efficient as possible. Competition will benefit the consumer because the incumbent LEC and its competitors must constantly provide the best possible quality, price and service in order to survive. If the federal Act taken as a whole, intends to increase local competition, then Section 252(D)(3) must be interpreted in a manner that is consistent with this intent.

It is clear that Congress intended that incumbent LECs would experience competitive pressure as competition increased. A view that the federal Act insulates the incumbent LEC from the harmful effects of competition is unreasonable. The problem with Ameritech's pricing proposal is that it immunizes it from the effects of competition. Ameritech's wholesale pricing methodology places the incumbent LEC in a win-win position. Under Ameritech's pricing scheme, which only removes avoided costs from the retail price to reach a wholesale price, the incumbent LEC will not suffer a loss of any profits as it loses market share to resellers. The resellers, in effect, become an outside sales force that will, if anything, generate an increase in gross sales for the incumbent LEC. With profits unaffected by loss of market share, competition would not exert any competitive pressure on the incumbent LEC. This result is simply inconsistent with the intent of the federal Act. Section 252(d)(3) of the federal Act must be interpreted on its own and in conjunction with the entire federal Act. In the context of the entire federal Act, this section allows this Commission the discretion to set a wholesale price in a manner that places some competitive pressure on the incumbent LECs as local competition increases, thereby creating effective competition.

Ameritech's argument that adoption of Staff's proposed methodology will cause a significant drop in revenues is not a convincing argument to support its own methodology. In reality, the opposite is true. Missing from Ameritech's numbers is the reduction in profit that its own proposal will inflict as competition increases. We believe that the reason that this number is missing is because there would be no net loss in profit to the incumbent LEC under Ameritech's proposal. Adoption of Ameritech's proposal, where loss of market share would have no impact on profit, would only create the illusion of competition. This would be inconsistent with the intent of the federal Act and the policy of this Commission to promote competition.

Ameritech's argument that contribution is cost recovery and not profit is unpersuasive. The Commission understands that some of the contribution that Ameritech receives is allocated to cover expenses. The Commission is not, however, removing the recovery of all contribution associated with the provision of wholesale services. In fact Staff's proposed methodology allows Ameritech a reasonable level of profit on its wholesale business. The loss in contribution occurs because the wholesale business is not and

should not be as profitable as the retail business. As stated above, this is because the incumbent LEC is providing less service as a wholesale provider.

This is also an issue of fairness. If a pro rata share of contribution is not included in the determination of wholesale rates, wholesale customers would pay a greater mark-up on incremental cost than would retail customers -- making wholesale more profitable than retail. This result would be unfair, as well as anti-competitive.

In addition, Staff's methodology should be applied on a "individual service element" basis rather than a "service family" basis. This approach avoids unnecessary and undesirable variation in the contribution margin between the corresponding wholesale and retail versions of the same service. This approach is also consistent with the federal Act, which describes the wholesale rate calculation methodology for "the telecommunications service requested...." Section 252(d)(3)(Emphasis added).

The Commission, accordingly, rejects AT&T's interim pricing proposal. AT&T's use of a uniform discount rather than a service-by-service discount would encourage cherry picking of the most profitable services. In addition, AT&T's proposal structures the wholesale/resale market in a way that guarantees that resale is profitable. This would not be consistent with this Commission's policy regarding competition. Competition should be encouraged only to the extent that it is economically feasible.

With respect to AT&T and MCI's proposal to price wholesale services at LRSIC, the Commission is of the opinion that this methodology would not sufficiently compensate the incumbent LEC for the costs associated with offering wholesale services. Wholesale LRSIC, by definition, excludes the portion of common costs that would be incurred in the process of providing wholesale services.

Effective competition, which is the intent of the federal Act, requires Ameritech and Centel to lose some contribution when they lose a customer to a competitor. If this were not the case, Ameritech and Centel would feel no competitive pressure and, thus, would not have any incentive to provide higher quality service. The Commission, therefore, adopts Staff's proposed pricing methodology for setting wholesale prices. Centel has stated that it will take approximately six months to complete cost studies. In the interim, the Commission will adopt Staff's proposal to set Centel's discounts equal to those discounts offered by Ameritech until appropriate cost studies are completed. We agree with Staff that the discounts are to be reflective of avoided costs on a service-element-by-service-element basis.

III. REVIEW OF AMERITECH'S PRICES FOR WHOLESALE SERVICES

A. Usage and Custom Calling

Ameritech

Ameritech argues that volume discounts embedded in the current retail rate structure should not be applied for wholesale usage. Ameritech proposed that the pricing of usage and Custom Calling/CLASS services be developed based on the average price for those services at the retail level. The Company proposed prices were developed by taking its avoided retail costs and dividing them by the actual (discounted), retail revenues for each of the services shown. The resulting quotients are percentage discounts on a service-by-service basis. These discounts were in turn applied to the retail rates for the corresponding services.

Ameritech applied these discounts to the retail rate element for each service to determine the appropriate corresponding wholesale rate element. The only exception to this rate calculation process was for usage and Custom Calling/CLASS services, where the Company first calculated an average retail rate, and then applied the proper percentage discount to this average rate to create the appropriate wholesale rate.

Ameritech took the position that the use of average retail rates for usage and Custom Calling/CLASS services, as the basis for corresponding wholesale rates, is consistent with the federal Act and should be approved by the Commission.

Ameritech contends that, under the literal language of Section 252(d)(3), average wholesale rates for usage and Customer Calling/CLASS services have been developed "on the basis of the retail rates" for the "telecommunications service" requested. Further, Ameritech submits that it is neither unreasonable nor discriminatory for the Company to have done so, in accordance with Section 251(c)(4). In addition, Ameritech asserts that the development of the average wholesale rates for these services will facilitate competition for a broad range of customers (and not just large customers) in the resale marketplace. In particular, it will enhance competitive choices and opportunities for low volume customers.

AT&T

AT&T contends that Section 252(d)(3) requires a state Commission to "determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection and other costs that will be

avoided by the local exchange carrier." (Emphasis added). In AT&T's view, the wholesale schedule of the incumbent LEC, consistent with the procompetitive intent articulated in the federal Act, should directly mirror the LEC's retail schedule. AT&T recommends that each retail rate have a corresponding wholesale rate, and that all discount structures included in the retail rate schedules must be carried over to the corresponding wholesale rate schedules.

Additionally, AT&T contends that imputation testing should be applied to wholesale rates as well as their corresponding retail counterparts. Imputation is necessary to fulfill the Illinois statutory requirement, and it is a vitally important competitive safeguard which must be preserved, AT&T contends.

Staff

Staff disagrees with Ameritech's position that the wholesale prices should not be determined based on the volume and term discounts in the retail rates. Any discounts included in the retail rate structure must be applied to the wholesale rates, otherwise the wholesale rates would not be calculated "on the basis of" the retail rates. Section 252(d)(3). Staff sees no reason why the Company should be required to run the usage data through its system twice in order to apply the retail volume discounts or, if that is the case, why that would be a reason to not offer wholesale volume discounts in accordance with the requirements of the federal Act.

Commission Conclusion

The Commission is of the opinion that Ameritech's wholesale rate structure must mirror its retail rate structures. This conclusion applies to any prospective wholesale tariff filed by an incumbent LEC, including Centel. The Commission, therefore, directs Ameritech and Centel to replicate their retail rate structure, including all discounts, in their wholesale rates. This is necessary in order for the rates to be consistent with the procompetitive intent of the federal Act.

The averaging and aggregation present in Ameritech's proposed wholesale rate structure can lead to instances where wholesale rates actually could exceed retail rates. For example, in some instances, Ameritech's retail rates contain specific time of day and volume discounts while wholesale rates are set on an average basis with some assumed average time of day distribution and customer volume. Under this scenario, a retail usage rate for a high volume user who places a call during the off-peak rate period may actually be below the average wholesale usage rate calculated

by Ameritech. Such a condition is unacceptable and clearly contrary to effective competition.

This averaging approach proposed by Ameritech has other consequences adverse to the development of competition. Specifically, this would introduce a systematic bias against the resellers marketing to high-volume retail customers. The same would be true if Ameritech were permitted to charge a per minute wholesale rate for a service which is billed on a per message (untimed) retail rate, which is exactly what Ameritech has proposed with respect to residence Band A usage.

The Commission rejects Ameritech's assertion that the development of the average wholesale rates for these services will facilitate competition for both large and small customers. Under the Ameritech averaging approach, resellers would not be able to effectively compete with the incumbent LEC for high-volume retail customers because they would be at a pricing disadvantage. Clearly, competition for these customers would not be on a level playing field.

Discount structures, moreover, must be available to carriers on the same basis as they are available to end users. For example, Ameritech offers aggregation of usage to its Centrex customers. It also provides a service called "Priority Plus Local Usage Optional Calling Plan" for business customers which provides both volume and term discounts to business customers on the basis of usage revenues generated from all the customer's accounts and locations. These arrangements, which are available to its large business customers, also must be made available to its carrier customers for resale, in order to comply with the requirements of the federal Act.

As indicated previously, Ameritech also has proposed to price services not offered on a wholesale basis on the basis initially of the average discount for all wholesale services. Given the problems associated with averaging, this proposal should not be approved for more than a brief transitional period not to exceed ninety (90) days. For example, the prices for network access lines in the more competitive areas are lower than average. Development of wholesale prices for such access lines based on an average discount factor would result in inadequate and inappropriate retail price discounts, thereby discouraging competition for these access lines.

The evidence in the record indicates that mirroring of retail rate structures and rates in the wholesale schedule can be done. In fact, Ameritech has conceded viability of the mirroring concept by indicating that its billing system can and will be modified in the future to meet the needs of resellers. Accordingly, in the absence of a persuasive showing of infeasibility by Ameritech or

Centel, and in view of this Commission's conclusion that comprehensive mirroring of the incumbent LEC's retail rate structure is required, the Commission directs Ameritech and Centel to replicate their retail rate structure, including all discounts, in their wholesale rates.

B. Imputation

AT&T

AT&T argues that the issue is whether imputation applies to its wholesale rates. AT&T contends that Section 13-505.1 of the PUA requires imputation of "noncompetitive services or noncompetitive service elements" used by other carriers in the provision of "competitive services" and "switched interexchange services." That Section, AT&T argues, does not apply only to the LEC's "retail" services, as Ameritech contends. AT&T also maintains that Ameritech's objection -- that the Commission would be required either to raise wholesale rates or to lower access if wholesale rates failed imputation -- is without merit. Access reductions from a wholesale imputation test would be neither undesirable nor unexpected in view of the Commission's policies articulated, for example, in the Customers First proceedings.

Staff

Staff advocates an imputation requirement for wholesale services. Staff contends that Section 13-505.1 requires imputation, and that even if it did not, the Commission should require imputation. Staff witness Webber provided an example of the competitive abuses which could result in the absence of imputation. Mr. Webber testified that, without the safeguards of Section 13-505.1, incumbent LECs could use the prices of their wholesale services to squeeze their facilities-based competitors out of the retail markets. Mr Weber stated:

> Essentially, the LECs could price wholesale services low enough such that the resellers could undercut the facilities-based competitors. For example, Ameritech could price wholesale Band B Minutes Of Use ("MOUs") at an average rate of $0.00375, which is above LRSIC, and at the same time charge facilities-based competitors $0.0075 to terminate local traffic through a tandem office or $0.005 through an end office. (IBT Ex. 7.3 at 1). Clearly, with rates like these, resellers would be in a position to underprice the facilities-based competitors. Such a scenario is particularly troublesome when I consider the fact that Ameritech Communications Inc. ("ACI") is seeking certification (Docket No. 95-0443) to be a new LEC (and a reseller of Ameritech's services) and

> might be in a position to squeeze the facilities-based competitors out of the local market where Ameritech is unable to do so because of the imputation requirements of Section 13-505.1.

ICC Staff Ex. 7.00P at 20.

Ameritech

Ameritech recognized that wholesale pricing creates new inputs for purposes of imputation testing and, as a result, Ameritech has stated it will impute the wholesale bundled rates approved in this proceeding to corresponding Ameritech Illinois retail service rates. Such a test would be in addition to the imputation test which Ameritech performs today for its retail, interexchange usage service to which Ameritech imputes both originating and terminating access charges paid by IXCs when providing competitive toll services.

Ameritech has also stated that it is prepared to perform additional, informational imputation test of wholesale rates to insure that these rates exceed applicable, imputed cost consisting of imputed, termination access rates and applicable long run service incremental costs ("LRSICs"). As explained by Ameritech, such a test would be performed from the perspective of competing, facilities-based providers like MFS and TC System which purchase terminating (but not originating access) from Ameritech in order to provide their own, competing, wholesale services. Ameritech argued that such a test is not required under Section 13-505.1 of the PUA because the imputation requirement therein applies only to retail prices. As described by Mr. Gebhardt, one of the individuals involved in imputation legislation, Section 13-501.1 was never intended to apply to wholesale rates. However, Ameritech stated that the Commission could require such a test pursuant to the Commission's informational imputation policy as articulated in Docket 94-0096/0117/0301 (consolidated), the Customer First proceeding.

Ameritech also responded to the suggesting of Staff that he Company must perform imputation tests to determine if carrier access rates purchased by interexchange carriers for their provision of toll services exceed wholesale (as opposed to retail) usage rates. Ameritech argued that Staff's concern does not properly fall within the area of imputation because Section 13-505.1 is not directed toward addressing any rate inequities that might arise between wholesale rates and carrier access rates. Ameritech Illinois further contended that Staff's concern could be addressed by the Commission pursuant to its authority to determine "just and reasonable" under Article IX of the PUA.

Commission Conclusion

The PUA contains an imputation requirement which must be met by telecommunications carriers that provide both competitive and noncompetitive services. 220 ILCS 5/13-505.1. The intent of this requirement is to ensure that incumbent LECs (e.g., Ameritech and Centel) are not able to use the prices of their noncompetitive inputs to squeeze their competitors out of the retail markets.

The plain language of the PUA does not support Ameritech's recommendation. As a matter of law, the Commission cannot adopt such a policy. Furthermore, the PUA notwithstanding, the incumbent LECs should not be allowed the opportunity to squeeze their competitors out of the retail markets in the manner described by Staff. For these reasons, the Commission is of the opinion that Section 13-505.1 of the PUA is applicable to the wholesale services provided by Ameritech and Centel.

C. **Administrative Functions**

Ameritech states that it will provide the necessary administrative and operational support functions as requested by AT&T. AT&T has requested that the following be included in a wholesale local exchange tariff: (1) access to on-line systems; (2) data interfacing; (3) reseller branding; and (4) directories. Ameritech addressed how the cost for various administrative functions should be recovered, including access to on-line systems, the creation of data interfaces, reseller branding, and directories. The Company argued that because wholesale prices are to be determined on the basis of the avoided "marketing, billing, collection and other costs," the incremental wholesale costs for administrative/interface functions must be included in the retail avoided costs analyses in order to determine the actual level of avoided costs incurred in providing services to resellers.

Staff takes the position that access to these functions represents access to network elements and, therefore, must be priced separately and not included as part of the costs for wholesale services.

Centel proposes that such network elements be priced based on cost, with "as much contribution to shared costs as the LEC receives through the wholesale prices and operational and support systems prices charged to resellers."

Conclusion

The Commission is of the opinion that these administrative and operational support functions as requested by AT&T are network elements as defined by the Act and not services as Ameritech

maintains. They clearly fall within the definition of network elements as provided for in Section 3(a)45. Accordingly, they should be priced separately based on the pricing requirements of Section 252(d)(1) of the Act which governs the pricing of network elements if purchased separately. The administrative and operational support functions are also part of the wholesale services; and when so purchased, the costs should be included in determining the avoided costs to provide wholesale services. The Recovery of all start-up costs associated with providing these network elements shall be allowed consistent with Section IV. A.

IV. IDENTIFICATION OF AVOIDED RETAIL COSTS OF PROVIDING TELECOMMUNICATIONS SERVICES ON A WHOLESALE BASIS

A. Incremental Start-up Costs

There is debate in the record over the identification and recovery of the costs incurred when providing services on a wholesale basis. Ameritech contends that the federal Act cannot reasonably be interpreted to require companies to exclude any costs incurred in offering services on a wholesale basis. The Company argues that Section 252(d)(3) specifies that wholesale prices for resold services are to be based on retail rates excluding the portion "attributable to any marketing, billing, collection, and other costs that will be avoided by the [incumbent LEC]." Under this approach, Ameritech argues that costs incurred as a result of making services available on a wholesale basis are not avoided and, thus, cannot be excluded in the calculation of just and reasonable wholesale prices.

Ameritech identified at least $2.2 million in additional start-up costs which will be incurred in providing services on a wholesale basis. For example, Ameritech witness Mr. Palmer testified that the Company will incur additional maintenance expenses based upon the need for increased manual intervention in the maintenance provisioning process. He further testified that the Company will incur computer system expenses to establish a new service order system for customers purchasing wholesale services.

Ameritech pointed out that wholesale costs that are incremental to the provision of wholesale services fall into two categories: recurring costs and start-up costs. With respect to the recurring cost category, Ameritech argued that AT&T did not articulate a clear position on how such costs should be recovered. At the same time, the Company agreed with CUB and Staff that any recurring wholesale costs should be recovered in the prices for the wholesale services.

With respect to start-up costs, Ameritech took the position that they should be recovered in the prices of wholesale services.

Ameritech argues that resellers causing start-up wholesale costs to be incurred should be responsible for compensating it for such costs. However, if the Commission does not adopt its position, the Company argued that, at the very least, the Commission must permit exogenous treatment of such costs. Ameritech argues that without exogenous treatment, start-up costs would be charged against earnings instead of being recovered in the rates charged to customers.

AT&T and CUB take the position that start-up costs should be recovered from all providers in proportion to each provider's market share.

Staff agrees with AT&T's position to the extent that these costs should not be recovered through wholesale prices. It recommends that such costs be recovered in a competitively neutral manner. Staff indicates that one option would be similar to the treatment of intraMSA presubscription costs as ordered by the Commission in Docket 92-0048. The Commission's cost recovery mechanism established in that docket allows incumbent LECs to recover fully the initial incremental expenditures associated with intraMSA presubscription over a time period which should not burden or shock the ratepayers unduly. Furthermore, it applies to all intraMSA MOUs which are eligible for presubscription under the premise that all users of such MOUs benefit from the increased level of competition encouraged by intraMSA presubscription.

Staff contends that in order to remain consistent with that mechanism, any cost recovery mechanism ordered in the instant proceeding should be applied to all services which are available in the LEC's wholesale offerings. In addition, because the LEC's current retail customers should benefit from the competitive entry encouraged by a wholesale offering, the charges also should be applied to the LEC's retail services if those services have wholesale counterparts.

MFS argues that the appropriate means of determining the costs actually avoided in providing wholesale service is to take into account not only cost savings to the LEC in providing the service, but also the additional costs incurred by the LEC in doing so. MFS argues that the added costs of wholesale services must be included in the overall calculation to arrive at the amount which accurately reflects the avoided costs of wholesale service. MFS presented the analogy the following analogy to support its position:

> If the price of a bus ticket to Chicago is $15 and the price of a plane ticket is $100, switching from a plane ticket to a bus ticket avoids $85 in costs, not $100.

MFS argues that avoided costs must take into account costs, such as the price of the bus ticket, that are nonetheless incurred. MFS contends that if the Commission is not careful, an incorrect assessment of avoided costs could act as a barrier to entry to facilities-based competitors. MFS maintains that the failure to take account of additional costs could create the kind of barrier to entry that Section 253 of the federal Act proscribes. MFS states that if the retail price of a particular service is at or near LRSIC, subtracting avoided costs without adding additional costs could enable resellers to purchase resold local service below cost. MFS argues that it would be extremely difficult for facilities-based carriers to compete with resellers whose principal inputs would be priced below cost. MFS contends that in the resale context, there is no basis in the federal Act to recover implementation costs from anyone other than resellers of LEC services. Accordingly, MFS states that requiring facilities-based providers to pay for these costs would be entirely inconsistent with the federal Act's preference for facilities-based competition and would seriously hamper its development at this critical juncture.

Commission Conclusion

The Commission concludes that all fixed costs incurred by the incumbent LEC in setting up the wholesale/resale market structure should be recovered from all wholesale providers in proportion to each provider's local wholesale market share. As a matter of policy, this Commission has consistently ruled that costs should be borne by the parties causing such costs. Thus, in this instance, wholesale resellers causing start-up wholesale costs to be incurred should be responsible for compensating the incumbent LEC for such costs.

B. **Advertising, Maintenance, and Uncollectible Expenses**

Ameritech, Staff and AT&T addressed the proper identification of advertising, maintenance, uncollectible, and customer service expenses. With respect to advertising expenses, the Company contended that it will continue to incur advertising expenses in a wholesale environment. Ameritech had initially modified its product specific LRSICs and its administrative and shared costs to better reflect the advertising expenses it would incur in a wholesale environment. Essentially, Ameritech witness Palmer indicated that he removed from the wholesale cost studies all advertising expenses which were related to Ameritech's end users. These examples, include advertising to carriers purchasing operator services, directory services, video services, and resold local exchange services. Mr. Palmer calculated that Ameritech will incur $9 million in advertising at trade shows, in trade publications, and in product guides for purposes of Account 6613.

In response to AT&T's position, Ameritech further contends that no cost to advertise retail services has been included in the Company's wholesale advertising. Further, although AT&T contends that Ameritech does not need to advertise wholesale services, Ameritech contends that AT&T's position ignores the fact that such advertising, in fact, does take place today and provides a key means for the Company to communicate with other carriers.

Staff agrees that the Company is likely to incur advertising expenses in the wholesale environment and suggests that Mr. Palmer's original modification should not be altered.

AT&T witness Henson, however, stated that all of Ameritech's advertising expenses are avoidable and recommended that the Company's cost studies be modified accordingly.

Ameritech's wholesale studies included an adjustment to the ordinary maintenance factor which is applied to all LRSICs that contain capital costs. This modification accounts for an anticipated increase in maintenance expenses which purportedly will occur because the maintenance ordering process will become more time consuming in the wholesale environment, and it serves to increase the Company's wholesale costs.

Ameritech calculated the maintenance adjustment factor based upon the percentage of time that manual intervention will be required by the Company in handling maintenance cases with resellers which do not wish to incur the expense of developing an electronic interface for maintenance purposes. Ameritech estimated the frequency of manual intervention based upon its current experience with Centrex resellers. Ameritech's maintenance adjustment factor represents $3.4 million of the total assigned maintenance costs of providing wholesale services.

Staff takes the position that while the Company's rationale may be forward looking, the cost assumptions are based on expectations rather than experience with the maintenance ordering process in a wholesale environment and are speculative. Staff contends that the Commission should not allow this maintenance adjustment factor until the Company has had experience upon which such an adjustment can be based.

AT&T agreed with Staff on the issue of maintenance expense. It endorsed Staff's adjustment to offset Ameritech's claim that maintenance expense will be higher in a wholesale environment. AT&T's objection was based upon the fact that Ameritech derived the adjustment factor based upon a series of speculative assumptions.

Ameritech also developed a wholesale uncollectible expense for purposes of developing its wholesale avoided billing costs. The

estimate was based upon actual experience with IXCs, information providers, competitive payphone providers, independent LECs, competitive access providers, Centrex resellers, and large business customers. As a result, the Company utilized an uncollectible expense factor of 1.32% in comparison to the factors of 1.29% and 1.05% recommended by Staff and AT&T, respectively.

With respect to uncollectible expenses, AT&T proposed to remove the varied and unrepresentative collection of customer types considered by Ameritech and, rather, to base the calculation on actual experience with IXCs. AT&T explained that given the nature and qualifications of resellers that will be certificated, the result will be uncollectible expense more in line with experienced with that IXCs. Furthermore, AT&T contends that it would be reasonable to assume that the uncollectible expenses incurred in the wholesale environment would be similar to those which the Company currently experiences with its current carriers like AT&T. Therefore, he recommended that the wholesale uncollectible expenses and, implicitly, the uncollectible expense be recomputed based upon data related only to IXCs.

Staff witness Webber, however, opined that the wholesale customers, in terms of their ability and willingness to pay debts, would likely be similar to the Company's current wholesale customers, as opposed to the mix of wholesale and retail customers assumed by Mr. Palmer. Therefore, he recommended modifications which were based upon data that excludes all end users. Staff states that this adjustment originally was an attempt to account for the reduction in uncollectible expenses which likely will occur as a result of the Company offering wholesale services and, therefore, it is logical to conclude that the adjustment should exclude retail end users. Staff contends that this expense should be based upon its experiences with wholesale customers.

Ameritech contended that Staff's and AT&T's views of the uncollectible expense factor are not credible because the Company would be required to ignore data that it has accumulated when dealing with large business customers. Further, under AT&T's position, Ameritech would have to take the myopic view that the uncollectible expense factor should be based solely on the experiences of carriers like AT&T, while ignoring Ameritech's Illinois' experience with other types of customers, including smaller carriers with which it has had billing disputes.

Conclusion

Because Ameritech provided evidence as to its advertising expenses related to current wholesale operations, it is reasonable to assume that it will continue to incur these expenses. Thus, its avoided costs should not be based upon the assumption that all such

costs are avoidable. The Commission will affirm the Company's original cost modifications.

The Commission concludes that Ameritech has estimated its advertising expenses in a wholesale environment accurately. The Commission rejects AT&T's position that the Commission should, in effect, disallow such costs from Ameritech's cost studies. Such advertising takes place today and serves a useful purpose by informing resellers of available services. The Commission agrees with Ameritech's position that such advertising will continue to serve a useful purpose in the future.

With respect to the maintenance adjustment factor, the Commission finds that Ameritech properly estimates that it will incur additional maintenance expenses when dealing with resellers. As the Company contends, its current maintenance experience with Centrex resellers is clearly relevant, as is evidence that some resellers will not utilize electronic interfaces, thereby causing maintenance expenses to increase. This is forward looking information which the Company properly used under the cost of service rule in developing an accurate maintenance expense factor.

With respect to the uncollectible expense factor, the Commission agrees with Staff that the calculation for this item should be based on data that based upon data that excludes all end users. Because this adjustment was originally an attempt to account for the reduction in uncollectible expenses which will likely occur as a result of the Company offering wholesale services, it is, therefore, logical to conclude that the adjustment should exclude retail end users.

Further, the Commission concludes that the level of expense identified by Ameritech and Staff in the customer services expense category (Account 6623) is reasonable. When this level of expense is added to its analysis of avoided costs in Ameritech Exhibit 7.13, the total level of avoided costs increases to $161 million (from $128.3 million) and the corresponding discount level increases to 8.47% (from 6.8%).

C. **Administrative/Shared Costs**

AT&T contends that several major areas of administrative and shared costs would be avoided in a large-scale shedding of retail activity by the incumbent LEC. Examples of these costs include buildings, vehicles, computer equipment, furniture and artwork, personnel and other assets and functions supporting retail operations. AT&T states that Ameritech has not identified administrative/share costs adequately for purposes of its avoided cost analysis.

Ameritech responded that administrative/shared costs are those that are incurred by two or more services. Ameritech states that administrative and shared costs are added to the LRSICs of services on the basis of the relative LRSICs of those services. The end result is the TAC of the service. A significant portion of avoided retail costs is attributable to the administrative/shared costs category.

Ameritech argued that AT&T's position is totally lopsided and illogical because it advocates the removal of such administrative/shared costs only from the wholesale TAC, not from the retail TAC. In addition, Ameritech argued that it presented extensive, responsive testimony in which Mr. Palmer described the methodology used by the Company to identify administrative/shared costs.

Commission Conclusion

The Commission concludes that Ameritech has sufficiently identified its administrative/shared costs incurred when providing wholesale services. The Company cost studies are derived from its 1995 Annual Filing and are pursuant to the Company's alternative regulation plan filing in Dockets 92-0448/93-0239. AT&T has provided no sound reason why the Commission's previous approval of the Company's studies, including identification of TAC of retail services, now should be disregarded for purposes of calculating avoided wholesale costs. Accordingly, the Commission rejects AT&T's position that Ameritech is entitled to recover none or only a limited amount of wholesale administrative/shared costs in the prices of its wholesale services.

D. **AT&T's Embedded Cost Study and AT&T's Proposed 25% Discount**

AT&T witness Dr. Selwyn stated that it would be preferable to utilize a "bottoms-up" or LRSIC study when developing each LEC's wholesale rates. Under such a scenario, wholesale rates would be based upon wholesale costs and therefore would exclude retailing costs. He further stated, however, that a "tops-down" or Fully Distributed Cost ("FDC") study could be used as an interim measure until the appropriate cost studies are available. This approach essentially seeks to remove all retailing costs from the LECs'current cost structures and then sets wholesale rates based upon the estimated avoidance of retailing costs.

Ameritech addressed AT&T's embedded cost analysis performed by Dr. Selwyn. Under the Selwyn analysis, the level of the Company's avoided costs in offering services on a wholesale basis would be 25%, or nearly triple the level identified by Mr. Palmer.

Ameritech argued that Dr. Selwyn's analysis should not be relied upon because the definition of costs reflected in the analysis is totally contrary to Commission policy and precedent. The Company contends that the Commission has fully explored -- and rejected -- the use of accounting, embedded costs in FDC studies. Ameritech also argued that the Commission's approval of its LRSIC studies is fully consistent with the Commission's cost of service rule, which requires the calculation of LRSIC costs as a basis for attributing costs to a service. Ameritech argues that AT&T's embedded approach, on the other hand, is inconsistent with this approach, and even Dr. Selwyn conceded that the use of LRSIC studies is preferable over the long term.

Ameritech also contended that Dr. Selwyn's analysis was fundamentally flawed because it relied upon out-of-date data and made gross, simplistic assumptions with respect to the account expenses that allegedly would be avoided on a wholesale basis.

Conclusion

The Commission rejects AT&T's embedded cost analysis as inconsistent with our cost of service rule. AT&T's embedded analysis is not a long-term approach to identifying avoided costs. On the other hand, Ameritech's analysis of avoided costs, with certain adjustments set forth in this Order, is consistent with the Commission's cost of service rule. The Commission therefore will rely upon it for purposes of determining Ameritech's avoided "marketing, billing, collection and other costs" under Section 252(d)(3).

V. THE SCOPE OF AMERITECH'S WHOLESALE TARIFF

A. Specific Services Proposed by Ameritech

Ameritech has filed a proposed wholesale tariff setting forth those telecommunications services and associated non-recurring charges that the Company is initially proposing to offer on a wholesale basis. These services are:

Network Access
IntraMSA USS Calling
ISDN Direct
Custom Calling
CLASS
Complimentary Central Office Features
Remote Call Forwarding
DID Trunks
Directory
Directory Assistance
Non-recurring Charges

Non-Coin Operator
Other (e.g., toll restriction, temporary intercept, foreign district)

Ameritech contended that the foregoing list of services consists of virtually all of the Company's major noncompetitive services and is at the same time responsive to the petitions of AT&T and LDDS and the services requested therein under the PUA. Ameritech stated that it recognizes the federal Act requires an expansion of those services that would be subject to resale and wholesale pricing, citing competitive services as an example. However, the Company further argued that the Commission need not resolve in this proceeding the issue of precisely what additional telecommunications services must be offered on a wholesale basis pursuant to the federal Act. Resolution of those issues will occur when Ameritech expands its wholesale tariff in a separate tariff filing for additional wholesale telecommunications services. Further, the Company stated that since it has not yet performed avoided retail cost studies for an expanded wholesale offering, the Company will use as a basis for the wholesale discount for the expanded offerings the average discount for all wholesale services for which the avoided LRSIC costs were developed. Such an average discount will be used until additional LRSIC studies are performed.

AT&T contends that the federal Act requires incumbent LECs to offer for resale at wholesale rates "<u>any</u> telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers...." Section 251(c)(4)(A). (Emphasis added). AT&T further contends that consistent with the procompetitive intent of the federal Act, all LEC services should be made available, without exception, for resale by new entrants to the local exchange marketplace. According to AT&T, the incumbent LECs cannot be permitted, consistent with the intent of the federal Act, to select out retail services they choose not to offer at wholesale. Therefore, AT&T contends that the total resale services offered by Ameritech and Centel must include all services including all "grandfathered" or "sunsetted" services, promotional offerings and service "package" offerings, proprietary services and carrier access services.

AT&T objects to the Ameritech and Staff position that new services need not be offered automatically on a wholesale basis. AT&T contends that the incumbent LEC would have, at a minimum, a six month competitive advantage over resellers in the retail market.

Staff responds that Ameritech and Centel are not required to provide new local exchange services on a wholesale basis automatically; rather, incumbent LECs should provide new services on a wholesale basis after a request is made by the reseller, based

on the wholesale pricing method required by the Commission. Staff, however, states that the reseller should not be required to apply to the Commission under Section 13-505.5 in order to have a new service priced on a wholesale basis. Staff contends that the federal Act simply does not require resellers to apply to the state commissions each and every time a new service is introduced. Staff agrees that such a reading of the federal Act would vest the incumbent LECs with, at least, a six-month window before they would have to compete against resellers.

Ameritech also argues that proprietary services need not be made available at wholesale rates. The Company cites FAXTRA as an example of a proprietary service; FAXTRA is a network based fax service. Staff agrees with Ameritech that proprietary services may be excluded from a wholesale offering. However, it is Staff's position that the incumbent LECs should not be allowed to decide unilaterally which services are proprietary and excluded from a wholesale offering. Staff recommends that the Commission review such proposals on a case-by-case basis.

Commission Conclusion

Ameritech and Centel are required by the federal Act to provide wholesale services throughout their entire service territory. In addition, Section 251(c)(4)(A) requires that all retail local exchange services be made available for resale. However, the federal Act later states that wholesale prices shall be calculated "on the basis of retail rates charged to subscribers for the telecommunications service requested ..." (Section 252(d)(3), emphasis added). Since AT&T already has provided a detailed and exhaustive listing of retail services it requests on a wholesale basis, Ameritech and Centel should be required, in this proceeding, to provide all local exchange services requested by AT&T on a wholesale basis. If AT&T or any other telecommunications carrier desires additional retail services on a wholesale basis, then it should file a request with Ameritech and/or Centel or any other incumbent LEC. The Commission is of the opinion that this request need not be in the form of a Section 13-505.5 proceeding. Therefore, Ameritech and Centel should be required to offer all retail services outlined in AT&T's petition on a wholesale basis as required by the federal Act.

With respect to the provision of proprietary services on a wholesale basis, the Commission is of the opinion that Staff's proposal is the most reasonable. While Ameritech and Centel should not be required to provide proprietary services on a wholesale basis, they cannot have the authority to unilaterally define what service qualifies as proprietary. The Commission retains the authority to review such proposals on a case by case basis.

B. **Promotions and Service Packages**

Ameritech contended that it should not be required to make promotional rates available at wholesale rates, whether offered individually or as part of service packages. In response to the positions of AT&T and MCI that a price squeeze could be created through promotional offerings, Ameritech argued that Section 252(d)(3) requires wholesale rates to be established on the basis of "retail rates" and imposes no express requirement with respect to promotional rates. Further, Ameritech committed to limit promotional offerings to a duration of 120 days or less in a calendar year. In addition, the Company agreed with Staff's position that should a promotional offering fall below the corresponding wholesale rate, Ameritech will lower the wholesale price to prevent a price squeeze. Finally, Ameritech contended that excluding promotions from the wholesale service obligation will stimulate LECs to develop promotions and, at the same time, stimulate resellers to develop their own pricing and discount schemes.

AT&T proposes that anytime an incumbent LEC engages in a promotional offering for its retail services, then the reseller should receive credits so that it also receives benefits of the promotion. AT&T bases its position on the argument that without this requirement, the incumbent LEC, which also competes in the retail market, will be able to drive out and undercut its resale competitors.

Staff disagrees with AT&T's position and believes that promotional offerings are retail costs of competing in the market. Therefore, Staff argues that the pricing equation should not apply to promotional offerings by wholesale LECs as long as the promotional price is equal to or greater than the wholesale price. Staff contends that if the wholesale LEC chooses to make promotional offerings available that are below the wholesale price, then the wholesale price should be lowered to the promotional offering price. According to Staff, this requirement will allow the incumbent LEC to compete with facilities-based LECs, while not harming resale LECs. However, Staff recommends that the Commission review such promotional discounts on a case-by-case basis to determine their reasonableness.

Commission Conclusion

The Commission agrees with Ameritech and Staff that the Company should not be required to provide promotional offerings and service packages, limited to 120 days or less in a calendar year and priced above the wholesale price, on a wholesale basis. The Commission finds that nothing in the federal Act requires LECs to offer such time limited promotions and service packages on a

wholesale basis. Further, the Commission concludes that a contrary result would discourage the offering of such time limited promotions and service packages by LECs, discourage competition, and chill the offering of such time limited separate promotions and service packages by competing resellers.

C. Grandfathered and Sunsetted Services

As discussed above, Ameritech has committed to expand its wholesale tariff in a separate tariff filing. However, the Company has proposed to exclude those services (or rate plans or offerings) from its expanded filing that have been grandfathered or sunsetted. In determining those services to be grandfathered or sunsetted, the Company stated it will rely on the following criteria: current and projected demand for the service; the scope of service; and the availability of reasonable substitutes for the service. Because such services would not be available for resale, a wholesale requirement would also not apply.

The Company argued that it should be permitted to grandfather or sunset services because substitute services will form the basis for any Ameritech marketing initiatives directed at customers of grandfathered or sunsetted services. Similarly, resellers will rely upon identical, substitute services (albeit priced at wholesale) in marketing to these customers. Accordingly, resellers will not be disadvantaged.

Staff agrees with AT&T and MCI that Section 252(d)(3) of the 1996 Act does not allow for incumbent LECs to exclude grandfathered and sunsetted services from a wholesale offering. Staff recommends that Ameritech Illinois and Centel initially be allowed to exclude such services from a wholesale offering until it receives a request from a carrier using the pricing methodology adopted by the Commission in this Order. Staff states that this recommendation is fully consistent with the Act, while preventing the incumbent LECs from having to incur unnecessary administrative costs. Staff notes that the PUA requires a LEC to petition the Commission to withdraw noncompetitive services. 220 ILCS 5/13-406. Staff also would expect Ameritech or Centel to petition the Commission before it grandfathers a service.

AT&T and CUB argue that even though Ameritech or Centel may not be adding new customers for such services there is no justification for withdrawing its existing customer base from competition. According to AT&T, these are retail customers, and the services must be available for resale so that the customers may benefit from retail competition. AT&T contends that Ameritech's proposed exception would curtail competition for these customers.

Commission Conclusion

The Commission adopts the position of Staff that LECs be permitted to exclude grandfathered and sunsetted services from a wholesale offering unless they receive a request from a carrier to make such services available on a wholesale basis. In such an instance, the wholesale provider can only provide the requested service to the customers that receive the grandfathered service. This will ensure that wholesale providers are competing on an equal footing, while still providing the incumbent LEC with the flexibility to terminate the offering of certain services.

D. Carrier Access

Carrier access services are not included in Ameritech's proposed wholesale tariff. The Company argued that Section 251(c)(4) imposes a duty on incumbent LECs to offer for resale at wholesale rates only those telecommunications services which the carrier "provides at retail to subscribers who are not telecommunications carriers." Ameritech argued that carrier access services are already wholesale services which Ameritech offers to telecommunications carriers, not retail end users. Therefore, they are not encompassed by the Company's wholesale obligation.

AT&T argues, first, that Ameritech's access service tariff defines customer(s) as follows: "The term 'customer(s)' denotes any individual, partnership, association, joint-stock company, trust, corporation, or governmental entity or any other entity which subscribes to the services offered under this tariff, including both Interexchange Carriers (IXCs) and end users." Because access is available to subscribers "who are not telecommunications carriers" (and is in fact provide to end user customers) access must be made available under the federal Act as part of the wholesale offering at a wholesale price.

Second, AT&T contends that the Company's assertion that carrier service contains no retail cost that would be avoided is likewise incorrect. AT&T states that Ameritech ignores the manner in which access charges have been developed. AT&T argues that access charges do contain retailing costs. AT&T argues that a wholesale service, priced so as not to include those costs, can and must be developed.

Ameritech responds to AT&T's position that carrier access services should be included because of Ameritech's definition of a "customer" in its access tariff includes end users, Ameritech pointed out that there is no evidence in this record that end users are, in fact, taking service under the Company's access tariffs. In addition, Ameritech argued that even if access services were encompassed by Section 251(c)(4), the IXCs would not receive a

discount under the federal Act's avoided cost standard. Since carrier access already is a wholesale service, there are no retail costs that would be avoided if carrier access were supplied to resellers for resale.

Ameritech also states that while AT&T claimed in its initial brief that there are avoided retail costs in carrier access services because of the FCC's ratemaking methodology, the Company argued that AT&T provided no record support for this contention and that there are no avoided LRSIC costs in intrastate carrier access services as the undisputed testimony of Mr. Palmer's testimony demonstrates.

Commission Conclusion

The Commission concludes that carrier access service is properly excluded from Ameritech's proposed wholesale tariff. Very simply, Section 251(c)(4) is addressed to services provided to "subscribers who are not telecommunications carriers." Carrier access services are not being provided to such "subscribers." Furthermore, there is no record evidence of any avoided retail costs of offering carrier access to resellers. Accordingly, Ameritech is not required to offer carrier access as part of its wholesale tariff offering.

E. Other Services

Ameritech addresses several other types of limitations which it proposes on the resale of services. One of those limitations dealt with flat-rated service. The Company argues that allowing resellers to be able to take advantage of flat rate pricing where it still exists would simply distort competitive entry decisions and encourage resellers to serve high end customers, while being provided with flat rate, low cost usage from the underlying LEC. As a matter of policy, Ameritech argues that the Commission should be encouraging resellers to serve all customers, not just high end customers. Excluding flat rate services from resale accomplishes this objective.

In addition, Ameritech submitted that it should not be required to "build out" its facilities where none exist today in order to provide resold/wholesale services in new areas and, instead, should be permitted to negotiate cost recovery on a case-by-case basis with any reseller requesting services in a new area. Ameritech contends that such negotiations would ensure a process whereby the Company would be compensated for additional costs through special construction charges and any applicable tariff charges, and through appropriate payments for any early discontinuation of services purchased by resellers and carried over the new facilities.

AT&T contends that Ameritech's basis for this proposed exclusion is misplaced. According to AT&T, whether a service is offered on a flat-rated basis or on a usage basis is irrelevant to the issue of whether the resale of the service will facilitate competition: if it is consistent with the public interest for Ameritech to offer a flat rated service to its retail customers, then the same public interest is served if a reseller is able to offer the flat rated service to its customers. AT&T also argues that there is nothing in the federal Act to support this exclusion.

Staff disagrees with Ameritech's position with respect to requiring the Company to extend or build facilities to provide service for resellers' customers. The proposed pricing methodology advocated by Staff allows the wholesale LEC to earn a pro rata share of contribution on all resold services, including build out to new subdivisions. Staff further states that, any additional costs, such as special construction costs, may be charged by the wholesale LEC.

Like AT&T, CUB also argued that flat rate service should be made available for resale. CUB notes that Ameritech relies on a 12-year-old Commission Order as the basis for this proposed exemption. CUB asserts that by proposing such an exemption, Ameritech ignores the clear language of Section 251 (c)(4) of the federal Act, which mandates that all telecommunications services be made available on a wholesale basis. Moreover, CUB argues that prior Commission decisions are not entitled to res judicata. Finally, CUB argues that excluding flat rate service from resale keeps Ameritech's flat rate customers, who reside in the relatively less populated areas of the state, from enjoying the benefits of competition. CUB argues that there is no basis in fact or in law for such a restriction.

Commission Conclusion

The Commission agrees with AT&T that flat rate services should properly be included the resale of services. There is simply no authority for this Commission to do otherwise.

With respect to the issue of network build-out, the Commission agrees with Ameritech and Staff that LECs should be able to recover any additional costs, such as special construction costs, through appropriate charges to the reseller. For example, early termination charges may be an appropriate method to ensure adequate cost recovery, given the circumstances of a particular request for network build-out and the duration of the service being requested by the reseller.

F. Stripping of Operator Services and Directory Assistance from Resold Services

AT&T

AT&T also has proposed that the LECs unbundle Operator Services and Directory Assistance ("OS/DA") from the basic local service package. AT&T contends that resellers should have the option of providing these transaction-based services themselves, through a third party, or via resale of the incumbent LEC's services. Accordingly, AT&T states that this option would create an opportunity for competitive differentiation in local service. AT&T argues, therefore, that these local services should be unbundled from basic local service by the incumbent as a stand-alone part of its wholesale offer.

AT&T takes exception to Ameritech's contention that "AT&T's proposal in this proceeding would allow it to capture the remaining operator service calls (i.e., Bands A and B calls) and directory assistance calls -- calls that would not be routed to them as a facilities-based usage provider on a 1+, 0+, or 411 basis." AT&T maintains, that the premise of this argument is that because these remaining operator services supposedly produce higher than average levels of contribution, AT&T would be able to take these allegedly high margin services and leave Ameritech with the remaining services. AT&T states that the federal Act renders Ameritech's argument moot.

AT&T argues that the federal Act now requires incumbent LECs to make these services available on an unbundled basis without regard to the amount of contribution they provide. More importantly, Ameritech states that a true cost-based pricing plan, as mandated by the federal Act, would make Ameritech's concerns about maintaining, appropriate contribution levels irrelevant. Consequently, AT&T contends that the total wholesale service is justified under Section 13-505.5 as well as under the federal Act.

Ameritech

Ameritech stated that it will provide directory assistance and operator services to resellers at wholesale rates. The Company did not agree with AT&T's proposal that Ameritech also be required to allow resellers, at their option, to "strip" all operator and directory assistance calls from the bundled resold service so that the reseller or a third party can provide the operator and directory assistance services directly through their own facilities.

Ameritech argued that there are several reasons for rejecting AT&T's proposal. First, the Company maintained that it is a thinly

veiled plan to revisit the Commission's order in the Customers First case. In that proceeding, the Commission addressed dialing parity and developed presubscription rules. Presubscription was limited to Band C and toll usage and Band C and toll operator services traffic and did not include directory assistance. Ameritech argued that if AT&T's proposal were adopted, it would significantly change the Customers First Order and would conflict with earlier Commission policy decisions.

Ameritech also contended that it would be inappropriate to grant AT&T's request from a competitive perspective. By offering reseller services, AT&T would be in a position to offer direct dialing on Bands A and B operator services and directory assistance traffic; a purely facilities based carrier would not. Thus, AT&T's proposal, according to Ameritech, would favor "one-stop shopping" IXCs over competitors which provide only toll services or purely "switchless" resellers. Ameritech suggested that changes, if any, in the scope of presubscription should be addressed in a generic proceeding where the interests of all carriers could be addressed.

Ameritech also argued that AT&T's proposal is not technically feasible. Current switches can route presubscribed calls to another provider's directory and operator assistance services. However, the current switches do not permit the routing of local calls to different service providers based on who is purchasing the bundled service. AT&T argued that these calls could be routed using routing guides which it claimed are included within the software of the AT&T 5ESS switch. Ameritech responded that using routing guide techniques would require the assignment of numerous new line class codes. According to Ameritech, there would not be enough line class codes available to support such an offering. AT&T argued that Ameritech witness Mr. Kocher was unable to confirm or deny whether the AT&T 5ESS switch had the ability to accommodate AT&T's request for special routing of operator services and directory assistance. Ameritech responded that was not Mr. Kocher's testimony.

Ameritech also discussed why Staff's suggestion to utilize AIN technology was not feasible. Today, neither local operator calls nor directory assistance calls are routed using AIN technology. The Company stated that it is not clear whether AIN technology could be utilized; to do so would require significant additional developments using the AIN platform's service creation capabilities in order to create new databases to develop the routing algorithms necessary to provide this functionality. In addition, Ameritech suggested that it would be necessary to obtain more information from reseller customers prior to any such development of the AIN technology so that the routing capability being requested could be defined and it could be determined how such capability would interact with the other options associated with the end user's