consultant. Staff and Cook County made motions to strike all or portions of both of these individuals' testimony. Staff, Cook County, and MCI have all renewed the objections in their briefs and replies. Centel, Alltel and ICTC argue that this testimony should be admitted.

The Commission is of the opinion that the testimony of both Shooshan and Busch was admissible. The basic fact overlooked by all of those opposing the testimony is that this docket was established as a rulemaking rather than a contested case. There is a distinct difference between proceedings designed for the purpose of promulgating policy-type rules or standards, on the one hand, and proceedings designed to adjudicate disputed facts on the other. In a rulemaking, we are sitting in our legislative, as opposed to our judicial, guise. To our way of thinking, the only restraints against the admissibility of testimony in rulemaking cases are tests of relevancy, materiality and qualifications. While Staff has raised a brief argument concerning the relevancy of legal opinion testimony, their argument again goes to contested case scenarios as opposed to rulemaking proceedings. To the extent that any issues have been raised concerning the qualifications of either of these witnesses, a review of their backgrounds and educations proves that both were qualified and that their testimony was appropriate in the record under consideration here. The objections are, therefore, overruled and the testimony of Mr. Shooshan and Mr. Busch is admitted.

IV. STAFF'S PROPOSED RULE

Ms. Rettle testified that in May of 1992, the Universal Telephone Service Protection Law of 1985 ("Act"), including Section 13-507, was amended. On June 10, 1992, the Commission passed a resolution to initiate this docket "to develop rules for the implementation of Section 13-507, including, but not limited to, cost apportionment, cross subsidization, the definition of long-run service incremental costs, and the aggregate revenue test." She noted that in response to the resolution, Staff held numerous workshops to discuss the implementation of the amendments to the Act. The rule which she was sponsoring had undergone several changes in an effort to achieve consensus among Staff and the various parties on as many issues as possible. The Commission notes that the rule was also amended several times during the hearings held in this cause. The discussion which follows is confined to the rule as appended to Staff's initial brief, as opposed to ICC Exhibit No. 1.01 which was the original proposed rule.

Staff's proposed rule consists of 11 sections. It is applicable only to carriers providing both competitive and non-competitive services, except the class of carriers specifically exempted under Section 13-504(b) of the Act which consists of local exchange telecommunications carriers having fewer than 25,000 subscriber access lines. The rule adopts the definition of a new term, "long-run service incremental cost" ("LRSIC") as opposed to the term "long-run marginal cost" which was used in the previous version of the statute. LRSIC is defined as:

> the forward-looking additional cost(s) incurred by the telecommunications carrier ("Carrier") to provide the entire output of a service, including additional resources such as labor, plant, and equipment. LRSIC does not include any costs, including common expenses, that would not be avoided if the entire output of the service were not produced.

LRSIC utilizes the concept of forward-looking costs in an effort to assure that incumbent carriers' costs are reflective of the costs that would be incurred by an efficient new entrant into the market. The underlying assumption is that a carrier's non-competitive services are not subsidizing its competitive services as long as its competitive services are priced at or above the level that a new entrant into the non-competitive market would price its services in order to cover its costs.

Staff's rule sets forth subsidy tests which provide that: a service is not being subsidized if the total revenue resulting from the service equals or exceeds the long-run service incremental costs of providing that service; and that a group of services is not being subsidized if the total revenue resulting from the group of services equals or exceeds the long-run service incremental costs of providing that group of services. A LRSIC study is intended to reflect costs using current least-cost technology and any LRSIC study which does not employ least-cost technology would not be consistent with the requirements of Staff's proposed rule. The rule adopts a cost causation principle as follows: Costs must be attributed to individual services or groups of services if the costs are brought into existence as a direct result of providing the service or a group of services or the costs are avoided if the service or a group of services is not provided.

The Staff's proposed rule requires LRSIC filings under the following circumstances: for the service when a carrier offering or providing non-competitive services files a tariff to reclassify a previously non-competitive service as competitive; for the service when a carrier offering or providing non-competitive services files a tariff classifying a new service as competitive; for facilities and functionalities that are not specifically tariffed and are utilized in providing a service subject to the requirements of Section 13-505.1 of the Act, when a tariff for a subject service is filed; for all non-competitive services in any proceeding under Section 13-506.1 of the Act to implement an alternative form of regulation; for all services for purposes of the aggregate revenue test as described in Section 791.200 or for any service when the Commission requests a LRSIC study in order to establish just and reasonable rates for such service. The rule provides a waiver of the requirement to provide a LRSIC study under some circumstances which will be discussed more fully later in this order.

The Staff's proposed rule also provides for an aggregate revenue test for competitive services. The competitive services of a carrier that provides both competitive and non-competitive services must provide revenues which equal or exceed the sum of the LRSICs of all competitive services less the LRSICs of non-competitive tariffed elements imputed into the cost of services subject to imputation; plus the sum of the imputed costs of the non-competitive tariffed elements that are inputs to competitive services subject to imputation; plus the common overhead expenses and residual revenue requirement that are to be allocated to competitive services pursuant to a formula referred to as the "relative LRSIC method." The formula is based upon the ratio of: a) the sum of the LRSIC's of all competitive services, minus the LRSIC's of non-competitive tariffed elements imputed in the costs of services that are subject to imputation and b) the sum of the LRSIC's of all competitive and non-competitive services of the carrier. The aggregate revenue test must be provided in any proceeding approving, implementing or evaluating an alternative form of regulation under Section 13-506.1 of the Act; in a general rate case; in a proceeding involving the introduction of a new competitive telecommunications service; in a proceeding to reclassify a non-competitive telecommunications service to competitive; and in any other proceeding permitting, approving, investigating or establishing rates, charges, classifications or tariffs for telecommunications services, as necessary. The rule provides an 18-month period after which telecommunications carriers with more than 25,000 access lines but gross annual revenues of less than $100 million (only ICTC and Alltel fit this description) must comply with various portions of the rule.

V. CONTESTED PROVISIONS

The parties to this docket generally recognize the need for a rulemaking to implement the legislative changes in Section 13-507 of the Act. They are all largely supportive of Staff's proposed rules with certain exceptions. Contested provisions of Staff's proposed Part 791 and alternative proposals are considered in this section. Each section is preceded by relevant portions of Staff's proposed rule.

Before turning to a discussion of the contested issues, one common thread which runs throughout the parties' arguments must be dispensed with to avoid reiterating it in each discussion of each disputed section. Throughout much of Staff's presentation of this case, it indicated that it was relying upon the reasoning of the Commission in the order on remand and the reasoning of the Appellate Court in IBT II as a basis upon which to develop many of the rules under consideration here. Centel, GTE, and ICTC have all pointed out repeatedly that IBT II was a rate case, in which the Commission had not indicated its intention to establish policy and as such, was inappropriately relied upon by Staff as authority in developing the rule under consideration here.

To the extent that Staff has relied upon the order on remand and IBT II as compelling authority for the development of this rule, such reliance is misplaced. The language and intent of the Commission in the order on remand was explicit in its pronouncement that the decision was based upon the record of that case, and was specific to Illinois Bell. The order clearly stated that it was not to be interpreted as a generic Commission policy for the treatment of cost of service issues.

A. Aggregate Revenue Test

Centel, ICTC, Alltel, and GTE all raise arguments concerning aspects of the aggregate revenue test as proposed by Staff in Section 791.200 of the Rule. All parties seem to agree that some sort of aggregate revenue test is required by Section 13-507 of the Act. The areas of contention involve when the test must be performed, the allocator that is to be used in performing the test, whether what has been described as the residual revenue requirement must be allocated and whether it is appropriate to waive certain requirements of the rule when conducting the test.

i. Filing Requirements

Staff's proposed Section 791.200 provides, in pertinent part:

b) The aggregate revenue test shall be provided in the following proceedings:

1) In any proceeding approving, implementing, or evaluating an alternative form of regulation under Section 13-506.1 of the Act;

2) In a general rate case;

3) In a proceeding involving the introduction of a new competitive telecommunications service;

4) In a proceeding to reclassify a non-competitive telecommunications service to competitive;

5) In any other proceeding permitting, approving, investigating, or establishing rates, charges, classifications, or tariffs for telecommunications services, as necessary.

Centel argues that Sections 3, 4 and 5 of Staff's proposed Section 791.200(b) should be deleted and that a new Section 3 should be added as follows:

3) when the Commission requests an aggregate revenue test in order to establish just and reasonable rates which insure that there is no subsidy of competitive services by non-competitive services.

Centel argues that the language proposed in clauses 3 and 4 of Section 791.200 goes well beyond the statutory mandate and that absent some positive determination by the Commission that there is a need for the performance of the aggregate revenues test to assure that there is no cross-subsidy of competitive services by non-competitive services, on a case-by-case basis, there should be no general filing requirement in service classification proceedings. Centel notes that any new competitive service must, pursuant to Section 13-502(c) of the Act, be priced such that the tariffed rates and charges equal or exceed the average LRSIC of the service. Centel goes on to argue that when a new competitive service is offered by a LEC, the Commission does not need the aggregate revenue test to determine whether there is a likelihood that the new service may be subsidized by non-competitive services. Since, in Centel's view, the thrust of Section 13-507 is preventing the subsidization of competitive services by non-competitive services and this is accomplished by pricing new or reclassified competitive services at or above LRSIC, there is no need for the company to go through the time and expense of filing LRSIC studies for all services in single-service specific scenarios.

Centel goes on to argue that the broad language of the rule would make it possible for an actual or potential competitor of a LEC to force the LEC to incur the expense of developing LRSIC studies for all services simply by filing a complaint against a LEC challenging the classification of a non-competitive service. Because the rule is, in Centel's view, beyond the statutory mandate, Centel urges that subparagraphs 3, 4 and 5 be replaced by their proposed new Section 3.

Centel also has concerns about the phrasing of subparagraph b(5) which provides for the performance of an aggregate revenue test "as necessary" in proceedings involving rates, charges, classifications or tariffs. Centel believes that the proposed rule should be specific as to who makes the decision as to whether a test is required. To that end, Centel has submitted the previously-referenced language which would require the Commission to make the decision as to whether a test is required.

Alltel and ICTC also object to Staff's requirement that the aggregate revenue test be provided upon the filing of a new competitive service or the reclassification of an existing non-competitive service as competitive. Alltel notes that the evidence adduced during these hearings was that the cost of developing LRSIC studies for all services offered by a LEC was extremely high. Alltel notes that Staff has recognized the extent of the expenses by exempting for 18 months, carriers with more than 25,000 access lines with gross annual revenues of less than $100 million, from certain portions of its own rule.

Alltel further argues that the rule would create barriers to the provision of competitive services or the reclassification of non-competitive services as competitive in that the aggregate revenue test would be triggered anytime such a proceeding were docketed. Alltel goes on to argue that the rule could be used by competitors as a tool to squeeze LECs out of a soon to be competitive market through the filing of a complaint challenging the classification of its services as non-competitive. The filing of such a complaint would trigger the aggregate revenue test requirement and would thus require the challenged LEC to perform LRSIC studies of all of its services. In such a situation, the LEC might decide not to offer or to discontinue offering the competitive service if the spread between the revenues the LEC derives from the service and the cost that it will incur in performing LRSIC studies is not sufficiently great. During testimony, Staff witness Rettle conceded that competitors could have an economic incentive to take actions that would result in the decision by a LEC not to offer a service.

GTE also opposes the performance of an aggregate revenue test in any proceeding other than general rate proceedings, where the LRSIC of a new competitive service exceeds 25 percent of the total LRSICs of all competitive services (from the last filing for competitive services), and when an aggregate revenue test has not been performed in the last five years. GTE notes that Section 13-507 mandates performance of an aggregate revenue test in general rate proceedings and other proceedings necessary to insure against the subsidy of competitive services by non-competitive services. GTE feels that the Commission has discretion to determine when such tests will be performed and that the aggregate revenue test is unnecessary to prevent subsidies as long as a LRSIC study shows that the revenues of a service exceeds its LRSIC. GTE reiterates many of the arguments referenced above relating to the ability of competitors to impede or delay LEC competition through the filing of complaints or other matters which would be docketed and result in a proceeding that would require the satisfaction of an aggregate revenue test.

Staff, LDDS, AT&T and MCI all support Section 791.200(b) as written. Their basic argument is that Section 13-507 requires an apportionment in general rate cases and other proceedings including "service classification proceedings" where necessary to insure against subsidies. In their point of view, the logical end point of the apportionment process is the aggregate revenue test, which, as Staff puts it, is necessary "to determine that the new service which will cause the company to incur costs also receives enough revenues to pass the Aggregate Revenue Test."

The Commission has examined Staff's proposed rule, Centel's proposed modifications, and the arguments of all parties and finds that Sections 3, 4 and 5 of proposed Section 791.200(b) are consistent with the statute's goal of insuring against cross-subsidies of competitive services by noncompetitive services. Telecommunications service providers offering new competitive services or reclassifying non-competitive services as competitive, must provide the Commission with LRSIC studies as part of their filings. Section 791.90 of Staff's proposed rule provides that services or groups of services are not being subsidized if revenues equal or exceed the LRSIC of providing the service or group of services. However, compliance with Section 13-507 of the Act also requires that a carrier demonstrate that a proper and reasonable level of common expenses are apportioned to competitive services in the aggregate and noncompetitive services in the aggregate.

The directive in Section 13-507 is that the Commission shall not allow a subsidy of competitive services or non-regulated activities by non-competitive services in any proceeding dealing with rates, charges, classifications, or tariffs. The statute requires the apportionment of shared facilities and expenses between non-competitive services in the aggregate and competitive services in the aggregate and the establishment of rates or charges for the non-competitive services which reflect the portion of shared facilities or expenses found to be properly and reasonably apportioned to those services. The statute requires that "an apportionment of facilities or expenses between competitive and non-competitive services, together with any corresponding rate changes, shall be made in general rate proceedings and in other proceedings, including service classification proceedings, that are necessary to insure against any subsidy of competitive services by non-competitive services." The Commission agrees with Staff's interpretation of the statute regarding the proceedings in which the aggregate revenue test should be provided.

The Commission is cognizant of the fact that there may be occasions when an aggregate revenue test is necessary in a situation which cannot be currently contemplated. The Commission agrees with Centel's arguments and therefore subsection 5 to Section 791.200(b) has been revised which will allow a party, upon motion, to request a Hearing Examiner in a docketed case to require the filing of an aggregate revenue test. By establishing the deliberative process as an adjunct to the mandatory filing of the aggregate revenue test in subsections 3 and 4, the discretionary powers granted in proposed subsection 5 accommodates most of the concerns raised by those objecting to this portion of the rule while still requiring the filing of an aggregate revenue test where appropriate. Revised subsection 5 shall read as follows:

5) Not withstanding the provisions of subsections (b) (1), (2), (3) and (4) of this Section, and upon good cause shown, the aggregate revenue test shall be provided, upon motion of a party and order of the Hearing Examiner, in any other proceeding approving, investigating or establishing rates, charges, classifications or tariffs for telecommunications services offered by a telecommunications service provider that provides both competitive and non-competitive services. Any motion requesting an aggregate revenue test shall be filed within fourteen days of the docketing of the underlying proceeding. Responses to such motions shall be filed within seven days of the filing of the motion. Failure to file the motion within fourteen days of the docketing of the proceeding shall be an independent ground for denying the motion. Failure to file responses within seven days of the filing of the motion shall be an independent ground for granting the motion. Factors to be considered in determining the propriety of granting such a motion shall include but not be limited to:

A) The length of time elapsed since the LEC last filed an aggregate revenue test;

B) The revenues projected to be generated by the service or services under consideration compared with total company service revenues;

C) The number of competitive and non-competitive services currently being offered by the LEC; and

D) The cost associated with performing the aggregate revenue test;

ii. <u>Residual Revenue Requirement</u>

Staff's proposed Section 791.200 provides, in pertinent part:

Aggregate Revenue Test for Competitive Services

a) The competitive services of a carrier that provides both competitive and non-competitive services shall provide revenues which equal or exceed the sum of the following:

3) The common overhead expenses and the residual revenue requirement that are to be allocated to competitive services pursuant to the relative LRSIC method.

Centel, GTE, ICTC and Alltel all oppose the apportionment of the residual revenue requirement as required by Section 791.200(a)(3). In their briefs, all four parties raised arguments substantially similar to the arguments raised by the Intervenors in IBT II. The arguments are as follows: 1) the calculation and apportionment of the residual revenue requirement is unnecessary to prevent impermissible cross-subsidies or to satisfy the cost apportionment requirements of the Act; 2) the residual revenue requirement is not required by the Act or by past court or Commission decisions; 3) the residual revenue requirement is inconsistent with the competitive service pricing standard set forth at Section 13-502(c) and is in effect a fully-distributed costing method of apportioning common costs; 4) the residual revenue requirement is an excessive burden on competitive service offerings by LECs and incompatible with the competitive goals enunciated in Section 13-103 of the Act; 5) the residual revenue requirement is a computational exercise as opposed to a term with any real economic meaning; 6) there is no showing that any of the costs associated with the residual revenue requirement are caused by or incurred for competitive services; and 7) the computation of the residual revenue requirement is unduly costly and burdensome.

Staff, ICPA, MCI, AT&T, Cook County and CUB all support the inclusion of the residual revenue requirement as part of the aggregate revenues test.

In IBT II, the court found that the Commission had acted properly in apportioning both common overheads and the residual revenue requirement between IBT's competitive and non-competitive services. Section 13-507, as it existed at the time of IBT's tariff filing, contained but two mandates. First, in a proceeding dealing with a non-competitive offering by a company offering both non-competitive and competitive services, the Commission was to assure that the non-competitive services did not subsidize the competitive services. Second, in the event that the competitive and non-competitive services had shared facilities and expenses, the rates established for the non-competitive services were to reflect only that portion of such facilities and expenses found to be reasonable and proper. The remaining powers conferred by the statute were all discretionary with the Commission.

Section 13-507 has now been painted in much broader strokes. The statute now applies to proceedings dealing with both competitive and non-competitive services. The Commission "shall" apportion shared facilities and expenses between competitive services in the aggregate and non-competitive services in the aggregate. The apportionment "shall" be made in rate proceedings and other proceedings necessary to insure against the subsidization of competitive services by non-competitive services. Finally, the Commission is to assure that the aggregate gross revenues of all competitive services are equal to or greater than the sum of their LRSIC's plus the value of their apportioned facilities and expenses.

In addition to the numerous new mandates, the Legislature also expanded the discretionary powers of the Commission by (among other things) specifically permitting the establishment of a procedure for apportioning shared facilities and expenses between competitive and non-competitive services, with common overheads being given as an example.

Turning to the Order on Remand and the decision of the Court in IBT II, both recognized that the residual revenue requirement was a non-economic, computational factor which reflected the lower ongoing costs of providing services brought about by technological advancement. In short, it is generally less expensive to provide service on a forward-looking basis than it is on an embedded or sunk-cost basis. In IBT II, the court recognized and accepted the Commission's finding in the Order on Remand that the costs included in the residual revenue requirement were similar to common overheads in that they may well have no causal connection to the provision of competitive services. The court, in construing the older, more limited statute, found that treatment of the residual revenue requirement as the subject of apportionment between competitive and non-competitive services was within the Commission's discretion based upon the record in that case. The treatment of embedded costs related to investment in technology which has become uneconomic is a significant issue which all commissions and providers of competitive and noncompetitive services will be forced to confront as we move toward the development of a truly competitive marketplace for telecommunications services. However, there is insufficient evidence in the record of this rulemaking to develop a policy for the treatment of this investment.

The Commission is of the opinion that the residual revenue requirement is not appropriately included as a portion of the aggregate revenues test. Therefore, it is the determination of this Commission that 60 days after the release of the final Order in this rulemaking, that a generic proceeding be opened to investigate the source and appropriate treatment of those embedded costs which have been characterized in this docket as comprising the "residual revenue requirement."

iii. Relative LRSIC Allocator

Staff's proposed Section 791.200 provides in pertinent part:

> 3) . . . . The portion of common overhead expenses and residual revenue requirement that shall be recovered by competitive services in the aggregate shall be equal to the ratio of the amount in subsection (a)(3)(A) to the amount in subsection (a)(3)(B):
>
> A) The sum of the LRSIC's of all competitive services, less the LRSIC's of non-competitive tariffed elements that are imputed into the costs of services subject to imputation; and
>
> B) The sum of the LRSIC's of all non-competitive and competitive services of the carrier.

As noted previously in this Order, numerous methods were advanced for the apportionment of common expenses as required by Section 13-507. The two methodologies that raised the most discussion were the relative LRSIC and the relative revenues allocators. The allocation of revenues based upon the ratio of LRSICs is termed the "relative LRSIC method" or "relative LRSIC allocator." Centel, GTE, and ICTC all argue that the Commission should reject the portion of Staff's proposed rule that relates to the use of a relative LRSIC methodology in performing the aggregate revenue test. The arguments raised are virtually identical to the arguments propounded by Intervenors in the immediately preceding section of this order against the apportionment of the residual revenue requirement. All three propose that the Commission adopt a relative revenues allocator which would look to the ratio of the revenues generated by competitive services to total revenues and allocate or apportion shared facilities and expenses based upon that ratio. Centel provided proposed language to this effect in its original brief.

Unlike the relative revenue allocator which is derived from the revenues of competitive and non-competitive services, the relative LRSIC allocator is based on cost of service studies. Therefore, it is less susceptible to variations and complications due to changes in market conditions.

Staff, ICTA, MCI, AT&T, ICPA and CUB all support the relative LRSIC allocator. The arguments against the use of the relative revenues allocator are set forth in the reply brief of ICPA. According to the ICPA, the relative revenue allocator is faulty because it predetermines, by definition, that if the revenues generated by a service are low then the cost of that service must, accordingly, be low. Therefore, the ICPA contends, the relative revenues allocation method as a basis for the aggregate revenue test predetermines the outcome of the test.

The purpose of the aggregate revenues test is to determine whether competitive services are priced at a level that covers the costs of providing the services. Unless the Commission were to require fully distributed cost studies ("FDC") some method must be adopted to allocate shared costs and facilities between competitive and non-competitive services. In the final analysis, the choice of a methodology is a matter of judgement for the allocation of the costs common to the provision of both competitive and noncompetitive telecommunications services.

Section 13-507 specifically calls for the establishment of appropriate methods for calculating long-run service incremental costs and, where appropriate, apportioning the value of facilities utilized and the expenses incurred to provide both competitive and noncompetitive services between competitive and non-competitive services in the aggregate. Apportioning these shared costs through the use of the relative LRSIC methodology would be compatible with Section 13-507 of the Act. However, the Commission is cognizant that, in some instances and for some carriers, the relative LRSIC allocator may be cost prohibitive and impose an undue regulatory burden. In addition, since the evidence in the record indicates that methodologies apportioning common costs may not accurately reflect cost causation, the Commission prefers not to preclude considering superior methodologies should they arise. Therefore section 791.200 contains a waiver for using the relative LRSIC allocator which provides for the following:

C) The carrier may file a petition pursuant to 83 Ill. Adm. Code 200 for a waiver of the requirement to use the methodology required by subsection (a) (3) to apportion costs common to the provision of both competitive and noncompetitive services. The waiver shall be granted within 90 days after the filing of a petition for waiver if the carrier can demonstrate that using the methodology required by subsection (a) (3) would be cost prohibitive or, in accordance with subsection (b) (3), would prevent a carrier from offering the new competitive service. To comply with Section 13-507 requiring a telecommunications carrier providing both competitive and noncompetitive services to recover the aggregate LRSIC's of its competitive services plus a proper and reasonable apportionment of common costs, a substitute allocator is required. The burden of proving the reasonableness of a substitute common cost allocation methodology shall be upon its proponent. The Commission reserves the right to authorize the use of superior methodologies apportioning common costs should they arise.

B. Least Cost Considerations

Staff's proposed Section 791.30 provides in pertinent part:

> Cost Causation Principle
>
> Costs shall be attributed to individual services or groups of services based on the following cost causation principle. Costs are recognized as being caused by a service or group of services if:
>
> a) The costs are brought into existence as a direct result of providing the service or group of services, or
>
> b) The costs are avoided if the service or group of services is not provided.

MCI and Illinois Bell have proposed language which would modify Sections 791.30 of Staff's proposed rule. The modification is an attempt to deal with the fact that many LECs are now contemplating the installation of fiber optic cable as part of their loop plant. Much of the evidence and testimony in this cause went to the fact that while fiber optic cable is much more expensive to install, it is much less expensive to operate on a per unit basis than copper wire. Bell and MCI propose a modification to the cost causation section of Staff's rule as follows:

> the cost of a resource or facility shared by separate services is caused by a single service to the extent that the shared resource or facility is purchased in a larger amount or sooner because the single service is offered by the firm.

Staff initially opposed any alteration to the definition of cost causation, out of fear that the proposed alteration would arbitrarily limit the amount of an investment that could be recovered from existing services that would also use the investment. In Staff's view, this is simply an attempt to make a major policy decision well beyond the scope of the rulemaking here. The decision is whether the deployment of a major new technology (e.g., fiber) that would make new services (e.g., video) possible, should be borne entirely by the new services, even if existing services will make use of the new technology. Staff notes that while each competitive service should be priced so that it provides revenues that equal or exceed its LRSIC, local residential services, because of universal service mandates at both the federal and state levels, have been typically priced at levels below LRSIC. In Staff's view, the Commission may appropriately decide that the cost of fiber installation should be borne in large part or in whole by the competitive services it will support or by the non-competitive services that will also make use of it, but that this rulemaking is not the place to make that decision. Upon review of the language suggested by MCI and Bell, Staff amended its position and in its reply brief indicated that Staff could accept the inclusion of the proposed language with a minor modification to read as follows:

> b) the cost of a resource or facility shared by separate services is caused by a single service to the extent that <u>additional costs are incurred because</u> the shared resource or facility is purchased in larger amount or sooner because the single service is offered by the firm.

Staff's reply brief indicates that although it is willing to accept some change in the cost causation portion of its rule, it does not wish its acquiescence to mean that it has taken any position regarding the Commission's ultimate determination as to which set of ratepayers, competitive or non-competitive, should bear the proportionate increase in costs if a firm's least cost technology were to change dramatically because of a decision to employ new technology. Cook County, LDDS and ICPA have joined in MCI and IBT's proposal while ICTA has argued against Staff's proposed cost causation principle.

The language proposed does little to resolve and much to complicate the issues it is intended to address. The concept of purchases in "larger amounts" and "sooner" are so fraught with ill-definition that their inclusion in a rule would not only increase the likelihood of litigation and argument, but might well be found to be too vague to pass legislative muster once this rule is proposed to the Joint Committee on Administrative Rules. The cost causation principle as found in Staff's original rule provides a sufficient basis upon which to decide cost allocation issues. It is also consistent with the definition of LRSIC found elsewhere in the rule and is adopted by the Commission without modification.

C. Demand for Service

Staff's proposed Section 791.40(c)(4) provides, in pertinent part:

Methods and Assumptions

c) Since LRSIC represents a measurement of the costs to a carrier of providing a service or group of services on a prospective basis over a planning horizon long enough to have no sunk inputs or costs, when determining the LRSIC of a service or a group of services, use of the following assumptions and methods shall be presumed reasonable:

4) The LRSIC study shall reflect the demand for the service that is affected by the business or regulatory decision at hand.[1] If the LRSIC study is for a new service, the study shall include all demand forecasts used in the computations.

AT&T, MCI and IBT have proposed changes to the portion of Section 791.40(c)(4) which describes the demand for the service that should be reflected in a LRSIC study.

AT&T proposed that the first sentence of Staff's proposed rule be modified to read: the LRSIC study shall reflect the demand for the entire service that is affected by the business or regulatory decision at hand. MCI and IBT propose that the first section in Section 791.40(c)(4) be stricken and be replaced with the following sentence: the demand forecast used in the LRSIC study shall reflect the entire output of the service.

In its reply brief, Staff has indicated an ambivalence as to which proposal should be adopted but shows a slight inclination for the first proposed modification. Since none of the parties have been able to point out any major difference that might result from accepting one proposal over the other, we will accept Staff's acquiescence in the change proposed by AT&T, noting that this

[1]It is assumed, but by no means certain, that this language is intended to address the decision by a LEC to reclassify an existing service or offer a new service as either competitive or non-competitive, and the manner in which that determination will affect the ensuing demand for the service.

change was also agreed to during cross-examination of Staff witness Rettle.

D. Waivers

Staff's proposed Section 791.100 provides, in pertinent part:

Required LRSIC Filings

a) A LRSIC study shall be filed with the Commission under the following circumstances:

4) For all non-competitive services in any proceeding under Section 13-506.1 of the Act to implement an alternative form of regulation;

5) For all services for purposes of the aggregate revenue test as described in Section 791.200; or

b) The carrier may file a petition pursuant to 83 Ill. Adm. Code 200 for a waiver of the requirement to provide a LRSIC for all services as required by subsection (a)(4) or (a)(5) above. The waiver shall be granted on a service-by-service basis within 90 days after the filing of a petition for waiver if the carrier demonstrates that the cost of performing a LRSIC for a service is unreasonable based on the revenues currently being received from such service or projected to be received from offering such service. The Commission shall not grant a waiver if the service is competitive or if a LRSIC study is required by subsection (a)(1), (a)(2), or (a)(3) above. A petition for waiver shall be deemed granted if no order granting or denying the petition is entered by the Commission within 90 days after the filing of the petition.

c) To comply with Subsections (a)(4) and (a)(5) above, a substitute for the LRSIC's of services that qualify for the waiver is required. The LRSIC of a service which qualifies for the waiver can be estimated by assuming that the service has a contribution margin similar to that of the carrier's other services that provide a positive contribution, given the service's revenues and the revenues and LRSICs of other services. Another reasonable substitute for the LRSIC of a service qualifying for this waiver is its revenues.

Section 791.100 provides a number of circumstances under which LRSIC studies must be filed with the Commission. Section 791.100(b) provides that a carrier may file a petition seeking the waiver of the requirement to provide LRSICs for all services when required by subsections a(4) or a(5). In order to be granted the waiver, the carrier must demonstrate that the cost of performing a LRSIC study for a service or all services is unreasonable based upon the revenues currently being received from such service or projected to be received from such service. Section 791.100(c) provides that carriers may satisfy the requirements of subsections a(4) and a(5) by assuming that the service has a contribution margin similar to that of the carrier's other services that provide positive contribution, given the services and the revenues and LRSICs of other services. The rule goes on to provide that an alternative substitute for the LRSIC of a service is its revenues.

Cook County opposes the waiver language because of its belief that the waiver will allow a carrier to circumvent the requirements of complying with the aggregate revenue test. Cook County argues that the assumptions underlying the estimates of LRSICs allowed by Section 791.100(c), do not comport with economic reality in that not all services exhibit the same demand characteristics, cost factors or profit levels and thus different services will reflect different contribution margins which are not susceptible to estimation and do not support the assumption found in subsection (C). ICTA joined in Cook County's objection to the waiver provisions but the exact nature of its objection is unclear. LDDS and ICPA also apparently oppose any exemptions from any of the rules for the mid-size LECs, based upon the negative inference raised by the legislature's having specifically exempted telecommunications carriers with no more than 25,000 subscriber access lines from the operation of Section 13-507. To their way of thinking, this requires the rule in its entirety to be applied to all other carriers in the state.

Staff and IBT both argued in favor of a provision for "waiver" of the requirement for LRSIC studies of non-competitive services under an alternative regulation plan and for purposes of the aggregate revenue test. IBT argues that because Section 13-507 provides that the Commission "may" order a telecommunications carrier to conduct a long-run service incremental cost study that it can be inferred that waiver of a LRSIC study is within the Commission's discretion. The Commission notes, however, that the statute itself makes no express reference to "waiver" that would support deviation from the LRSIC requirement otherwise imposed by Section 13-507.

However, the Commission is of the opinion that it is more important as a matter of policy to insert consistency and certainty into any rule on cost of service. Given the exemptions already allowed under Section 13-507 of the Act and the waiver in section 791.200, it is unnecessary to allow for further exemptions in this rule. Therefore, Staff's proposed Section 791.100 (b) and (c) has been deleted. In addition, Staff's proposed Section 791.100 (a) 5) has been deleted because of the waiver contained in Section 791.200.

VI. FINDINGS AND ORDERING PARAGRAPHS

The Commission, having considered the entire record and being fully advised of the premises, is of the opinion and finds that:

(1) the Commission has jurisdiction over the parties hereto and of the subject matter of this proceeding;

(2) the statements of fact and conclusions reached in the prefatory portion of this order are supported by the record herein and are hereby adopted as findings of fact;

(3) the proposed rule, 83 Ill. Adm. Code 791, Cost of Service, as set forth in the attached Appendix, should be submitted to the Secretary of State for publication in the Illinois Register thereby initiating the first notice period under Section 5-40 of the Illinois Administrative Procedure Act;

(4) all objections, petitions or motions in this proceeding which remain unresolved should be considered resolved consistent with the ultimate conclusions contained in this order.

(5) the Commission shall open a generic proceeding 60 days from the entry of the final Order herein, to investigate the source and appropriate treatment of those embedded costs which have been characterized in this docket as comprising the "residual revenue requirement."

IT IS THEREFORE ORDERED that the proposed 83 Ill. Adm. Code 791, as set forth in the attached Appendix, shall be submitted to the Secretary of State for publication in the Illinois Register, thereby initiating the first notice period required by Section 5-40 of the Illinois Administrative Procedure Act.

IT IS FURTHER ORDERED that 60 days after the release of the final Order in this rulemaking, that a generic proceeding be opened to investigate the source and appropriate treatment of those embedded costs which have been characterized in this docket as comprising the "residual revenue requirement."

IT IS FURTHER ORDERED that all objections, petitions or motions in this proceeding which remain unresolved are hereby resolved consistent with the ultimate conclusions contained in this order.

IT IS FURTHER ORDERED that subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is not final and is not subject to the Administrative Review Law.

By order of the Commission this 17th day of August, 1994.

(SIGNED) Dan Miller

Chairman

(S E A L)

92-0211
APPENDIX A

TITLE 83: PUBLIC UTILITIES
CHAPTER I: ILLINOIS COMMERCE COMMISSION
SUBCHAPTER f: TELEPHONE UTILITIES

PART 791
COST OF SERVICE

Section

AUTHORITY: Implementing Section 13-507 and authorized by Section 10-101 of the Public Utilities Act (Ill. Rev. Stat. 1991, ch. 111 2/3, pars. 13-507 and 10-101, as amended by P.A. 87-856, effective May 14, 1992)[220 ILCS 5/13-507 and 10-101].

SOURCE: Adopted at Ill. Reg. , effective .

Section 791.10 Carriers Subject to Cost Rules

This Part applies to telecommunications carriers providing both competitive and noncompetitive services, except those carriers that are specifically exempted in Section 13-504(b) of the Act. See Sections 13-202, 13-209, and 13-210 of the Public Utilities Act ("Act") (Ill. Rev. Stat. 1991, ch. 111 2/3, pars. 13-202, 13-209, and 13-210, as amended by P.A. 87-856, effective May 14, 1992)[220 ILCS 5/13-202, 13-209, and 13-210].

Section 791.20 Terminology

a) The long-run service incremental cost of a service ("LRSIC") is the forward-looking additional cost(s) incurred by the telecommunications carrier ("carrier") to provide the entire output of a service, including additional resources such as labor, plant, and equipment. Long-run service incremental cost excludes any costs, including common costs, that would be incurred if the service is not produced.

b) Long-run costs are the economic costs over a planning horizon long enough so that there are no sunk inputs or costs.

c) Forward-looking costs are the costs to be incurred by a carrier in the provision of a service. These costs shall be calculated as if the service were being provided for the first time and shall reflect planned adjustments in the firm's plant and equipment. Forward-looking costs ignore embedded or historical costs; rather, they are based on the least cost technology currently available whose cost can be reasonably estimated based on available data.

d) Volume-insensitive costs are costs that do not vary with changes in output.

e) Volume-sensitive costs are costs that vary with changes in output of a particular service.

f) A group of services that is referenced in this Part consists of those services that share a common network technology, element, or business function that is necessary and unique to the provision of all services in the group, and where that common network technology, element, or business function cannot be attributed to any one service or subgroup of services in the group.

g) LRSIC of a group of services: Where additional resources are used in common and are necessary to provide a group of services, the long-run service incremental cost of that group of services includes the cost caused by the portion of such additional resources used solely by that group of services, including the LRSIC's of the individual services. Resources include labor, plant, and equipment.

h) Common costs are those costs that a carrier must incur in order to operate that are not directly attributable to any particular service or to any group of services smaller than the group of services consisting of all the services of the carrier.

i) Ad valorem taxes are those which are levied on the value of plant as determined by a governmental taxing authority (e.g., local property taxes levied against telephone plant).

j) Capital costs are the recurring costs that result from expenditures for plant facilities which are capitalized. These annual capital costs include depreciation, cost of capital (return), and income taxes.

k) Expenses are the cost or resources consumed in the production of revenue that are expensed rather than capitalized in accordance with the Uniform System of Accounts applicable to the carrier (83 Ill. Adm. Code 710).

l) Investment is a long-term capital asset (normally with a life exceeding one year) which is depreciated rather than expensed in accordance with the Uniform System of Accounts applicable to the carrier (83 Ill. Adm. Code 710).

m) Recurring costs are costs which will continue throughout the revenue producing life of the service. They include capital costs and expenses.

n) Usable capacity is the maximum physical capacity of the equipment or resource less any capacity required for maintenance, testing or administrative purposes.

Section 791.30 Cost Causation Principle

Costs shall be attributed to individual services or groups of services based on the following cost causation principle. Costs are recognized as being caused by a service or group of services if:

a) The costs are brought into existence as a direct result of providing the service or group of services, or

b) The costs are avoided if the service or group of services is not provided.

Section 791.40 Methods and Assumptions

a) The methodology and assumptions in this Part apply to cost studies required by this Part and the Act.

b) Nothing in this Part shall require a carrier in any LRSIC study to account for, allocate, apportion, assign or reflect costs in any manner inconsistent with the Uniform System of Accounts (83 Ill. Adm. Code 710) or the Federal Communications Commission's Uniform System of Accounts (47 CFR 32).

c) Since LRSIC represents a measurement of the costs to a carrier of providing a service or group of services on a prospective basis over a planning horizon long enough to have no sunk inputs or costs, when determining the LRSIC of a service or a group of services, use of the following assumptions and methods shall be presumed reasonable:

1) The LRSIC study shall be based upon the locations of, and planned locational changes to, the existing network configuration;

2) To the fullest extent possible, volume-insensitive costs shall be directly attributed to particular services or, where shared by a group of services, to that group of services, consistent with the cost causation principle;

3) Volume-sensitive costs shall be directly attributed to the service that causes the costs, consistent with the cost causation principle;

4) The LRSIC study shall reflect the demand for the entire service that is affected by the business or regulatory decision at hand. If the LRSIC study is for a new service, the study shall include all demand forecasts used in the computations.

Section 791.50 Cost Study Component Presentation

All cost studies provided by a carrier shall specifically identify the components outlined in Section 791.60 when such components are incurred and directly attributable to the service being studied. Further detail on each component shall be provided where identified.

Section 791.60 General Cost Study Components

a) Service description. Each cost study shall include a definition of the service being studied. This definition shall be in terms of technical characteristics, functionality, application, targeted market, and availability. The elements of the service shall also be defined.

b) Demand Information. The carrier shall provide the demand figures and/or forecast(s) used in the LRSIC computations and an explanation detailing the explicit and implicit assumptions and methods used to derive the figures and/or forecast(s). Demand forecasts for new services shall reflect total demand for the service, averaged over the projected revenue producing life of the service.

c) Revenue life. Each cost study shall identify and provide a basis for the projected revenue producing life of the service or group of services.

d) Economic life. Each cost study shall identify and provide a basis for the projected economic life of the equipment involved in providing the service or group of services.

e) Input prices. Each cost study shall reflect input prices (e.g., the prices for materials, labor, and capital) that the carrier is actually expected to face. The carrier shall provide the underlying bases for projected changes in input price levels, using, wherever possible, projections based on market expectations and rates set in labor contracts. Where appropriate, costs shall be based on prevailing vendor prices or vendor prices under consideration that reflect volume discounts or term discounts off listed input prices. These discounts shall be reflected in the cost study.

f) Factors. Whenever any factors are used to estimate costs, such as maintenance or labor costs, the basis for those factors shall be described in an annual filing with the Director of the Telecommunications Section in the Public Utilities Division of the Illinois Commerce Commission. Factors shall be based upon historical costs only to the extent that it can be demonstrated that those historical costs are relevant to the study of forward-looking costs. Any deviations in individual cost studies from factors filed on an annual basis shall be identified and explained in each cost study.

g) Volume-insensitive costs. To the fullest extent possible, volume-insensitive costs shall be directly attributed to particular services or, where shared by a group of services, to that group of services.

h) Volume-sensitive costs. Volume-sensitive costs shall be directly attributed to the service that causes the costs.

i) The cost study shall include all relevant service-specific start-up costs, including installation costs.

Section 791.70 Investment-related Cost Study Components

a) Material. The material component of investment shall be based on the most recent vendor prices, reflecting applicable discounts and all applicable taxes, for the hardware and software resources required to provide the service. The carrier shall provide a breakdown of the material involved in providing the service.

b) Inventory and supply. The inventory and supply components shall reflect the costs to the company of inventory, administration, storage and delivery.

c) Labor investment. The labor investment component shall consist of the labor required to install and put into service capitol assets. The labor investment component shall be divided into two components, vendor-related and carrier-related labor investment. Vendor-related labor investment shall include billed installation and engineering. Carrier-related investment may be calculated based on either account averages or product specific plant engineering and installation hours. Total labor costs shall be computed by multiplying the account average or product specific work time by the appropriate labor hours. Hourly labor rates shall include the operational wages, benefits, paid absence, tools, and miscellaneous expenses.

d) Utilization factors. The utilization factor measures the usable capacity of a capital resource pursuant to the definition of usable capacity in Section 791.20(o). Investment shall be adjusted to reflect the usable capacity by dividing the dollar amount of investment by the utilization factor estimated pursuant to this Section.

Section 791.80 Annual Cost Study Components

a) Depreciation.

1) Depreciation shall represent the periodic recognition of investment cost as dictated by accounting rules (83 Il. Adm. Code 710). Depreciation costs for a service shall be computed based upon the projected life of plant at age zero underlying the depreciation rates most recently approved by the Commission. (For purposes of a cost study submitted in a rate proceeding which includes a depreciation represcription proposal, a telecommunications