The essence of the GCI/City's error, in Staff's view, is that they simply refuse to grapple with this principle.

Staff notes that the Commission should not assume, however, that it is in complete, or even substantial, agreement with the Company. While Ameritech might suggest that the incentive mechanisms which underlie the fundamental superiority of alternative regulation vis-à-vis rate of return ("ROR") derive from, and depend on, an absolute absence of a ceiling on earnings under alternative regulation, Staff clearly disagrees. This type of "sky is the limit" view on earnings, Staff maintains, is simply unsupportable.

Staff believes it has well-demonstrated that the proper standard to be applied under alternative regulation is not the imposition of rate levels associated with rate of return regulation, but rather an evaluation of whether the Plan produces affordable, just, and reasonable rates – a price performance analysis. To the extent that AI would contend that an earnings analysis has no place in an alternative regulation environment, i.e., that any level of earnings produced by a plan are acceptable, and that any rates produced by a plan are, by definition, just and reasonable, it is wrong.

According to Staff, the statutory fair, just and reasonable rate standard places upper and lower limits on acceptable rate levels under an alternative regulation plan, and earnings levels associated with those rates. For a variety of reasons, the "zone of reasonableness" of rates is broader and more elastic under alternative regulation than under rate of return regulation. This is an inherent part of the alternative regulation "compact" and reflects such realities as increased competitive entry, generally increased risk for the regulated firm, and the potential for increased benefits for all stakeholders, notably consumers. Nevertheless, Staff asserts, the zone of just and reasonable rates under alternative regulation is far from being unlimited.

It is bounded on the lower end, Staff explains, by considerations of financial integrity of the regulated company, and its attendant ability to deliver appropriate levels of service availability and quality. To illustrate this concept, Staff assumes that Ameritech's financial condition had deteriorated during the Plan to a degree that threatened its ability to provide adequate service to consumers. There can be no doubt, Staff contends, that in this situation, the Commission's statutory responsibilities would require it to intercede by adjusting prices and/or key plan parameters to forestall or ameliorate significant adverse consequences.

The zone of reasonableness, Staff asserts, is bounded on the upper end by earnings levels that clearly exceed those that could be explained by enhanced cost effectiveness, and technical and market progressiveness of the regulated company. Beyond this bound are earnings levels associated, at least in part, with such things as significant misspecification of Plan parameters, misapplication of the Plan, or behavior that successfully defeats the overall effectiveness of an alternative regulation plan.

These bounds and the fair, just and reasonable standard under alternative regulation are not readily susceptible to prior or precise quantification Staff contends. To achieve the desired end, requires informed regulatory judgement and analyses. This does not, however, diminish the importance of these bounds, or call into question their existence. Since prices alone do not provide directly the required information, earnings appropriately and necessarily are used as a proxy indicator. This is the major role of earnings analyses in any review of an alternative regulation plan. Having applied its judgment, Staff concludes in this proceeding that Ameritech's rates and related earnings are not outside the zone of reasonableness, either on the low or high side, and notes the absence of persuasive evidence to the contrary. It must be recognized however, Staff claims, that prices and associated earnings outside this zone might have occurred, and there was no assurance in 1994 against such a result. Similarly, it is conceivable that this might still occur in the future under an extension of the alternative regulation plan, despite the expectations or intentions of the Commission, Ameritech or other parties.

For this reason, Staff recommends that an extension of the plan should provide for a review comparable to this proceeding, to be concluded no later than five years from the date of extension of the Plan. An analysis of Ameritech's earnings, as well as its price performance, Staff maintains, should also be an integral component of that review.

GCI/City's Position

CUB claims that the rates currently being charged under the Plan are *not* just and reasonable based on the analysis that GCI/City witness Smith performed of the Company's pro forma income statement and the hundreds of data requests he reviewed in order to assess the earnings of AI under the price cap plan and to propose adjustments. His work, CUB contends, showed an AI intrastate return on equity of a staggering 43.08% -- nearly four times the authorized return on equity established by the Commission in the Alt Reg Order. On the basis of Mr. Smith's calculations, CUB claims that AI is currently overearning by approximately $956 million for AI's intrastate operations.

According to CUB, the Company's own assessment of its 1999 intrastate operating results(which include AI proposed adjustments to intrastate revenues and expenses), also reflects an astounding 24.53% return on common equity or more than double the cost of common equity approved by the Commission in 1994. These results, GCI witness Smith noted, indicate that the present plan has permitted the Company to dramatically overearn, such that rates must be reduced significantly before any new regulatory plan is established.

While AI asserts that rates are just and reasonable because annual overall revenue reductions have been passed through each year since the inception of the price cap plan and the revenue reductions passed through to consumers under the plan exceed what might have occurred under rate of return regulation, CUB finds the testimony on these points unpersuasive.

According to CUB, only a small portion of the cited revenue reductions were applied to residential usage rates. CUB further claims that some residential customers experienced rate *increases* under AI's price cap plan, depending on the calling plan selected. In addition, the Company's reported level of earnings shows that AI is earning more than double the authorized level of intrastate earnings that was adopted by the Commission back in 1994, thus confirming CUB's view that the rates AI charged to its noncompetitive customers declined far less than the Company's actual costs. Finally, AI witness Gebhardt admitted that his tally of a purported $943 million in cumulative rate reductions to customers does *not* include the increases in rates that have accompanied AI's reclassification of "noncompetitive services." (Tr. at 398-399.)

According to the AG, the fact that some prices decreased as a result of the Plan, does not show anything other than that the mechanics of the plan were followed and operated as intended to decrease rates. (AG Initial Brief at 24)

AI witness Gebhardt's comparison of what would have happened to rates under rate of return regulation is flawed, CUB argues, because it assumes the Commission would not have instituted any rate case over the life of the plan. According to CUB, Staff witness Mr. Hoagg indicated that with the rapid growth in demand for telecommunications services provided by AI and the earnings performance of the Company over the life of the plan, it is likely that the Commission would have instituted one or more revenue investigations which may have resulted in aggregate revenue and rate reductions.

While AI argues that the Commission's examination of the justness and reasonableness of its rates should be based on an "affordability" analysis that compares telephone rates with the changes in the consumer price index ("CPI"), wage levels and the rates of other local exchange carriers, on the theory that customers are more interested in the price they pay relative to the value they attach to the service, CUB disagrees.

CUB notes that Mr. Gebhardt chose a comparison of rates of other LECs, and not competitive carriers, for purposes of defending the Company's rate levels. Such is the case, CUB claims, because there is insufficient competition in the local market to provide any other comparison. Examining other LECs' rates is a poor criterion for measuring the justness and reasonableness of AI's rates according to CUB. As noted by GCI witness TerKeurst, AI is one of the lowest cost incumbent LECs in the nation and AI's earnings were are also some of the highest among incumbent LECs. Given its lower costs and higher earnings levels, it is reasonable to expect that AI's rate would be lower than those of other incumbent LECs. Because AI is still the monopoly provider of residential local telephone service, and a comparison of prices of competitors is impossible, CUB believe that the criterion of "affordability" requires an examination of the Company's costs and earnings.

CUB also notes Dr. Selwyn testimony that, if a "competitive outcome" analysis cannot be conducted due to a lack of competitors, then the other principal means by which the justness and reasonableness of AI's rates can be judged is on the basis of the Company's earnings. For example, if AI consistently earns a return on its investment that is well in excess of the rate of return that the Commission would customarily authorize under rate-of-return regulation *and* is higher than would be expected to arise under competitive market conditions, then according to Dr. Selwyn, it is reasonable to conclude that AI's rates are excessive and thus violate the "fair, just and reasonable" requirement. CUB further notes GCI witness TerKeurst observations that, while it may not be possible to determine with precision what rates would have been under rate-of-return regulation, i.e., when rate cases would have been held or with what result, it is clear that Ameritech Illinois would not have been allowed to reap its current earnings levels.

According to CUB, there is no provision in the Alt Reg Order or in Section 13-506.1 of the Act to suggest that the regulatory compact inherent in the approval of alternative regulation includes an open-ended right to unlimited, excessive earnings. If anything, CUB claims, the Alt Reg Order includes numerous provisions that reflect the Commission's desire to monitor the Plan and the Company's earnings in order to assess the Plan's performance. For example, the Commission noted that its decision to exclude earnings sharing from the Plan is not to be construed as a rejection of all earnings sharing mechanisms of the future. The Commission further stated that it would in future review proceedings, entertain evidence and argument of policy considerations for the provision of some forms of earnings sharing in a revised plan. (See Alt Reg. Order at 51).

According to CUB, the statutory requirement that rates be fair, just and reasonable is not limited to noncompetitive services. And, as intervenor witnesses TerKeurst and Selwyn point out, a regulatory plan that produces reclassification of services to competitive with corresponding price *increases* does not further the goal of fostering competition or providing just and reasonable rates.

Further, CUB claims, all of AI's local and intraLATA services are furnished using a common set of network infrastructure and other corporate resources. As noted by Dr. Selwyn, the FCC has concluded that it was not possible to develop jurisdiction-specific estimates of total factor productivity because no economically meaningful separation of state and interstate inputs could be made. This same reasoning, CUB contends, applies to services labeled as competitive and noncompetitive here. And, because the Commission no longer requires detailed cost studies to support "competitive" services, CUB claims that it has no adequate means of determining whether AI is over allocating costs to noncompetitive services and thereby depressing the noncompetitive rate of return, while under allocating costs to competitive services.

CUB notes that when the Commission first approved price cap regulation for AI in 1994, only 7% of the Company's revenues were derived from competitive services yet today, AI reports that about 58% of the Company's intrastate revenues come from competitive services. This massive reclassification effort, CUB maintains, has been accompanied by rate increases for some of these services. As noted by Dr. Selwyn, "(t)he very fact that such rate increases were possible as an economic matter for services that were already priced in excess of their costs and that ostensibly faced actual competition undermines fundamentally the Company's contention that any such competition is present in the first place."

Accordingly, CUB maintains that the Commission should reject AI's proposal to ignore the earnings produced by its competitive services when examining the Company's returns. The AI Plan has not achieved, the all-important requirement that rates be just and reasonable. The preponderance of the record evidence, CUB claims, clearly demonstrates that rates are too high given the Company's reported earnings level.

The City maintains that Ameritech Illinois' current rates are unjust and unreasonable, in part, because the 4.3% X factor that the Commission adopted in the 1994 Order was set too low. As a result, the City claims, the Plan rates produced earnings well in excess of the rate-of-return that the Commission would authorize or which would be expected to arise in an effectively competitive market. According to the City, this ineffective price/earnings constraint, coupled with Ameritech Illinois' dubious reclassification of services (followed by price increases), allowed Ameritech Illinois to achieve a net return on investment in 1999 of 28.49% for intrastate operations and 43.08% return on equity.

Nothing in Section 13-506.1, the City claims, limits this Commission's review to Ameritech Illinois' noncompetitive rates. Rather, Section 13-506.1(b)(4) specifically requires as part of this review proceeding that the Commission consider Section 13-103(a) which mandates that "telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates..." 220 ILCS 5/13-103(a). According to the City, Ameritech has reclassified over half of its services as competitive under the Plan and given the ease with which reclassification has taken place and the absence of effective competition for reclassified services, AI has been able to raise the rates of many of these new "competitive" services immediately after reclassification.

If effective competition existed in the local telecommunications market today, as was anticipated in 1994, the City argues, the Commission could compare Ameritech Illinois' rates to those of its competitors to determine whether Ameritech Illinois' rates were just and reasonable. The City notes, however, that AI remains the dominant carrier in the local market and any competitors that exist generally price their services in relation to the prices charged by Ameritech Illinois. Thus, the City argues comparing Ameritech Illinois' rates to those of its competitors serves no useful purpose and cannot be a basis for finding Ameritech's rates to be just and reasonable. Instead, the City maintains, the Commission must determine whether Ameritech Illinois' service prices are just and reasonable based on its realized earnings.

According to the City, the record suggests four possible explanations for the level of earnings produced under the Plan. The earnings increase may have been achieved (1) at the expense of service quality, (2) by aggressive and premature reclassifications of services from noncompetitive to "competitive" followed by price increases; (3) because the current Plan, flowed in either or both (a) an insufficient productivity offset factor, (b) an unduly limited scope (i.e., the price adjustment mechanism was confined solely to services classified as "noncompetitive"); or (4) the actual improvement in productivity was greater than the 4.3% "X" factor imposed by the Commission in the 1994 Order.

There is evidence, City claims, that the Company failed to meet the Commission's set of service quality standards in five of the six years during which the current Plan has been in operation. The City notes, however, that in response to aggressive regulatory intervention (outside the Plan) Ameritech Illinois appears to be on pace to fix its service failures very soon.

The City further contends that, the criteria for service reclassification has not been applied in a way that assures the presence (not simply the hypothetical prospect) of alternative services that can constrain the Company's prices for its reclassified services. The City maintains that the Company has increased prices for some of the reclassified services shortly after such reclassification. Even as to reclassified services for which prices were reduced, the City claims that prices still exceeded the formulaic price that would apply absent reclassification. Finally, City argues that on the basis of data apart from Ameritech Illinois' price behavior, GCI and City witness Selwyn calculated that the 4.3% "X" factor was too low.

The GCI/City contend that Staff witness Hoagg confirmed the propriety of reviewing AI's non-competitive rate and earnings to determine if they were just and reasonable. (Tr. 1223). Staff witness Genio Staranzcak, noted that if the Company believed that its earnings were insufficient, it would certainly seek rate increases. Such testimony, the GCI/City claim, shows that it is not realistic to ignore earnings when evaluating the alternative regulation. Either the earnings are reasonable, and the resulting rates are reasonable, or they are not and adjustments are necessary.

GCI/City disagree with AI's assertion that the productivity offset "flowed through to consumers <u>all</u> of the productivity gains achieved by the Company during the 1995-99 period. They maintain that If the productivity offset had flowed all savings to consumers, one of two things would have happened: (1) AI's rates would have decreased consistent with the 11.06% X factor which Dr. Selwyn determined was the offset necessary to have maintained the Commission's 1994 rate of return, or (2) AI's 1999 test year data would not have shown earnings $276.1 of million (AI calculation), of

$824.6 million (Staff calculation), or of $956 million (GCI calculation) greater than their current, reasonable cost of capital.

GCI/City believe that the most obvious and direct method to assess the accuracy of the price cap mechanism is to review AI's rates and earnings using rate of return principles. Using a rate of return analysis to determine what rate and revenue level is reasonable, and the rate cap mechanism to produce the rates being assessed, compares two separate and independent methods. According to the GCI/City, if rate of return regulation would produce rates between $276.1 million and $956 million lower than price cap rates, it is clear that the rates produced by alternative regulation are unnecessarily high and are not just and reasonable.

While AI and Staff would limit the Commission review to whether AI's non-competitive rates are just and reasonable, the GCI/City continue to disagree.

Commission Analysis and Conclusion

Fair, just and reasonable rates is the standard set by law and the goal of all regulatory schemes. The determination as to whether rates meet this objective, however, cannot be made by a comparison and contrast of the earnings to be derived from one regulatory scheme against the earnings produced under a wholly different regulatory scheme. Staff recognizes this fundamental mismatch by noting that alternative regulation plans regulate the price of services rather than a company's earnings.

Staff reminds us that the Plan's going-in rates were determined to be fair, just and reasonable. The Commission agrees with Staff's observation that rates have declined during the term despite modest levels of inflation. In the end, Staff, provides us with a reasonable assessment of rates and earnings in this matter than is wholly compatible with the precepts of alternative regulation. Indeed, Staff's zone of reasonableness test is viable because it cuts both ways. The symmetrical treatment of both robust earnings and under-earnings works in fairness to both the Company and the ratepayer.

Staff also contends, and we agree, that the analysis of fair, just and reasonable rate under the Plan applies only to rates for non-competitive services. We read the statute just this way.

The CUB/AG complaint and the GCI/City position on this review CUB complaint is the same: rates are not reasonable because earnings are higher than initially authorized. That is a premise we cannot accept. The evidence shows that the justness and reasonableness of rates is not inherently a function of the earnings of a company. That is a proposition which underlies ROR but it is inappropriate for alternative regulation. At its most basic, ROR regulation consists of a Commission determination as to what is a reasonable rate of return on the company's equity. The Commission then sets rates at levels designed to produce the target rate of return. Under alternative regulation, the price-cap index assumes the place of general rate proceedings with rates a function of the formula. Earnings are not the primary focus.

In this review of AI's performance under the Plan, the evidence shows that it earned more than the rate of return analysis in 1994 established. When adopting the Plan for AI, however, the Commission recognized the possibility of just such an outcome. Those earnings are the result of a number of variables, both under and outside the control of the Company and, in Staff's assessment of all the underlying circumstances, not outside the zone of reasonableness

The position taken by GCI/City that fair, just and reasonable rates must equate to what would result from a traditional rate case fails in its simplicity as well as in the complexity by which these parties press their claim. Simply put, the comparison which the GCI/City would have be done is neither realistic nor telling for present purposes. The underlying characteristics, incentives and the very nature of the Plan is such that it will not allow any reasoned comparison with the outcome of a ROR analysis.

We accept Staff's analysis and its judgment the Company's earnings are not outside reasonable limits and that rates have remained just and reasonable. This analysis appears wholly consistent with the concepts which underlie alternative regulation. We note that the Company's affordability analysis has some merit and adds to our determination that earnings should not, and will not be our primary focus. To the extent, however, that AI would maintain that earnings are wholly irrelevant under alternative regulation, it is way off the mark.

We would note that service reclassifications, if improper, might have affected rates. But that is a separate matter which is presently being considered in another docket. The outcome of that proceeding, however, may well have implications for the Plan, if it is continued, as well as on rates.

In the final analysis, it is the reasoned judgment of the Commission that noncompetitive rates under the Plan have been, fair, just and reasonable. We have not been shown otherwise. Thus, the statutory requirement we consider here, has been met.

2. Has the Plan Reduced Regulatory Delay and Costs Over Time?

Authority: Section 13-506.1 (a) and Alt Reg Order.

In its 1994 Order, the Commission recognized that traditional rate of return regulation imposed significant costs on all parties involved, with exhaustive 11-month proceedings. The Commission found that price regulation, in contrast, would permit streamlined proceedings and would eliminate regulatory review of the "prudence of incurred costs, equipment replacement and cost of capital". (Alt Reg Order at 180-81).

AI's Position

AI takes the position that the Plan clearly met the requirements of the law and the Commission's expectations. According to the Company, the annual filing process has worked well. It has been very streamlined and rate changes go into effect in three months, and not the customary 11 months.

It makes no sense, AI contends, to count against the Plan the 22 months which it took the Commission to adopt it in the first place given that this was a major and unexplored regulatory change warranting serious review. In AI's view, none of the usual active participants in telecommunications dockets (the Company, Staff or the Intervenors) could possibly have devoted more resources to the price cap filings than they would have to one or more general rate cases during this period.

While CUB complains that the cumulative amount of time required by the annual filings exceeds that of a general rate case, such a contention is, according to AI, patently untrue. CUB further claims that the SBC/Ameritech merger and competitive, classification proceedings would not have occurred under rate of return regulation. According to AI, however, SBC made clear in the merger proceeding that the driving force behind the merger was the need to achieve the scale and scope of a global telecommunications company and thus, only financially punitive regulatory climates in all five Ameritech states (not just continued rate of return regulation in Illinois) would likely have changed SBC's decision. AI further contends that competitive classifications actions have nothing to do with the Plan. It states that these reclassifications could and would have been made regardless of what form of regulation applied.

Staff's Position

According to Staff, here is little doubt but that the Plan has resulted in reduced regulatory delay and costs. This is especially so, Staff maintains, given that rate reductions thereunder have been automatic. (Staff Initial Brief at 32)

CUB's Position

CUB contends that, as GCI witness Dr. Selwyn observed, the Plan has not met the objective of Section 13-506.1(a). To begin, CUB notes that the Alt Reg. proceeding took 22 months to complete. In addition, CUB notes that a 3-month proceeding occurs each year whereby noncompetitive rates are set. To this, CUB would add both the time expended on the SBC/Ameritech merger proceeding and the proceeding to challenge premature classification of services from noncompetitive to competitive. These proceedings, CUB argues, only occurred because AI was under price cap regulation and may well have been avoided had the Company remained under rate of return regulation. When considered cumulatively, CUB argues, these proceedings significantly surpass the amount of time that would be spent on three, 11-month rate cases and show that the AI price cap plan has *not* reduced regulatory delay and costs over time.

Commission Analysis and Conclusion

CUB's position on this item is simply not credible. The standard is the reduction of delay and costs "over time" and, as such, does not count the 22 months spent at the outset to establish a plan. We are not persuaded that either the merger or reclassification proceedings are viable considerations. Moreover, the measure includes not only time but the breath and depth of the work involved. The annual filings here produce an outcome for each year of the Plan without the intensity and effort required in rate cases. It is thus only reasonable to conclude that the Plan has satisfied this requirement.

3. Has the Plan Encouraged Innovation in Telecommunications Services?

Authority: Section 13-506.1(a)(1) and Alt Reg. Order.

In 1994, the Commission expected that the prospects of higher earnings would incent the Company to aggressively develop and offer new services; that the removal of prudency reviews would encourage the Company to be more innovative and take more risks; and that the ability to change prices without regulatory involvement would allow the Company to experiment more in the marketplace. (Alt Reg Order at 181.)

AI's Position

Ameritech Illinois contends that it has been more innovative with new services being an important factor in generating revenue growth. AI provides, as an example, its offering of "Privacy Manager" which allows customers to pre-screen their calls and eliminate telemarketing or other unwanted intrusions. Ameritech points out that it was the first RBOC in the nation to offer this service which is now widely imitated. The Company also claims to have experimented in the marketplace with a large number of promotional offerings and the introduction of optional calling plans. Today, AI contends, a substantial portion of its residential customers take service under one of these plans.

In response to Dr. Selwyn's apparent belief that the Company's usage rate structure should be less distance-sensitive, AI points out that this is a rate design judgment call, not a matter of "innovation". So too, AI notes, Dr. Selwyn's claim that Ameritech Illinois's roll-out of DSL has been too slow ignores the fact that this service is offered by Ameritech Illinois' affiliate AADS. The Company argues that, as in other instances, AADS' deployment record cannot be counted against Ameritech Illinois.

The complaint that most "innovations" can be traced to equipment vendors and not Ameritech Illinois does not make it a Company failing, AI maintains. Indeed, the point that vendors develop the switch hardware and software which enables new features and functionalities for the entire industry, was first set out in AI's own testimony. (See, Am. Ill. Ex. 1.1, p. 51). There, Mr. Gebhardt explained that the development of truly "new" services depends on the capabilities of the switching fabric itself, which has been the province of switch vendors. Short of becoming an equipment manufacturer, hardly a realistic alternative, AI maintains that its service introduction record is solid.

CUB's Position

CUB suggests that no more innovation occurred under the Plan than would have otherwise under rate of return regulation. As pointed out by City witness Dr. Selwyn, CUB maintains that basic telephone service in Illinois today is hardly different than that which existed in 1994. According to CUB, whatever "enhancements" or "innovations" in services have taken place are traceable primarily to equipment vendors rather than to specific AI initiatives.

CUB further contends that despite the fact that the costs of individual telephone calls are virtually distance-insensitive, and the costs of network usage have declined dramatically over the past decade, AI continues to make unwarranted distinctions in name and price in local and toll calls. In addition, CUB claims, AI has actually increased its rates for certain local and intralata calls. Further, CUB notes that although DSL technology has been around for a number of years, it is available in only a limited number of exchanges, and to only a limited number of subscribers within those exchanges to only a limited number of subscribers. CUB also notes that AI has chosen to suspend its "Project Pronto" deployment of DSL service. According to CUB, the Plan has *not* encouraged innovation in telecommunications services.

Commission Analysis and Conclusion

As a practical matter, innovation is the life-blood of any company and one feature it would not intentionally neglect. While the innovations which Ameritech described are limited, there is nothing relevant on record to suggest that the Plan failed to encourage innovation. Thus, this provision is satisfied.

4. Did the Plan Respond to Changes In Technology And The Structure Of The Telecommunications Industry That Are, In Fact Occurring.

Authority: Section 13-506.1(b)(3) and Alt Reg. Order.

In its 1994 Order, the Commission found that that the Plan met this objective because Ameritech Illinois' market environment would be increasingly competitive; that significant changes in technology were taking place; and that price regulation was better suited to these changes than rate of return regulation. (Alt Reg Order at 187-88.)

AI's Position

AI contends that the market environment has increasingly become more competitive with many more, as well as many more diverse, providers today than there were in 1994 and these competitors are successful in winning business from Ameritech Illinois. AI notes that in 1994, CLECs like MFS and TCG were just beginning to offer switched services to customers in Ameritech Illinois' service territory. Today, AI maintains, the Commission has certificated at least 59 CLECs, which collectively use a mix of resold services, UNEs and their own facilities to provide local exchange service. These CLECs, according to AI, include major IXCs like AT&T and MCI, fixed wireless competitors, cable companies and data CLECs. The scope of local competition has increased to the point, AI contends, where CLECs now have investments in place that can readily serve most of Ameritech Illinois' business and residential customers.

So too, AI maintains, there have been some significant changes in technology. An explosion in data traffic, driven in significant part by the Internet, is transforming the industry and requiring significant changes in Ameritech Illinois' network and network architecture. In 1994, AI contends, the Internet was just beginning to be used for commercial applications and voice communications constituted 87% of the revenue generated by the network. Today, however, evidence shows that business customers are restructuring their operations around the Internet and 45% of U.S. households have Internet access. AI explains that traffic on the network has fundamentally shifted from voice to data, and Internet transactions are substituting for voice transactions. Further, AI notes, wireless capacity has expanded rapidly and prices have declined, as customers increasingly substitute wireless for wireline calls.

As such, AI believes that the marketplace dynamics which drove the adoption of price regulation in 1994 are even more compelling today. Increased pressure from competitors using different, and more advanced, technologies than exist today in the Company's network will require appropriate responses for AI to keep competitive.

In contending that the Plan was not responsive because the residential local service marketplace is not yet fully competitive, AI believes that CUB and the AG misperceive the Commission's expectations for the Plan. According to AI, the Commission adopted price regulation because it would adapt to marketplace changes over the long run -- not just for the next five years. To be sure, AI contends, the Commission imposed a five-year rate cap on residential services because it assumed that residential local service would <u>not</u> become fully competitive and would <u>not</u> become subject to marketplace pricing constraints during this period. AI notes that the Commission specifically stated that this rate cap would allow it to "grapple with the complex social and economic issues associated with new technologies and <u>emerging competition</u>" during this period. (See, <u>1994 Order</u> at 65 (emphasis added).

AI takes issue with the CUB/AG complaints as to the inadequacy of upgrades to its network. The record demonstrates, AI contends, that it has invested in the technology required to bring advanced services to this state. AI maintains that the Attorney General's claim that pair gain technology (digital loop carrier systems) disadvantages customers is incorrect, noting that this technology has been widely used by local exchange companies since the 1980's and provides the most cost effective means of provisioning a high quality outside plant network. AI further observes that the demand for high-speed Internet access is a relatively recent phenomenon which customers can obtain from any of the many alternative providers.

More to the point, AI claims, CUB and the Attorney General flatly ignore the risks associated with technological change and the Commission's concern that ratepayers be protected from those risks. (See, Alt Reg Order at 87-88.) The record shows, AI maintains, that technology is changing at a rapid rate and that, over the long run, the Plan will better protect customers from the financial consequences of that change than rate of return regulation.

CUB's Position

While AI witness Gebhardt pointed to the Company's digital network as evidence that the plan has delivered technological advancements to AI's customer base, CUB is unimpressed. The Company's testimony in the original Alt Reg Order Docket, Cub claims, shows that AI would have only 18 analog switches (the precursor technology to digital switching) remaining at the end of 1994. (See Alt Reg. Order at 150.) With or without price regulation, the Company anticipated that it would complete the analog switch replacement work by the end of 1997. Hence, CUB argues, the Company's delivery of its end-to-end digital network is not evidence of, or attributable to, any alternative regulation success.

Even if it is true that the Company, as AI witness Gebhardt testified, has spent millions of dollars opening its networks to competitors, CUB claims that this has not been enough to alter in any meaningful way the competitive nature of the local exchange marketplace, particularly for residential customers. In any event, CUB argues, the additional investment made by AI to spur competitive growth has been more a function of Commission decisions and federal law, than alternative regulation. As such, CUB relies on Dr. Selwyn's observation that AI's testimony is absent any evidence showing that it addressed changes in technology any differently under the price cap plan than it would have under rate-of-return regulation.

Commission Analysis and Conclusion

New wireless technology and the internet explosion came to prominence during the Plan term we here examine. The Federal Communications Act was also adopted in this time frame. Without question, AI has had to respond and adapt to all of these changes and it must be prepared to address new challenges in the near future.

5. Has the Plan Produced Efficiency Gains and Cost Savings

Authority: Sections 13-506.1(b)(5); 13-506.1(a)(3) and Alt Reg Order.

The law requires findings that the Plan will promote efficiency and that ratepayers will benefit from any efficiency gains, cost savings and productivity improvements arising out of the regulatory change. In 1994, the Commission concluded that the Plan would provide Ameritech Illinois with incentives to implement cost saving efficiencies and new services, because of the potential for higher earnings if the Company were successful. The Commission further determined that ratepayers would benefit from these efficiencies and new services through the X factor, which would apply regardless whether the expected productivity gains were achieved. (Alt Reg Order at 188-89.)

AI's Position

AI maintains that the Plan did provide it with new incentives to become more efficient. It not only maintained, but increased, its productivity over the term of the Plan, and improved its performance on standard measures of efficiency in the industry. Moreover, AI asserts that the X factor was higher than Ameritech Illinois' total productivity gains such that consumers reaped all of the gains which Ameritech Illinois achieved, as well as some that it did not, which more than satisfies the statutory standard. Further, AI insists that its efficiency gains were not achieved at the expense of service quality. If kept in a proper perspective, AI maintains that its service quality was generally excellent during the 1994-99 period.

Arguments whereby CUB and the Attorney General contend that ratepayers did not appropriately benefit from the efficiency gains and cost savings which resulted from the Plan rest on a commingled view of noncompetitive and competitive service rate changes and earnings which AI views as improper. According to AI, the Plan's performance has to be assessed in terms of the services to which it applied. It is undisputed on record, AI contends, that the X factor flowed through to customers of Ameritech Illinois' noncompetitive services all of the productivity gains which the Company achieved.

CUB's dismissal of the benefits associated with increased sales of vertical services ignores the fact that customers like and use these products -- if not, they would not buy them in the first place or would cancel them after a few months' experience. Further, CUB's claims that such increased sales were due to the merger and not the Plan are wrong, AI contends, since the financial analyses in this proceeding are based on 1999 data whereas the merger did not close until September of that year. Hence, vertical service sales during the Plan are not attributable to SBC.

CUB' Position

CUB challenges AI witness Gebhardt's claim that since the inception of the plan, the Company has focused on customer-oriented marketing strategies and streamlined its decision-making processes, thereby promoting efficiency and making AI a more responsive organization. From the residential customer perspective, as viewed by CUB, these marketing achievements are little more than the promotion of Caller ID and other vertical services – the implementation of which AI and SBC characterized as the "best practices" that would result from the merger, and not a byproduct of alternative regulation. As for the claimed improvements in the Company's management structure, CUB claims that residential customers clearly have not been the beneficiaries given the deteriorating service quality linked to AI.

CUB notes Dr. Selwyn's observation that any efficiency gains and cost savings arising out of the regulatory change, to the extent they exist, can only benefit AI ratepayers if they are passed on to them. CUB claims that because overall annual rate reductions triggered by the price cap formula have been accompanied by increases in rates reclassified as competitive, or bundled as new services, and left outside of the *pricing constraints of the plan, - any alleged efficiency gains or cost savings have not* benefited AI's captive business and residential customers.

GCI and City further dispute the suggestion that consumers benefited from efficiency gains, and that the price index mechanism resulted in rate reductions that exceeded AI's productivity. According to GCI, if the rate reductions required by the price index exceeded AI's cost savings and productivity gains, one would expect its return on rate base and its return on equity to be lower than it was at the inception of the plan. This has not happened, GCI maintains, and AI has retained the vast majority of the benefits from its productivity and efficiency gains, sharing only the amount required by the price index and not more irrespective of its actual cost savings. In short, the GCI/City maintain that the Company has presented no evidence that the approved alternative regulation plan resulted in increased efficiency for AI.

Commission Analysis and Conclusion

The Commission relied on the X factor in the formula to ensure that efficiency gains and cost savings benefited customers. The X factor worked as expected and thus the Plan met this requirement, but only in part. If we take a broader view, there are some issues.

6. Has the Plan Served to Prejudice Or Disadvantage To Customers

Authority: Sections 13-506.1(b)(7); 13-103(d) and Alt Reg Order.

Under Section 13-506.1(b)(7), an alternative plan of regulation must not unduly or unreasonably prejudice or disadvantage any particular customer class, including telecommunications carriers. In addition, the Commission must consider whether the Plan would result in discrimination or cross-subsidies under Section 13-103(d). In its 1994 Order, the Commission concluded at that time that the basket structure would ensure that all customer classes would be treated equitably. The Commission also determined that the pricing flexibility limitations and residential price cap would protect residential customers; and that carriers were further protected by the requirement that intrastate carrier access rates could not exceed interstate carrier access rates. (Alt Reg Order at 190-91). With respect to discrimination and cross-subsidies, the Commission relied on the reasonableness of the Company's going-in rates, as well as the Imputation and Aggregate Revenue Tests. (Id. at 185).

AI's Position

AI maintains that that the basket structure and residential rate protections functioned precisely as the Commission intended because: (a) all of the rate reductions required by the Plan were flowed through equitably to each customer group; (b) the limits on pricing flexibility, combined with the low rate of inflation over this period and the residence rate cap, more than protected consumers of noncompetitive services from any rate increases and those rates declined; (c) there were no rate-related complaints of any significance over the Plan's initial term; and (d) all of the statutory service cost and pricing rules continued in effect and the Company has complied with them.

AI disputes Dr. Selwyn's claim that the Plan disadvantaged noncompetitive service customers because the productivity offset "was woefully insufficient and misspecified". According to AI, the offset in the Plan today was based on Ameritech Illinois' own productivity performance and Dr. Meitzen's updated Company-specific analysis for the 1992-99 period demonstrates that it was, if anything, too high. (Am. Ill. Ex. 1.1, pp. 29-30). This analysis, AI maintains, was not contested by any party to the proceeding.

AI further asserts that the concept of prejudice involves the favoring of one customer class at the expense of another and, under Section 13-506.1(b)(7), the Plan may not unduly prejudice "any particular customer class" (emphasis added). Hence, AI maintains, it makes no sense from either a logical or statutory perspective to claim, as does CUB, that the Plan "unduly disadvantaged noncompetitive service customers as a whole.

AI further notes that CUB and the Attorney General erroneously recast their complaints about lack of competition, service quality, earnings, and the treatment of calling plans under the basket structure as "prejudice" issues. Again, AI explains, to the extent these complaints have any merit -- and the Company believes that they do not -- they would impact all noncompetitive customers equally and, thus, would not constitute prejudice or disadvantage under Section 13-506.1(b)(7).

AI notes the Attorney General complaint that Ameritech Illinois' rate design decisions under the Plan have primarily benefited customers who make use of the Company's network. The AG would have preferred reductions in network access lines, which are subscribed to by customers who make little or no use of the network. This, AI maintains, does not constitute "prejudice" or "disadvantage". The Company made clear in 1994 that residential network access lines were underpriced and that it had no intention of reducing those rates under the Plan. (See, Alt Reg Order at 63, 68). And, as evidenced by the Company's rate rebalancing proposal, circumstances have not changed. The Company's consistent pricing policy over the last seven years relative to this issue has not been "prejudicial" within the meaning of the statute. In AI's view, it is not unreasonable for rate reductions to flow more heavily in the direction of customers who actually make use of its network, as compared to customers who do not. Such a result, AI contends, increases overall consumer welfare.

GCI/City's Position

CUB believes that the Company's skyrocketing earnings, deficient service quality, and propensity to prematurely classify services as competitive (with increased rates for those services), all conspire to show that the plan has unduly disadvantaged noncompetitive service customers as a whole. According to CUB, residential customers have seen charges for Band C usage climb steadily since the inception of the plan and business customers have had basic network access and all usage services reclassified as competitive, with corresponding rate increases.

On the basis of the Company's exorbitant level of earnings under the plan, CUB views it clear that the price cap formula's insufficient productivity offset, and the lack of an earnings sharing mechanism has produced rates that are higher than would have occurred under rate-of-return regulation, all other things being equal. CUB also considers the failure of any measurable level of competition to develop in the local market, as evidence that competitive carriers likewise have been disadvantaged under alternative regulation.

The GCI/City agree with AI that the basket structure and pricing flexibility limitations were intended to protect consumers from undue or unreasonable disadvantage under the plan. They dispute, however, AI's position that the basket structure and residential rate protections functioned precisely as the Commission intended. GCI witness Charlotte TerKeurst and Staff witness Koch testified that AI manipulated the basket structure and the limitations on pricing flexibility by treating the rates for calling plans as "new services" under the plan, despite the fact that they simply repackaged and repriced residential Bands A and B usage rates. As Staff pointed out in its Initial Brief, calling plans account for over 90% of AI's revenues from new services. (Staff In Br. at 26). These revenues, the GCI/City contend, are from services that should have been included in the residential basket, and subject to the same pricing limitation applicable to other residential basket services.

The basket structure was intended to protect all classes of customers and insure that they all receive rate reductions as a result of alternative regulation. AI, however, has increased the rates for residential usage by offering calling plans as "new services" and has not decreased access charges or band A calling rates during the Plan. The GCI believe it clear that customers of "plain old telephone service" who purchase simple access and make band A and B calls, have not received any benefits from AI's efficiencies or alternative regulation because their rates have remained the same despite substantial cost reductions.

Commission Analysis and Conclusions

Prejudice or discrimination is a concept which calls for a comparison. It requires a showing of difference in treatment under the same or similar circumstances. We have not been provided with such a showing.

In addition to prejudice, however, we are directed to consider disadvantages. On the basis of Staff's account, the Commission believes that the service baskets which we structured have not operated as expected. Hence, we find that this requirement has not been fully satisfied. If the Plan is to be continued, we will surely give further attention to these matters.

7. Whether There Has Been Broad Dissemination of Technical Improvements and Economic Development

Authority: Sections 13 - 506.1(a)(4); 13-506.1(a)(5); 13-103(f) and Alt Reg Order:

Sections 13-506.1(a)(4), 13-506.1(a)(5) and 13-103(f) require the Commission to consider whether alternative regulation plans will facilitate the broad dissemination of technical improvements to all classes of ratepayers and enhance the economic development of the State. In its 1994 Order, the Commission concluded that price regulation provided the appropriate incentives to encourage market-based investment in infrastructure; that the Company had made a $3 billion commitment to grow and modernize its network; and that, because most of Ameritech Illinois' plant-in-service is used to provide service jointly to all customer classes, all classes of customers would benefit from this investment. (Alt Reg Order at 182, 183). The Commission also determined, based on economic analyses presented in that proceeding, that there was a generally positive relationship between network modernization and economic development.

AI's Position

Ameritech Illinois contends that it not only met, but exceeded, its $3 billion commitment by spending $3.7 billion. Those investments AI contends, facilitated the development of an advanced telecommunications infrastructure. Today, AI maintains all of Ameritech Illinois' customers have digital switching capabilities available to them. So too, virtually all of the Company's interoffice facilities are now fiber. Further, over 90% of the Company's access lines have access to ISDN. In addition, SS7 deployment is complete and 65% of the Company's central offices have been equipped with the AIN platform. All of these technologies, AI claims, are important building blocks for advanced services.

Ameritech Illinois notes that it also spent millions of dollars opening its networks to competitors. It contends that customers benefit from the expanded choice of alternative service providers. It notes further that the positive relationship between price regulation and network modernization which the Commission relied on in 1994 has now been further validated by a NARUC/NRRI study based on empirical data from jurisdictions throughout the United States. (Am. Ill. Ex. 4.2, at 3-4). Accordingly, AI asserts, the Commission can conclude that the Plan has enhanced economic development in the State.

With respect to Ms. TerKeurst contentions that AI's service quality problems demonstrate that it invested in high margin services/customers at the expense of basic service customers, the Company notes that there is no evidence whatsoever to support such a claim. In fact, AI contends, because the Company's network primarily consists of common plant, it is virtually impossible for to do as Ms. TerKeurst suggests. And if any customer group benefited disproportionately from Ameritech Illinois' network investments, AI argues, it is the CLECs -- who are most definitely not the Company's "high margin services/customers".

By subtracting depreciation accruals associated with existing plant from the $3.7 billion of new investment over the five-year term, Dr. Selwyn arrived at the proposition that Ameritech Illinois only invested a "net" of $300 million in its network and, therefore, is not infusing new capital into its business. This proposition, AI contends, has no basis in any legitimate financial or economic theory. Much like any capital intensive company, AI claims, it incurs substantial depreciation expense which reflects both wear and tear as well as technological obsolescence. The relevant measure of Ameritech Illinois' investment in its network is the $3.7 billion and not the net figure cited by CUB. According to AI, the Commission ignored Dr. Selwyn when he advanced a similar argument in the 1994 proceeding.

CUB and the Attorney General claim that Ameritech Illinois should have demonstrated that its network investment promoted economic development with more specificity. The relationship between network investment and economic development however, AI claims, can only be established at a broad, macroeconomic level. AI observes that the GCI's own witness, Dr. Selwyn testified that he was not expecting the Company to establish a linkage between specific network investments and economic development. While CUB also suggests that Ameritech Illinois was obligated to duplicate the economic analysis provided in the 1994 docket in this proceeding AI contends that nothing in the Commission's Alt Reg Order supports this claim.

The Attorney General and Cook County argue that Ameritech Illinois has failed to invest in aspects of the network which benefit POTS service noting, for example, that Project Pronto does little to benefit POTS customers. These arguments, AI contends, fundamentally misrepresent Project Pronto which is not a "DSL project" but rather an overall network modernization program which benefits all customers. In fact, AI points out, because the DSL aspects of Project Pronto are currently being deferred, Project Pronto now benefits only POTS services. (Tr. 1989-92).

CUB's Position

According to CUB, the Company presented no evidence to show that any technical improvements realized since 1994 would not have been achieved and spread over all customer classes if it had been operating under rate of return regulation. As pointed out by Dr. Selwyn, CUB claims that the $3.7 billion that AI invested over the term of the plan was not "new" investment, but was largely funded by ongoing depreciation charges and thereby represents the replacement of existing, "worn out" equipment rather than an infusion of new capital. Because it recorded a total of $3.4 billion in intrastate depreciation accruals over the 1995–1999 time period, AI actually made only $300 million in net investment according to CUB.

In any event, CUB claims, the $3.7 billion in investment claimed by the Company has not been sufficient to maintain basic service quality where AI did not target sufficient amounts into its basic local network, particularly to its outside plant, to ensure timely availability of network access – in new housing areas with high growth rates. According to CUB, executives at SBC, (AI's corporate parent), conceded that point to the investment community by blaming service quality failures on Ameritech's "lack of maintenance and capacity in the outside plant." (See, GCI Ex. 2.0 at 68-69). Neither AI witnesses Jacobs or Gebhardt, CUB notes, made mention of growth in the number of network access lines available to end users and, in addition, AI has chosen to suspend its "Project Pronto" deployment with respect to DSL service.

CUB further claims that the Company failed to provide a single example of economic development in this State that was a direct result of the AI price cap plan. The Company's assessment of its meeting the $3 billion commitment is suspect, CUB maintains, given that the majority of the investment represents replacement of worn equipment that, absent any evidence to the contrary, would have occurred under rate of return regulation. Thus, according to CUB, the Commission cannot assume that the plan has enhanced economic development simply because AI fulfilled its $3 billion investment commitment.

In CUB's view, the record evidence belies AI's claim that the plan has successfully facilitated any broad dissemination of technical improvements to all classes of ratepayers.

Commission Analysis and Conclusion

In 1994, the Commission concluded in the Alt Reg Order that there was a generally positive relationship between price regulation and network modernization, and between network modernization and economic development. We continue to believe in the worthiness of this proposition. In doing so, we take account of the investment promised and the Company's fulfillment of that commitment

The Commission further observes that economic development depends on the availability of telecommunications service of sufficient quality and quantity offered by a variety of carriers. As such we cannot disregard the investments AI made in opening its network to competitors. On the whole and in these premises, the statutory requirements have been fulfilled.

8. Competition

Authority: Sections 13-103(b) and Alt Reg Order.

Under Section 13-103(b), the Commission must consider whether any alternative regulation plan will promote the legislative goal of allowing competition to substitute for certain aspects of regulation, where consistent with the protection of consumers. In its 1994 Order, the Commission concluded that the Plan would further this goal, because price regulation better reflects the operating freedoms and constraints faced by competitive companies and reduces the economic burden of regulation generally. (Alt Reg Order at 184).

AI's Position

While City witness Dr. Selwyn contended that the Plan failed because it did not actually further local competition as measured by competitive entry and competitors' market shares, AI maintains that this position has no basis in the statute, economic theory or regulatory policy. By its very terms, AI claims, Section 13-103(b) addresses the elimination of unnecessary regulatory oversight and constraints, not promoting competition per se.

AI explains that price regulation is fundamentally a retail plan which governs the pricing of Ameritech Illinois' noncompetitive services to consumers and it establishes the governance structure relative to retail service quality, network investment and financial performance. It is not a wholesale plan. According to AI, price regulation plans do not, of themselves, either encourage or discourage the development of competition, except to the extent that they produce more efficient price signals to potential competitors. Indeed, AI notes, the original pioneering work on the merits of price regulation assumed a monopoly environment whereas now economists and regulators have concluded that price regulation is better adapted (than rate of return regulation) to the transition from monopolies to competition. In other words, AI claims, it makes no more sense to expect price regulation to promote competition than for rate of return regulation to do the same. In any event, AI maintains, it is uncontroverted that there is more competition today than there was in 1994.

AI further disputes Dr. Selwyn's claim that the Plan had actually harmed competition by allowing Ameritech Illinois to shift "costs out of its 'competitive' services and onto noncompetitive services -- including such bottleneck items as switched access and unbundled network elements...". (City Ex. 1.0 at 30-31). Nothing of the kind happened according to AI, and no party produced a shred of evidence to show that costs have been misallocated. Indeed, AI states, switched access rates declined more rapidly than any of Ameritech Illinois' other rates over the term of the Plan and were recently slashed by another $33 million as a result of Dockets 97-0601/0602. Further, AI contends, UNE rates were set at a very low level in 1997 based on TELRIC studies and they have not increased since then. In short, AI maintains, the Plan did not have and could not possibly have had a negative impact on any of these services.

AI notes GCI witness TerKeurst's claim that the Plan impeded competition, because the Company reclassified services as competitive and raised their prices. This argument, AI contends, posits the relationship between price changes and competition precisely backwards. According to AI, competitors are attracted to market segments and services where there is a reasonable opportunity to make a profit. Put another way by AI, price increases provide competitors with more, not less, incentive to enter.

Whereas the GCI/City continue to complain that residential competition has not developed sufficiently this is not, AI asserts, in anyway attributable to the Plan. According to AI, these parties ignore the numerous, complex factors which have contributed to the slow growth in residence lines served by competitors, i.e., low profit margins in the local exchange business relative to other CLEC business opportunities; strategic decisions by the IXCs; and unrealistic regulatory expectations. Despite these factors, AI claims that the CLECs have recently demonstrated a renewed interest in serving residence customers in Illinois. AI further observes that the GCI's intense concern with the level of competition simply cannot be squared with its proposed $1 billion rate reduction, hundreds of millions of which result from imputed revenues and/or disallowances which bear no relationship to financial reality. If these adjustments were adopted, AI believes that they would disincent all competition, including efficient competition. While the GCI want both uneconomically low consumer rates and competition, AI contends that this is not how the marketplace works.

Staff's Position

Staff notes that the transition to competition has not, in fact, taken place nearly as quickly as the Commission apparently believed, and presumably hoped that it would. It contends, however, that this factor be given "limited consideration at most." (Staff Initial Brief at 31).

GCI/City's Position

The City contends that one of the State's major policy goals, i.e., promoting competition, has not been furthered by the Plan. It claims that the level of competition in the local exchange services market is extremely limited such that the vast majority of residential customers and a substantial number of business customers still lack meaningful competition. According to the City, the combination of the Plan's incentives, the Company's reaction to those incentives, and the ineffectiveness of service quality protections have acted to hinder the growth of competition.

The AG further asserts that the Plan has neither led to increased competition nor seen competition constrain monopoly profits.

Commission Analysis and Conclusion

We see no casual connection between the Plan and the furtherence/hinderence of competition in the way that GCI and City attempt to frame the issue. The Plan simply does not have such powers. The conclusory arguments presented do not consider or discuss all of the essential variables for the premise, including that the rates generated under the Plan in Illinois may have deterred incoming hopefuls seeking high profits. To be sure competition in the residential local markets has not opened as quickly or extensively as the parties or the Commission would have desired but we also cannot deny its growth. Nor can we conclude other than that this statutory goal, if properly construed, has been met.

9. Service Quality

Authority; Sections 13- 506.1(b)(6); 13-103(c) and Alt Reg Order.

Under Section 13-506.1(b)(6), the Commission must find that an alternative plan of regulation will "maintain" the quality and availability of telecommunications services offered by the applicant carrier. The Commission must also consider whether the plan will disrupt the telecommunications system or consumer services under Section 13-103(c). In its 1994 Order, the Commission found that the then current quality of service provided by Ameritech Illinois was "fully satisfactory". The Commission concluded that the service quality component of the price index, which included penalties, would provide Ameritech Illinois with incentives to maintain service quality. The Commission also concluded that the incentives to invest in its network and the pricing restrictions in the Plan would ensure the availability of services to consumers. Finally, the Commission concluded that nothing in the Plan would change the way Ameritech Illinois delivered service to its customers. (Alt Reg Order at 184, 189-90.)

AI's Position

On the whole, AI contends, service quality improved significantly over the first five-year term of the Plan—the principal exception being the measure for out of service over 24 hours ("OOS>24"). During that term of the Plan, AI notes that its performance improved for seven of the eight current benchmarks.

AI observes that Staff witness McClerren focused on so-called monthly "misses" in his direct testimony. Aside from OOS>24, however, monthly data confirm that Ameritech Illinois' performance has improved steadily under the Plan. For the other seven (7) measures, AI claims its performance exceeded the benchmarks for 399 of 420 monthly data points (95%). The number of monthly "misses" fell steadily between 1994 (17 misses) and 1999 (four misses). Considering that those benchmarks were based on annual, not monthly, performance during 1990-91 AI claims, that is a remarkable record.

In his rebuttal testimony, Mr. McClerren suggested comparing the average level of performance prior to the adoption of the Plan (using data for the periods 1990-94 and 1990-91) to performance since the Plan was adopted (1995-2000). Those comparisons, AI confirms, confirm that performance has improved substantially, again with the single exception of OOS>24.

AI notes that Staff and GCI continue to focus primarily -- indeed almost exclusively--on two service quality issues: (a) performance for the measure Out of Service Over 24 Hours ("OOS>24") and (b) the more generalized installation and repair problems during the second half of 2000. Ameritech Illinois does not dispute its failures regarding those issues, nor has it minimized the seriousness of those failures. It would, however, direct the Commission to consider on this review whether the Plan on the whole succeeded in maintaining service quality. If service quality performance is considered for all measures over the entire period of the Plan, AI maintains, it is clear that the Plan's successes outnumber its failures by a large margin. This is true, AI contends, even if one measures the success of the Plan precisely in the ways that Staff and the GCI allege that the Plan should be judged.

Staff witness McClerren testified that the success of the Plan should be measured, at least with respect to the measures in the current Plan, by comparing performance before and after the Plan was adopted. He compared the years 1995-2000 to the years 1990-91 and 1990-94 respectively, but only performed this analysis for OOS>24.

The results for the other seven measures, AI contends, all show steady improvement over the initial term of the Plan. Indeed, AI claims, many of the most important measures of service quality improved by large margins. For example, Trouble Reports per 100 Access Lines, - the best overall measure of network performance in AI's view - improved by more than 30% from 1990-94 to 1995-2000. So too, AI argues, the other measures improved over that period by margins ranging from roughly 20% to 100%. Considered on the basis of Staff's approach, AI contends, most measures of service quality have improved markedly.

GCI witness TerKeurst testified that, to get a more complete picture, one must also consider measures of service quality other than those included in the Plan. She, did not actually perform that analysis, AI claims, on the grounds that no pre-Plan data were available for measures outside the Plan. On the basis of data submitted by CUB (in its 1996 service quality complaint case), AI notes, the comparison which Ms. TerKeurst suggests to show that service quality has not declined, but instead improved since the Plan was adopted. Data gathered since the adoption of the Plan are either consistent with, or better, than pre-Plan data for all such measures for which data are available: Business Office Answering Time, Repair Office Answering Time, Repeat Trouble Rate (Installation), Repeat Trouble Rate (Repair), and Missed Repair Appointments. Thus, AI maintains, service quality also improved based on the approach suggested by Ms. TerKeurst.

As for OOS>24, Ameritech Illinois does not deny it has struggled to comply the Commission's five-percent standard which it notes to be a very demanding benchmark. Nevertheless, Ameritech Illinois recognizes its responsibility to comply with this measure and is committed to meeting it. Its commitment, AI claims, is reflected in the sharp drop in OOS>24 cases, - from an average of 14.1% in 1995-97 to an average of 7.9% in 1998-99 - approximately the same level at which the Company was performing before the Plan was adopted. With the increases in network staffing and spending, Ameritech Illinois believes it is on track to comply consistently with this benchmark, as its recent performance shows. (AI requests that administrative notice be taken of its recent performance data, but it has not proceeded as required under the Commission's Rules of Practice.)

With respect to the installation and repair delays that occurred in the second half of 2000, Mr. Hudzik testified that such problems were the result of retirements by an unexpectedly large number of network employees in 1999, coupled with rising workloads and inclement weather.

While certain of the parties suggest that a lack of network facilities also contributed to the installation and repair problems in 2000, AI notes that the record contains little, if any, evidence that the network itself is deficient. Indeed, Performance for Trouble Reports per 100 Access Lines, - the most important measure of network performance in AI's view - improved significantly under the Plan, (from an average of 2.92 for 1990-94 to an average of 2.02 for 1995-2000). In year 2000, AI notes, only

1.81 access lines per 100 were out of service. Dial Tone Within Three Seconds and Trunk Groups Below Objective - which also measure network performance - improved to a point that problems are virtually extinct, such that Staff now proposes to eliminate both of those measures.

Furthermore, AI contends, its installation and repair performance has improved rapidly as with new hirings. Such improvement, AI contends, would not have been possible if adequate facilities were not available. AI maintains that all of this evidence shows that headcount losses and not inadequate network facilities, led to the installation and repair delays which occurred in the second half of 2000. Mr. Whitacre's comments, quoted by the GCI, are not to the contrary, AI claims, as Mr. Hudzik explained:

> "[T]o the extent that additional infrastructure investments could have offset the impact caused by the loss of much of our workforce, it might have mitigated some of the service problems experienced in 2000. However, the more immediate problem was the effect of construction forces that typically are devoted to infrastructure improvements and expansion to address the daily repair and installation loads, which were building due to loss of many of our technicians. I see nothing in Mr. Whitacre's statements that would be to the contrary. In fact, Mr. Whitacre specifically noted that the problem was being addressed by hiring additional technicians." (Am. Ill. Ex. 12.1, p. 12).

AI observes that while Cook County appears to agree that headcount was the problem, it would attribute the loss of headcount to post-merger cost cuts with early retirement packages and other incentives to retire some of its most experienced managers and technicians prior to the 'unanticipated' exodus that led to the service problems in the second half of 2000. AI maintains that these allegations are absolutely wrong because it offered no enhanced retirement benefits to either management or non-management network employees before the headcount losses occurred. According to AI, Cook County's allegations to the contrary have no basis in the record.

As AI's witness Hudzik explained, an unexpectedly high number of network employees retired in 1999 despite the fact that Ameritech Illinois' had proactively implemented measures which offset the impact of GATT-related changes for all network employees, both management and non-management, that would potentially be affected. Far from being an incentive to retire, as Mr. Hudzik explained, "the purpose of it was to get employees to change their minds and not retire." (Tr. 1953).

Ameritech Illinois maintains that it acted early and aggressively to maintain its network headcount. It renegotiated its collective bargaining agreements and offered additional benefits to non-management employees to avoid GATT-related headcount losses. Those changes were effective January 1, 1999. By mid-1999, when attrition proved greater than expected, Ameritech Illinois identified the problem and began hiring immediately.

By January 2000, long before service quality problems began, headcount was rising. And, in early 2000, still before service quality problems became apparent, Ameritech Illinois accelerated its hiring program. By the beginning of 2001, Ameritech Illinois had added 1468 network employees (over 17%), far more than restoring the 10% headcount loss that had occurred in 1999. AI notes that forecasts call for the Company to add another 900 network employees by the end of 2001. (Tr. 1958).

According to AI, the headcount increases have been accompanied by an enormous increase in network spending. Its network capital investments in Illinois have grown from $787 million in 1999, to $918 in 2000, to $1.043 million (estimated budget) for 2001. And, expenses have risen from $495 million in 1999, to $664 million in 2000, to nearly $800 million (estimated budget excluding network planning and engineering) in 2001.

AI claims that its performance has responded accordingly, since the second half of 2000, the average interval for installations requiring field visits fell, from 14 days to 5 days. Pending installation orders, requiring field visits, dropped from 48,506 to 22,411. In addition, OOS>24 was reduced to 4.3%, the average interval for all repairs fell from 54 hours to 21 hours, and the pending repair load shrunk from 19,501 cases to 9,323. In this same time period, customer complaints fell dramatically.

Certain of the GCI parties contend that business and repair office answering performance has also been deficient. But, AI maintains, there is little evidence to support this claim. It notes that, business and repair office answer times are "new" Part 730 standards in Illinois, made effective in October 2000. As a result, answer time data are limited, and the data available prior to October do not consistently measure performance for the same calling centers. While the GCI parties have characterized answer times as excessive, AI maintains that there is no evidence that actual consumers share that view. AI notes that, Staff's review of customer complaints did not identify answer times as a problem. Similarly, customer survey data for February through August 2000 showed that customers rated the ease of getting their calls through to Ameritech Illinois' business and repair offices in the neutral to satisfied range--from 64.6 to 75.3, where 54 is neutral and 84 is satisfied.

In any event, in response to the Commission's new rules, Ameritech Illinois has hired additional employees in its business and repair offices. This, it claims, will assure staffing sufficient to comply with the 60-second answer time requirement in the Commission's Part 730 rules. Here too AI claims, its recent performance reflects its additional hiring (and spending). As of the first of the year, business and repair office answering times averaged 60 and 31 seconds, respectively, for all calling centers.

AI notes that certain of the GCI parties i.e., CUB and the Attorney General contend that Ameritech Illinois "currently" queues customers from other states ahead of Illinois customers on calls to collection centers. Those claims are wrong, and Mr. Hudzik specifically explained, the queuing process described by the GCI was limited to a single call center for a short period of time prior to the effective date of the Commission's answer time standards. No such queuing of customers, AI maintains, has occurred since October 2000.

GCI/City's Position

GCI and City contend that the Company's performance, in key service quality areas, has been abysmal. The record, CUB claims, demonstrates a decline in Ameritech Illinois' service quality since the inception of alternative regulation and, more dramatically, since the Ameritech/SBC merger. CUB highlights the decline in AI's service quality as follows:

- Ameritech Illinois' performance in restoring service to customers within 24 hours of a reported outage (i.e., the OOS>24 measure) has declined dramatically. Its rate of failure in correcting "out of service" situations within 24 hours averaged about 14.1 percent between 1995 and 1998—over twice the average rate of failure in 1990 through 1994. While Ameritech Illinois reported some progress in 1999, its OOS>24 performance declined again in 2000, reaching 15.2 percent in August 2000. For the month of September 2000, AI reported an OOS>24 rate of 37%, more than seven times the allowed rate per 83 Ill. Admin. Code Part 730 and the existing plan.

- The number of lines that were "out of service" almost doubled between late 1999 and mid-2000.

- Since early 1999, the average number of days needed to install a new access line Plain Old Telephone Service ("POTS") (the POTS Mean Installation Interval measure)) has more than doubled for residential customers.

- Between December 1999 and June 2000, the speed at which customer calls are answered (the Average Speed of Answer measure) declined in the residential and repair call centers and the percent of customer calls answered in those call centers (as captured by the % Calls Answered measure) also declined.

- The average time to repair service, whether for all telecommunications service troubles as a whole (the Mean Time to Repair measure) or for POTS trouble on a stand-alone basis (the POTS Mean Time to Repair measure) has sharply increased since the SBC/Ameritech merger, with Ameritech Illinois reporting 77.7 hours to repair POTS in September 2000.

- Ameritech Illinois failed to keep an increasing percent of its POTS repair appointments (the POTS Missed Repair Appointments—Company Reasons measure) since 1998, missing 15.5% of its repair appointments in September 2000.

- Between 1999 and 2000, repair complaints increased by 71 percent, installation complaints increased by 190 percent, and construction and engineering complaints increased by 119 percent.

- By August 2000, the number of consumer complaints to Ameritech Illinois as tabulated through the executive appeals complaints process increased compared to 1999. Consumer complaint levels increased by 28 percent, 51 percent, 56 percent and 92 percent for maintenance, network, construction, and customer provisioning complaints, respectively.

- The percent of customers assigning Ameritech Illinois a low score of 0 to 5 (out of 10 points) for service quality in AI customer surveys increased by 20 percent from January 1999 to August 2000.

- Variations in state requirements have resulted in discriminatory treatment of Ameritech Illinois customers. Specifically, calls to Ameritech/SBC's collection offices by customers in other states are currently routed ahead of Illinois customer calls to meet other states' service quality standards.

- Ameritech Illinois' performance in answering calls from residential customers declined significantly between 1997 (the earliest year for which data is available) and mid-1999. The average speed at which Ameritech Illinois answers residential customer calls (the Average Speed of Answer—Residential Customer Call Centers measure) increased from

> 38.2 seconds in January 1997 to 413.1 seconds in June 1999. The percent of residential customer calls answered (the % Calls Answered—Residential Customer Call Centers measure) declined dramatically, from 93.2 percent in January 1997 to 59.5 percent in June 1999.

According to GCI, further indication of the decline in AI's service quality performance under the plan is found in the records of the ICC's Consumer Services Division ("CSD"), as discussed by Staff witness Jackson. In 1995, the first year of the plan, CSD received 14 complaints from AI customers regarding unsatisfactory performance of "scheduling or repair", and 20 complaints regarding unsatisfactory installation service. By 2000, those numbers had grown to 649 and 992 respectively, and excludes the 850 open service complaints that have not been closed and categorized. Ms. Jackson noted that specific complaints for poor performance by service technicians and customer service representatives have also increased. Ameritech Illinois' own data, GCI/City argue, also shows a pattern of serious degradation in critical service quality components.

GCI/City note Staff witness McClerren's assertion that the Staff has met with the Company for years to try to resolve the "out of service" problem, to no avail. His testimony shows that that in spite of the Commission's increased attention to the issue, the inclusion of a $30 million penalty in the SBC/Ameritech Merger Order for failing to meet the standard in calendar year 2000, and the Company's promises to the address the problem, AI *reduced* installation and repair technician staffing levels. Most of these technician headcount reductions occurred from August 1998 through January 2000, a period during which "increases in technician headcount were promised by the Company," according to McClerren.

The GCI/City also claim that AI's performance with respect to the "installation within 5 days" service quality measure has also been below par during the price cap plan, and particularly deficient in recent years. Mr. McClerren testified that the Company's installation performance has been unsatisfactory throughout the term of the plan. More specifically, the Company averaged more than five days for POTS installations throughout the January 1999 through September 2000 time frame, with the September 2000 time frames averaging more than 10 days.

According to GCI/City, AI also reported above-average delays in installation intervals for POTS service between June and August of 1999, at between 6.02 days and 6.41 days, when compared with average installation times of 5.86 days over the course of 1999. As noted above, installation intervals increased again during the August 2000 overtime restrictions.

Anecdotal evidence provided by AI's customers in a special meeting of the ICC and in complaints to CUB suggest that these numbers are deceivingly low given the fact that they do not capture Ameritech Illinois' performance for installation requests made