonable**

In an effort to obtain as much outside funding as possible, the IITA members propose that an appropriate affordable rate is the existing rate charged by each of its members (IITA Init Br., pp. 15-19; Leaf River Init. Br., p. 15; Grafton Init. Br., p. 30). To buttress their position these companies offer a number of unpersuasive arguments. For example, the IITA cites to the testimony of Mr. Thomas Hoops in support of their affordable rate position. (Hoops Dir.,

Harrisonville Telephone Company Ex. 4). The Commission, however, should give no weight to Mr. Hoops' testimony.

Mr. Hoops has never testified in a rate proceeding and never was involved in the development of rates. (*See*, Hoops Dir., Harrisonville Ex. 4.0). In fact, Mr. Hoops had no knowledge as to how the Commission sets rates. (Hoops Tr. 234). In sum, his testimony offers the Commission "affordable rate" testimony in a context completely unrelated to the manner in which the Commission sets rates. This testimony should not be relied upon when considering the development of an affordable rate for purposes of an intrastate USF under Section 13-301(d).

The 15 Companies further claim that Section 13-301(d) presumes the current rates to be the reasonable affordable rates. (Leaf River Init. Br., p. 21; Grafton Init. Br., p. 37). In reality, however, the Commission must establish the appropriate affordable rate. 220 ILCS 5/13-301(d). Here, the Commission has been presented with compelling evidence that a minimum affordable rate of \$22.23 is reasonable. This rate balances the interests of those customers subject to the possibility of paying a surcharge, with the interests of customer who will be receiving the benefits of a potential intrastate USF. (Beauvais Reb., Verizon Ex. 4.0, p. 8).

In conclusion, the Commission should not allow for an affordable rate to be set at less than \$22.23 per month because it is a simple approach. Verizon's proposal reasonably accounts for the operating characteristics of IITA members and reflects a rate that is in existence today. The IITA members offer no reasonable alternative. Instead, they argue that rates will increase and that such a result is unfair. Verizon submits that it would be more unfair for its similarly situated customers to pay more as an affordable rate, plus a surcharge, to support the customers of certain IITA member companies. (*Id.*)

**c. The 15 Companies Have Presented No Evidence Linking An Affordable Rate To Illinois' Current Penetration Rate**

The 15 Companies also try to inject Illinois' penetration rate for wireline telecommunications services as a basis to allow certain companies to maintain an affordable rate below \$22.23 per month. (Leaf River Init. Br., pp. 19-20; Grafton Init. Br., pp. 30-33). While the issue of a reasonable penetration rate may be interesting, it is irrelevant to this proceeding. The 15 Companies completely fail to present empirical support to link Illinois' penetration rates to an affordable rate. Rather, the 15 Companies offer conjecture through their briefs, rather than compelling testimony, to compare rates to penetration levels. Indeed, the only IITA member witness to discuss in detail Illinois penetration levels was Mr. Hoops, and he admitted that he had conducted no elasticity studies to measure the impact of rates on penetration levels in the State. (Hoops Tr. 246).

What the evidence does demonstrate is that more than 9 out of 10 citizens in the State have access to wireline telecommunications services. The 15 Companies have presented no studies, reports, or expert analysis that links Illinois' penetration rates to an appropriate affordable rate. The reason for this absence of evidence is simple: no such evidence exists. The existing penetration rate does not consider customers who use wireless telecommunications exclusively (Hoops Tr. 245), or other forms of telecommunications. Nor does the existing penetration rate account for customer decisions other than rates. Consequently, there is no basis to tie Illinois' penetration rates to the affordable rate to be set in this proceeding.

**d. A Phase-In Of The Appropriate Affordable Rate Is Contrary To Section 13-301(d)**

Verizon agrees with Staff that a minimum affordable rate should be established, and that such a rate be greater than the current rate for a number of IITA member companies. (Staff Init. Br., p. 28). Staff proposes that in order to mitigate the possibility of rate shock, the

establishment of an appropriate affordable rate should be phased-in over a period of years. (Staff Init. Br., p. 30). Staff's proposal, however, results in an intrastate USF being larger than it should be, requiring other ratepayers to pay more to support fund recipients. This result is contrary to Section 13-301(d).<sup>2</sup>

Section 13-301(d) does not provide for a phased-in affordable rate. Rather, Section 13-301(d) directs the Commission to establish an affordable rate to determine the need for and size of any fund. Both Staff and Verizon propose the establishment of a minimum affordable rate to be applied to the IITA member companies. Given that the Act makes no provision for the establishment of an interim affordable rate, the Commission cannot establish such a phased-in approach. (*Sorce v. Naperville Jeep Eagle, Inc.*, 309 Ill.App.3d 313, 322, 722 N.E.2d 227, 234 (2<sup>nd</sup> Dist. 1999)(“it is improper...to depart from the plain language by reading into the statute exceptions, limitations, or conditions which are not clearly expressed.”). In fact, the Commission previously has concurred with this interpretation of Section 13-301(d) when, earlier in this proceeding, it found that it could not establish an interim intrastate USF. (First Interim Order, p. 7). Accordingly, the Commission cannot phase-in the appropriate affordable rate.

The phase-in of an affordable rate does have superficial appeal. In this instance, however, the IITA members have been aware for some time of the impending demise of the DEM Weighting Fund and the possible need to rebalance rates in order to better recover costs. This fact is explicitly recognized in the Stipulations attached to Orders that established the DEM Weighting Fund. (IITA Petition to Continue DEM Weighting Fund, ICC Docket No. 98-0679, Ex. A, p. 4 of 14, ¶ 10). As such, the IITA members already have had the opportunity to phase-in appropriate affordable rates but have declined to do so. Other ratepayers around the State

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<sup>2</sup> In theory, Verizon may not be opposed to a phase-in. (Beauvais Reply, Verizon Ex. 5.0, p. 5). However, Section 13-301(d) does not permit an interim USF.

should not be required to pay a surcharge simply because these carriers elected to defer the rebalancing of their rates. To this end, Verizon urges the Commission to adopt its proposed affordable rate and implement it immediately.

**4. The Commission Cannot Award Intrastate USF Support To A Carrier That Has Not Met The Section 13-301(d) Requirements**

Similar to its proposal to phase-in the proper affordable rate, Staff also proposes to allow certain carriers to recover intrastate USF support immediately, even though such carriers may not have demonstrated a need under an ROR analysis. (Staff Init. Br., p. 4). In particular, Staff proposes a “grace period” until approximately September 2002 to demonstrate that a carrier’s ROR analysis is valid. (*Id.*) This position is inconsistent with the Act.

Section 13-301(d) directs the Commission to establish an intrastate USF, if such a fund is necessary. The Section does not authorize the Commission to establish a fund, with a proper size to be determined at a later date. Here, the IITA members have had ample opportunity to present a case to demonstrate need. If a company has not presented a proper case, Section 13-301(d) does not allow the carrier a “grace period” to receive funding it might not otherwise be entitled to receive. Moreover, the Act does not authorize the Commission to provide for such a result. 220 ILCS 5/13-301(d). Accordingly, the Commission should not accept Staff’s proposal to establish a grace period that provides a carrier with support now, and the obligation to demonstrate need at a later date. Such a proposal violates the Act.

**5. The Commission Must Reduce Any Intrastate USF To Account For Federal Funding**

In its Initial Brief and in testimony Verizon argued that the Act specifically requires the Commission to reduce the size of any Section 13-301(d) fund by the amount of relevant federal funding received by the IITA companies. (Verizon Init. Br., pp. 8-9). In compliance with the Act, Verizon proposed that the Commission must reduce the size of any intrastate USF to reflect

the recent FCC Order. No party has objected to this proposal. Accordingly, if a fund is found to be necessary, the fund must be reduced to reflect this additional funding earmarked for the IITA members.

Staff's Initial Brief does not address the additional federal funding the IITA member companies are likely to receive by virtue of the recent FCC Order. Verizon believes that this may be an oversight given Staff's position to reflect all appropriate federal funding. (Hoagg Tr. 870-873). Accordingly, the Commission must reduce the size of any potential intrastate USF by the additional amount the IITA carriers will receive pursuant to the FCC Order.

**6. Appropriate List Of Supported Services Should Not Include DSL Service**

In its testimony and Initial Brief, Verizon identified the list of services that would be eligible for any intrastate USF support. (Verizon Init. Br., pp. 9-10). The list of services parallels the list of services eligible for federal funding. In its Initial Brief, the IITA also proposed a list substantially similar to Verizon's proposal. (IITA Init Br., p. 15). Additionally, Staff, Ameritech and the IXCs each recommended the use of federal list of supported services.

Certain of the 15 Companies now argue that DSL service should be added as a supported service in light of the recent enactment of HB 2900. (Leaf River Init. Br., p. 51). This proposal is nothing more than an unabashed grab for money, with other ratepayers being obligated to pay a surcharge to subsidize this request.

Section 13-517 of the Act was recently enacted and requires incumbent local exchange carriers ("ILEC") to deploy advanced telecommunications services. 220 ILCS 5/13-517. However, an ILEC is not obligated to deploy such services until January 1, 2005. (*Id.*) That Section further provides that an ILEC may seek to obtain a waiver from the Commission. (*Id.*) Consequently, an ILEC can obtain a waiver of the Section before it is obligated to deploy advanced telecommunications services.

Despite this clear language and opportunity for waiver, certain of the 15 Companies want intrastate USF support now, for a service that they may not have yet deployed. Moreover, these carriers have presented no independent evidence why DSL service should be supported, or the costs for such service. The Commission, therefore, should reject any attempt to include DSL as a supported service.

**7. The 15 Companies Are Not Entitled To Intrastate USF Support Simply By Claiming That They Are Not Earning A Reasonable Rate Of Return**

Certain of the 15 Companies are laboring under the illegal assumption that they are entitled to intrastate USF simply premised upon a rate of return (“ROR”) analysis. (Grafton Init. Br., p. 1). Given their abandonment of the HAI cost model, it appears that certain IITA member companies are arguing that they are entitled to support solely if they can show they are earning below a reasonable rate of return. However, as has been thoroughly discussed herein, Section 13-301(d) requires much more than an ROR analysis. Accordingly, the Commission should reject any arguments for funding based solely upon an ROR analysis.

**B. Verizon Concurs With Staff That In The Event The Commission Establishes An Intrastate USF, Contributions To The Fund Should Be Based On Intrastate Retail Revenues**

In the event the Commission determines that the IITA members met their burden of proof under Section 13-301(d) to establish an intrastate USF, funding obligations should be assessed based upon intrastate retail revenues. This is the approach Staff proposes and to which Verizon concurs. (Staff Init. Br., pp. 16-22; Beauvais Dir., Verizon Ex. 4.0, pp. 16-18). As reflected in Staff’s Initial Brief, the proposals made by the IXC’s are inconsistent with the Act and do not reflect the purpose of an intrastate USF.

In addition to the appropriate manner to assess funding obligations, Verizon disagrees with Ameritech-Illinois and MCI with respect to the carriers required to provide funding.

Section 13-301(d) is very explicit about which carriers must contribute to the fund. Wireless carriers are not one of the types of carriers obligated to contribute to such a fund. 220 ILCS 5/13-301(d). Accordingly, Ameritech's and MCI's proposal to require wireless carriers to contribute to the fund violates the Act and should be rejected.

**C. There Is No Need To Conduct A True-Up Of The DEM Weighting Fund**

After a thorough review of the record in Phase I of this proceeding, the Commission properly found that the DEM Weighting Fund was established to replace otherwise lost access charge revenues. (First Interim Order, p. 7). The Commission further stated "that access revenue replacements are not tantamount to universal service subsidies." (Docket No. 00-0233/00-0235, Consol., First Interim Order, p. 7). Consequently, when funding obligations for the DEM Weighting Fund were assessed based upon intrastate toll minutes of use, that assessment reflected the purpose of the fund. The Commission should find that such a funding methodology is the appropriate permanent funding methodology for the DEM Weighting Fund.

Meanwhile, the IXCs continue to maintain that a true-up of the DEM Weighting Fund is required and universal service principals should apply. (AT&T Init. Br., p. 28; MCI Init. Br., p. 14). These arguments are not persuasive. The DEM Weighting Fund is not a universal service fund and the corresponding funding obligations should not be based upon universal service principles. In this regard, Verizon incorporates by reference the arguments on this issue found in its Initial and Reply Briefs in Phase I. These arguments were accepted by the Commission then, and should be accepted again here. The permanent funding methodology for the DEM Weighting Fund should be based upon intrastate toll minutes of use, which is an access charge principle.

**D. The Administrative Law Judge Properly Struck The Improper Embedded Cost Testimony, And The Commission Correctly Affirmed This Decision**

The Initial Briefs of the 15 Companies again attempt to claim that the Administrative Law Judge's<sup>3</sup> decision to strike the embedded cost rebuttal testimony was improper. (Leaf River Init. Br., pp. 22-34; Grafton Init. Br., p. 51). Their arguments are completely without merit.

The Administrative Law Judge properly struck the improper embedded cost rebuttal testimony. First, the testimony was not appropriate rebuttal testimony. (Tr. 102). Second, the parties seeking to file the testimony had the opportunity to do so according to the procedural schedule established by the Administrative Law Judge. (Tr. 103). Third, these parties were aware of this proceeding from its inception and chose to stand with the HAI 5.0a cost model until they realized that adjustments to the model would result in substantial reductions in funding. The Commission was correct in affirming the Administrative Law Judge's decision.

The companies seeking reversal of the Administrative Law Judge's ruling offer no basis for reversal. These arguments were previously heard, considered, and rejected. To that end, Verizon incorporates by reference the Joint Movants' Response to the Petition for Interlocutory Review, which responds to the arguments made again in the Initial Briefs of the 15 Companies. The Commission, therefore, should again affirm the Administrative Law Judge's ruling on this issue.

**III.**  
**CONCLUSION**

Verizon has presented testimony and argument to support a substantial reduction in the size of the intrastate USF that the IITA members are seeking pursuant to Section 13-301(d) of the Act. In fact, Verizon's proposed adjustments may well eliminate the need for any intrastate

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<sup>3</sup> The decision was made at a time before the Hearing Examiner's designation was changed to Administrative Law Judge

USF. The three principle adjustments Verizon proposes, establishing the appropriate affordable rate, accounting for all appropriate federal funding, and eliminating any support for switched access costs, will ensure that the Commission complies with the Act.

In addition to these three adjustments there is a more fundamental issue which now confronts the Commission: whether the Commission has a reliable cost study upon which to meet the requirements of Section 13-301(d) of the Act. This issue has been highlighted by the positions taken by the 15 Companies in their Initial Briefs. It is Verizon's position that the record contains sufficient questions concerning the model and its results to render it unreliable for purposes of meeting Section 13-301(d).

Verizon also has presented evidence and argument that demonstrates that the permanent funding methodology for the DEM Weighting Fund should be based upon intrastate toll minutes of use. This is the method that was used to assess funding obligations during the life of the fund, and is the method that reflects the purpose of the fund; the replacement of lost access charge revenues. The Commission, therefore, should conclude that no true-up of the DEM Weighting Fund is necessary.

Finally, pursuant to its First Interim Order in this proceeding the Commission must order the cessation of the DEM Weighting Fund and the Illinois High Cost Fund.

Dated: July 18, 2001

Respectfully Submitted,

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**CERTIFICATE OF SERVICE**

I, John E. Rooney, hereby certify that I served Phase II Reply Brief of Verizon North Inc. and Verizon South Inc. upon the service list in consolidated Docket Nos. 00-0233/00-0335 by email and U.S. regular mail on July 18, 2001.

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John E. Rooney