

Second, those Commission's findings must in turn be supported by substantial evidence. "[T]his court must [next] determine whether there is substantial evidence in the record to support the Commission's findings of fact." *Gary-Hobart Water Corp.*, 591 N.E.2d at 652. Under this standard, the Court will not "reweigh or reanalyze the evidence presented or substitute [its] judgment for that of the Commission." *Id.* The Court will reverse, however, "when a review of the whole record clearly indicates the agency's decision lacks a reasonably sound base of evidentiary support." *Id.* *Accord, e.g., In the Matter of Complaint of Indiana Payphone Ass'n v. Indiana Bell Telephone Co., Inc.*, 690 N.E.2d 1195, 1197 (Ind. Ct. App. 1997).

Finally, in addition to meeting the above standards for findings and evidence, the Commission's decision must not be contrary to law. "[T]his court must also determine whether the Commission's decision, ruling or order is contrary to law. Specifically, the Commission must stay within its jurisdiction and conform to the statutory and legal principles which must guide its decision, ruling, or order." *Gary-Hobart*, 591 N.E.2d at 652, *General Motors*, 654 N.E.2d at 758.

II. THE COMMISSION'S ORDER REQUIRING BLS RATES TO BE REDUCED IS UNLAWFUL.

A. In Cutting BLS Rates Based On A Price Cap Index/Productivity Offset Alternative Ratemaking Methodology, The Order Violates The Alternative Regulation Statute's Notice, Hearing And Findings Requirements.

1. The Alternative Regulation Statute Expressly Requires Notice, Hearing And Specific Findings Before The Commission May Use Alternative Ratemaking Regulation.

Ameritech's rates were established pursuant to Commission order and are Ameritech's lawful rates until proven otherwise and changed as provided under Indiana law, after notice and hearing.

Ind. Code §§ 8-1-2-44, 71, 72; *Indiana Tel. Corp. v. Public Service Comm'n*, 131 Ind. App. 314, 330, 336, 171 N.E.2d 111, 119 (1960). Under the traditional regulatory statutes, there is only one methodology for changing rates -- the rate-of-return methodology described in *City of Evansville v. Southern Ind. Gas & Elec. Co.*, 167 Ind. App. 472, 478-482, 339 N.E.2d 562, 568-71 (1975). Under that traditional ratemaking methodology, the Commission must first find that a utility's existing rates are unjust and unreasonable; if it does, the Commission may then order just and reasonable rates to be charged in the future. Ind. Code § 8-1-2-68; *Indiana Tel. Corp.*, 131 Ind. App. at 340, 171 N.E.2d at 124.

In this case, the Commission did not purport to find existing rates unjust and unreasonable under the traditional methodology, nor would the evidence be sufficient to support such a finding. Rather, the Commission was proceeding under the Alternative Regulation Statute, Ind. Code §§ 8-1-2.6-1 *et seq.* The Alternative Regulation Statute does not in terms grant ratemaking authority. Any such Commission authority must derive from its authority under Section 3 to develop and use alternative "regulatory procedures or generic standards" Ind. Code § 8-1-2.6-3.⁸

Section 3 in turn provides crucial safeguards that must be observed for the Commission to override the traditional utility regulation statutes and substitute alternative procedures or standards. First, there must be notice and hearing. Before using or imposing an alternative standard, the

⁸Under Section 2 of the Statute, the Commission may decline to exercise regulatory jurisdiction (in whole or in part). However, to the extent the Commission *continues* to exercise its jurisdiction and regulate telephone companies or services, but uses forms of regulation other than those permitted by the traditional regulation statutes -- as it is doing here in continuing to regulate BLS rates, but ordering them changed pursuant to a non-traditional methodology -- the Commission must proceed under Section 3.

Commission must provide notice of the specific alternative ratemaking or other standard which it is considering adopting. The Commission then must conduct a hearing on the specific alternative standard. Ind. Code § 8-1-2.6-3. The practical necessity for these requirements is obvious. Without notice of what the Commission proposes to do and a hearing on the specific proposal, there would not be a record upon which the Commission could make a reasoned and impartial decision as required by Ind. Code § 8-1-1-5, much less the findings required by the Alternative Regulation Statute.

Second, Section 3 further requires the Commission to make two types of specific findings. The Commission must find that the proposed alternative regulation standard or procedure is in the "public interest." Ind. Code § 8-1-2.6-3. The factors the Commission must consider in making this "public interest" determination are set forth in Section 2(b) of the Alternative Regulation Statute, Ind. Code § 8-1-2.6-2(b). The Commission must also find that the proposed alternative regulation standard or procedure promotes one or more of the additional criteria enumerated in Section 3. Ind. Code § 8-1-2.6-3. In *Telecommunications Ass'n of Indiana, Inc. v. Indiana Bell Tel. Co.*, 580 N.E.2d 713 (Ind. Ct. App. 1991), this Court relied on these statutory requirements in upholding Section 3 against a claim of unlawful delegation of legislative authority. 580 N.E.2d at 716.

2. The Commission Did Not Comply With The Notice And Hearing Requirements.

In the Final Order, the Commission reduced BLS rates pursuant to a newly adopted alternative regulation "concept". R.2727; App. 108. Specifically, the Commission adopted the concept of using a productivity offset to determine the appropriate level of price caps to accompany an interim alternative regulatory plan, and then imposed this new pricing concept to reduce

Ameritech's BLS prices. *Id.* This action was unlawful under the Alternative Regulation Statute for several reasons.

Section 3 precludes the Commission from acting on its own motion to adopt an alternative ratemaking standard without providing notice and hearing. The Commission did not give notice of a proposal to adopt any new alternative ratemaking standard, much less that it was considering utilizing the "productivity offset concept" adopted in the Final Order. Furthermore, the Commission did not conduct a hearing on the new standard before adopting this alternative regulation mechanism.

The notice the Commission published was that a hearing would be conducted on Ameritech's petition. R.1040. In its petition, Ameritech did not request any rate changes or use of new alternative ratemaking standards (*i.e.*, standards other than those previously adopted in Opportunity Indiana). The request for interim relief was narrower. Ameritech asked the Commission to maintain the current maximum prices and continue the declination of jurisdiction and alternative procedures contained in the Settlement until an order in the main case was entered. R.41, 871-881. Furthermore, in its Preliminary Order, the Commission rejected the suggestion that it was proceeding on its own motion and confirmed that it was proceeding on Ameritech's request for interim relief. R.1340; App. 77. The OUCC also took the position that the second hearing was conducted on Ameritech's request for interim relief and that the Commission had not given notice that it would act on its own motion. The OUCC argued: "No party could have properly responded to the infinite number of possible reasonable alternative regulatory plans prior to the Commission's critical determination in its October 15, 1997 Order that some form of interim relief was appropriate." R.2446. The OUCC further argued: "Additionally, no party, including the OUCC could or should

have been expected to anticipate the Commission's determination that this interim relief should also take the form of an alternative regulatory plan, and not a return to rate of return regulation." R.2446-2447.

Notwithstanding its prior confirmation that it was not acting on its own motion, the Commission then adopted a new ratemaking concept and applied it to reduce Ameritech's rates. The Final Order states that having ruled out Ameritech's request to maintain the present price caps, "we turn to perhaps the most difficult issue: setting some other rate." R.2727; App. 108. The Final Order further states that although the October 15 Preliminary Order neither adopted nor rejected RC's proposed rate reduction, "we implicitly accepted and now explicitly adopt the concept of using a productivity offset to determine the appropriate level of price cap to accompany an interim alternative regulatory plan." *Id.*⁹ The Commission then applied the FCC's productivity factor, subtracted for inflation, and ordered a 4.6% reduction for Ameritech's BLS rates. *Id.* In doing so, the Commission acted on its own motion without notice or hearing in violation of the Alternative Regulation Statute.¹⁰

⁹What the Commission actually did in the Preliminary Order was decide that BLS rates should be changed without deciding the ratemaking standard that should be applied -- thus plainly putting the cart before the horse and predetermining the result.

¹⁰The general testimony of RC's witness in the second hearing concerning price cap indices and productivity factors was not "notice" that the Commission was considering adoption of a new alternative regulation ratemaking standard incorporating such factors. Rather, RC's theory was that the Settlement itself "implicitly" required BLS rate reductions if the Opportunity Indiana regulatory structure were extended beyond the Settlement Period. Specifically, RC's witness contended that the rate reductions agreed to in the Settlement were intended by the settling consumer groups "to provide the outcomes expected from price cap regulation (and a competitive market) without specifying the details of a price cap plan, such as the proper inflation index and productivity offset, exogenous factors, and profit sharing." R.4160.

This "consumer groups' intention" theory was not adopted by the Commission. Furthermore, that theory has no support in the plain language of the Settlement, and there was no finding that the Settlement was ambiguous on this point. Hence, even the admission of this parol evidence over
(continued...)

3. The Commission Did Not Comply With The Findings Requirements.

In addition, Section 3 of the Alternative Regulation Statute precludes the Commission from adopting an alternative regulation procedure or standard without first finding that the procedure or standard serves the public interest and promotes one or more of the criteria enumerated in the statute. There is no finding in the Final Order that the productivity offset “concept” adopted by the Commission is in the public interest under the factors set forth in the Alternative Regulation Statute. See Ind. Code § 8-1-2.6-2(b). The only finding that mentions the public interest deals with Ameritech’s total company earnings during the period when the Commission had declined to exercise jurisdiction over earnings. R.2727; App. 108.

There is also no finding that either the productivity offset concept or the specific price cap index adopted by the Commission promotes one or more of the additional criteria in Section 3. Although the Commission did mention two of the five Section 3 criteria in its finding that continuing to cap the BLS and BLS-related prices “represents a potentially preferable alternative to rate of return regulation” (R.2726; App. 106), this finding does not satisfy the Alternative Regulation Statute. This finding concerns “continuing to cap the BLS and BLS-Related prices” (a form of alternative

¹⁰(...continued)

Ameritech’s objection (R.4131-4144) was error. Ind. Evidence Rule 408; 170 IAC 1-1-22; *Orkin Exterminating Co. v. Walters*, 466 N.E.2d 55, 60 (Ind. Ct. App. 1984) (“When a matter is expressly covered by a written instrument, the unambiguous provisions of that instrument control and the intent of the parties will be determined from within [its] ‘four corners’ . . .”); *Coplay Cement Co. v. Willis & Paul Group*, 983 F.2d 1435, 1438 (7th Cir. 1993) (“The rule in Indiana as elsewhere is that if the meaning of a written contract can be inferred from its terms, the judicial inquiry stops there; extrinsic evidence (for example, testimony by the negotiators of the contract concerning their intentions) is inadmissible.”).

regulation previously adopted after notice, hearing and findings in the Opportunity Indiana proceeding). The finding does not address reducing those BLS price caps, let alone the specific alternative regulation standard to change prices which the Commission adopted. It is not enough for the Commission to find that price caps -- a previously adopted alternative regulation standard -- promote one or more of the Section 3 criteria. The Commission must find that the specific (and new) alternative ratemaking standard it ordered here -- the productivity offset concept used to *change* rates -- is in the public interest and promotes one or more of the Section 3 criteria. Ind. Code § 8-1-2.6-3.

As the Indiana Supreme Court has long explained, the requirement of detailed findings covering all material basic and ultimate facts is essential. It enables the court "to review intelligently the Commission's decision," and thereby ensure that the agency has stayed within its legal authority and jurisdiction. See *General Tel. Co. of Indiana, Inc. v. Public Service Comm'n*, 238 Ind. 646, 652-54, 150 N.E.2d 891, 895, *reh'g denied*, 154 N.E.2d 372 (1958); *Perez v. United States Steel Corp.*, 426 N.E.2d at 31-32. These considerations apply even more forcefully when, as here, the Commission is proceeding under a statute which allows it to *override* in certain defined circumstances the standards and procedures provided by *other statutes*.

The pertinent portion of the Order is simply not supported by the requisite explanation and basic findings. There is, for example, no finding and no explanation why adoption of the productivity factor concept would provide a more accurate evaluation by the Commission of a telephone company's physical or financial conditions or needs, as well as a less costly regulatory procedure for the telephone company, its consumers, or the Commission. Similarly, there is no finding and no

explanation why the productivity concept and the BLS rate reductions are consistent with the competitive environment.¹¹

The Commission noted that without interim alternative regulation, there would be no immediate effect on Ameritech's rates when the Settlement expired, and that it would need to proceed under rate-of-return traditional regulation to review whether these rates result in unreasonable returns. R.2725; App. 106. The Commission implied that reducing BLS rates by some alternative mechanism would be in keeping with the policy set forth in Section 3. *Id.* Yet the Commission did not provide notice, conduct a hearing or make the statutorily-required findings concerning the "alternative mechanism" it used to reduce BLS rates. However easier or preferable it may be for the Commission to avoid applying the traditional regulatory processes to noncompetitive services, or to avoid notice, hearing and review of cost studies, productivity and inflation indices relevant to an alternative regulation price cap index standard, the Commission is a creature of statute and may not take such shortcuts.¹² The Commission's Order reducing BLS rates is unlawful for this reason alone.

¹¹In addition, of course, such findings would have to be supported by substantial evidence of record. Here there is no such evidence to support the necessary findings. Both defects trace back to the Commission's failure to provide notice and hearing on the new type of alternative regulation ratemaking standard it adopted.

¹²Constitutional due process rights also command fair notice, hearing and evidence when a utility regulator acts to reduce rates over the utility's objection. *Wisconsin Tel. Co. v. Public Service Comm'n*, 232 Wis. 274, 287 N.W. 122, 133, 139 (1939). See also *Public Service Comm'n v. Indiana Bell Tel. Co.*, 235 Ind. 1, 17-18, 130 N.E.2d 467, 475 (1955); *Public Service Comm'n v. Indianapolis Railways, Inc.*, 225 Ind. 30, 38-39, 72 N.E.2d 434, 438 (1947).

B. The Order Is Also Unlawful Because Neither The 1.9% Inflation Factor Nor The 6.5% Productivity Factor Used In The Price Cap Index Is Supported By Findings Or By The Evidence.

Nothing is to be treated as evidence that is not in the record. *Public Service Comm'n v. Indiana Bell Tel. Co.*, 235 Ind. 1, 24-27, 130 N.E.2d 467, 478-479 (1955). The Final Order adopts a 1.9% inflation factor based on a December 23, 1997 U.S. Department of Commerce Bureau of Economic Analysis National Accounts Data. R.2727; App. 108. This 1.9% inflation factor was issued after the close of the record. There is no explanation in the Final Order why this inflation index is appropriate. There is also no evidence in the record to support this index or this factor. The only inflation indices in the record were from the GDPPI for the period 1993 to first quarter of 1997. R.4164-4167. The factors ranged from 2.2% to 2.4%. R.4165.

In addition, in selecting the productivity factor used to order the reduction in BLS rates, the Final Order adopts a 6.5% productivity factor used by the Federal Communications Commission. R.2727; App. 108. The FCC, however, uses that productivity factor for *interstate access* services. See R.4169. In addition, this productivity factor is only part of the price cap index calculation used by the FCC for interstate access service. The FCC's price cap index formula also includes inflation and exogenous cost factors in its calculation. *Rules Concerning Rates*, 5 F.C.C.R. at 6792, 1990 FCC LEXIS 5301 at **47, App. 133; *Price Cap Performance*, 12 F.C.C.R. at 16711, 1997 FCC LEXIS 2725 at **155, App. 164. Notably, the Commission did not adopt the FCC's price cap index in its entirety. Instead, the Commission picked out the one piece of the formula that it desired and it did so without regard to how that one piece related to the other factors used in the FCC's price cap index formula.

Furthermore, there is no evidence to support the Commission's adoption of the FCC's productivity factor for intrastate purposes generally, or to support its application to BLS specifically. No productivity study was performed. The basic evidence in the record concerning the FCC's 6.5% productivity offset is at R.4169-4171. Specifically, RC's witness cited the 6.5% factor to show his "implied" 7.66% BLS rate reduction was in the same ballpark, percentage-wise, as productivity factors calculated by other regulators. *Id.* At a minimum, however, RC's contention that the elimination of the charges agreed to in the Settlement "imply" a productivity factor of 7.66% does not show that there had been or would be productivity gain in the provision of BLS. Nor did the Commission purport to find any such connection. Likewise, a reference to an interstate regulator's productivity factor does not establish that there had been or would be any productivity gain in the provision of BLS or other intrastate service, much less that the extent of such productivity gain would be the same as that for interstate services. Yet the Commission applied this factor as a measure of productivity growth in the provision of BLS and used it to reduce BLS rates. This action is not supported by the record evidence. Nor is it explained and supported by findings. The portion of the Final Order reducing BLS rates is unlawful for this reason as well.

C. The Order Is Also Unlawful Because No Rational Relationship Between The Rate Cut And The Existing Level Of BLS Rates Compared To Cost Is Shown By The Findings Or Established By Record Evidence.

Due to past regulatory policies designed to keep basic telephone rates low to promote the social goal of universal service (*i.e.*, a telephone in every household), local telephone rates are currently subsidized in a number of ways. *In the Matter of the Federal State Joint Board on Universal Service*, 12 F.C.C.R. 8776, 1997 FCC LEXIS 5786 (Part 1), *12-21 (May 8, 1997) ("*Universal Service*"), App. 154-158. "States have maintained low residential basic service rates

through, among other things, a combination of: geographic rate averaging, higher rates for business customers, higher intrastate access rates, higher rates for intrastate toll service and higher rates for vertical features.” *Id.* at *16, App. 156; *see also id.* at *14, App. 155. Indiana’s Commission has recognized that “due to other subsidies, the pricing for local service does not reflect its true cost.” *In the Matter of the Petition of MCI and GTE Sprint*, 1984 Ind. PUC LEXIS 796, *27-28 (Ind. PSC 1984), App. 175-176.¹³

These implicit subsidies were sustainable in the monopoly environment because some consumers (such as urban business customers) could be charged rates that significantly exceeded the cost of providing service, and the rates paid by those customers would implicitly subsidize service provided by the same carrier to others. *Universal Service*, 1997 FCC LEXIS 5786 (Part 1) at *20, App. 157. However, “[b]y adoption of the 1996 Act, Congress has provided for the development of competition in all telephone markets.” *Id.* “In a competitive market, a carrier that attempts to charge rates significantly above cost to a class of customers will lose many of those customers to a competitor. This incentive to entry by competitors in the lowest cost, highest profit market segments means that today’s pillars of implicit subsidies -- high access charges, high prices for business services, and the averaging of rates over broad geographic areas -- will be under attack.” *Id.* “New competitors can target service to more profitable customers without having to build into their rates the types of cross-subsidies that have been required of existing carriers who serve all customers.” *Id.* at *21, App. 157. The Telecommunications Act of 1996 (“TA96”) commands that any support

¹³In accordance with 170 IAC 1-1-18(f), Ameritech requested the Commission to take administrative notice of a portion of the record in Cause No. 40611, wherein witnesses for AT&T and Ameritech testified that Ameritech’s existing retail price structure for BLS was not cost based. R.1458. The Commission ignored this request.

to further universal service objectives should be explicit. 47 U.S.C. § 254(e). Thus, over time these implicit subsidies must be identified and converted into explicit subsidies. *Universal Service*, 1997 FCC LEXIS 5786 (Part 1) at *22, App. 158.

The Alternative Regulation Statute also commands economically rational pricing of alternatively-regulated telephone services. The statute envisions an environment where telephone services are available at the "most economic and reasonable cost possible." Ind. Code § 8-1-2.6-1(4). The criteria in Section 3 which focus on cost and regulation consistent with a competitive environment reinforce that price changes should be based on economically rational standards.

In the Final Order the Commission ignored these mandates and did not determine whether the BLS rates it reduced were already below the cost of providing that service. The Commission states that it was "satisfied that Ameritech Indiana has experienced and will continue to experience net productivity gains in the future." R.2726; App. 107. The reasons listed in the Final Order all concern why costs should be lower. None indicate whether the *price* for BLS exceeds the cost of providing the service. In addition, none indicate that net productivity gains have been achieved in the provision of BLS. Furthermore, none indicate that any supposed productivity gains achieved were in the provision of residential BLS as compared to business BLS. Finally, even when productivity gains do occur in a service priced below cost, that may simply mean that the rates are less below cost than they were previously. There is no finding -- and no evidence -- that any supposed net productivity gains in residential BLS were of such magnitude that the current prices exceed costs.

In the competitive environment created by TA96, implicit subsidies to a customer class cannot be sustained. Ordering a utility to provide a service below cost without providing an express mechanism to fund the subsidy is unjust and unreasonable. It is also contrary to the objectives of the Alternative Regulation Statute because such artificially low rates deter the development of competition for the subsidized service. Nor does the Commission conclude otherwise. Rather, the Commission relies on reasoning that is inherently flawed and not supported by evidence.

The Commission says that Ameritech's "impressive prosperity under Opportunity Indiana" resulted from "greater usage of its installed plant," and "further allocation of costs" should lower the "cost per use" of BLS. R.2726; App. 107. In fact, there is no evidence to support the conclusion that any further allocation of costs is reasonable, or that greater usage lowers the cost of residential BLS so much as to cause the existing prices to exceed the cost of that service.

Furthermore, the entire application of this concept to BLS is inherently flawed because BLS is offered on a flat rate basis. The Settlement provided that Ameritech "may not petition the Commission nor initiate on its own during the term of the Agreement any form of local measured service prohibited by P.L. No. 55-1992, even if such Act expires or is otherwise superseded by subsequent legislation." SR.25 (¶ 7b(iii)); App. 23.¹⁴ Even the Commission's authority under the Alternative Regulation Statute does not allow monthly BLS rates based on usage. Ind. Code § 8-1-2.6-7. As a consequence, unlike long distance or pay phone calls for which a charge is imposed for each use, in Indiana BLS is provided for one flat rate regardless whether the customer makes no, few,

¹⁴Section 3 of P.L.55-1992, an uncodified statute, prohibited rates for local service based on usage through July 1, 1995.

or many local telephone calls and regardless whether the local calls last a few seconds or many hours. The idea that greater usage lowers cost per use makes sense only when the service is priced on a usage basis.¹⁵ Since both the Settlement and Indiana law prohibited Ameritech from charging for BLS on a usage basis, the Commission's "cost per use" reasoning cannot rationally support the conclusion that the price per customer should be lower.

In addition, the Commission's conclusion that there had been greater usage is tied to a reference to Ameritech's "impressive prosperity" -- despite the facts that all of Ameritech's earnings during the Settlement were nonjurisdictional and that revenues in the BLS category decreased. The determination that Ameritech had "impressive prosperity under Opportunity Indiana" is unsupportable. There is no evidence concerning Ameritech's return on its property devoted to intrastate regulated services, because the Commission declined to exercise its jurisdiction over financial matters and earnings during the Settlement Period. The only evidence concerning the Company's financial viability is total Company earnings for both interstate and intrastate services and both regulated and unregulated services. There was no evidence that any prosperity, much less impressive prosperity, came from the provision of BLS. Furthermore, the uncontradicted evidence was that total BLS revenues fell during the Settlement Period. R.4727.

It is unlawful for the Commission to take revenues from interstate or unregulated service into account in setting regulated intrastate rates. To the extent that the Commission's jurisdiction is

¹⁵For example, if a hotel room rents for \$100 and one person rents the room, the cost per use is \$100. If, however, four persons rent one room (assuming no additional charge for extra persons), the cost per use is \$25.

limited to specific services, its ratemaking jurisdiction is likewise limited to those services. The jurisdictional limitations to consider revenues derived from interstate operations trace to the decision in *Smyth v. Ames*, 169 U.S. 466 (1898), which held that:

. . . the reasonableness or unreasonableness of rates prescribed by a State for the transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or to the profits derived from it. The State cannot justify unreasonably low rates for domestic transportation, considered alone, upon the grounds that the carrier is earning large profits on its interstate business, over which, so far as rates are concerned, the State has no control.

169 U.S. at 541-42. While *Smyth* dealt with railroads, the Supreme Court subsequently applied the same principles to intrastate and interstate telecommunications services. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 149-50 (1930). The Indiana Supreme Court has also ruled that separation of a utility's intrastate business from its interstate business is an essential limitation on the Commission's ratemaking authority. *Public Service Comm'n v. Indiana Bell Tel. Co.*, 235 Ind. at 28-29, 130 N.E.2d at 480.

The Commission also supported its conclusion concerning productivity gains with the statement that "[e]conomies of utilization plus further allocation of costs among an expanding group of services increases system efficiency even without innovation in local loop technology." R.2726; App. 107. As the Final Order acknowledges, however, this is argument of RC's counsel, not evidence. *Id.* There is no evidence that any economies of utilization had increased system efficiency even without innovation in local loop technology. Likewise, there is no evidence that it is reasonable to further allocate costs among an expanding group of services. Even if it were correct that the further allocation of costs among an expanding group of services increases *system* efficiency without innovation in the local loop, this would not necessarily mean that there would be a net decrease in the

cost of providing *BLS*. It also would not establish that any supposed BLS cost reductions achieved should be reflected in the price for residential as compared to business BLS. Nor would it in any way refute Ameritech's *uncontradicted evidence* that the price of residential BLS is below the cost of that service. See Statement of Facts, *supra* at 11.

The Commission said that it was skeptical of Ameritech's assignment of 100% of the cost of the local loop to BLS in showing that residential BLS rates are already below cost. However, the Commission pointed to no evidence to support this skepticism and none exists. Instead, the Commission went outside the record, referring to a statement by the FCC to conclude that some of the cost of the local loop should be allocated to other services and therefore the cost of BLS should be lower. R.2726; App. 107. The FCC's statement was made in another context, and did not address cost studies for, or pricing of, BLS service. Rather the statement concerned why the loop should be costed and priced as a separate unbundled network element under TA96. See *Local Competition Provisions*, 11 F.C.C.R. at 15846, 1996 FCC LEXIS 4312 at **60. App. 139-140. Furthermore, the cost models used by the FCC to cost basic service for purposes of supporting universal service include 100% of the cost of the local loop. *Universal Service*, 1997 FCC LEXIS 5786 (Part 2) at *80, App. 161; 47 C.F.R. §54.101 (1997).¹⁶ Thus it was arbitrary for the Commission to rely on this FCC statement. Even if that were not the case, the FCC statement would not establish (or even suggest) how much of the cost of providing BLS through the local loop should be allocated away

¹⁶Significantly, the Eighth Circuit Court of Appeals recently held that TA96 does not provide any basis for allocating the cost of the local loop to other services, such as local access to long distance service. *Southwestern Bell Tel. Co. v. FCC*, ___ F.3d ___, 1998 U.S. App. LEXIS 20479, *89 (8th Cir. 1998).

from BLS to other services. Much less would that FCC statement establish that the existing price caps for residential BLS are above cost. The portion of the Final Order reducing BLS rates is unlawful for these reasons as well.

D. The Order Is Also Unlawful Because The Commission Used The Alternative Regulation Statute To Cut Rates But Maintained Traditional Regulation Over Earnings, Contrary To Both The Commission's Own Finding And The Intent Of The Alternative Regulation Statute.

The Commission also erred in cutting BLS rates because the Commission did not do what it said it was going to do. The Commission found that its "agreement to relax our jurisdiction for the interim over Ameritech Indiana's earnings after December 31, 1997 in favor of a cap on Ameritech Indiana's rates necessarily depends on our determination of the appropriate level of the cap." R.2725; App. 106. However, the Commission then did not relax its jurisdiction over earnings. Instead, the Commission retained jurisdiction to conduct a traditional earnings review in another pending proceeding.

The Final Order notes that certain intervening parties had initiated another cause, No. 41058, seeking a review of Ameritech's earnings under traditional regulation (*i.e.*, rate-of-return) standards. *Id.* The Commission subsequently ordered that: "Subject to *other ongoing rate investigations*, until such time as this Commission issues an Order addressing the remainder of Ameritech Indiana's Petition other than for interim alternative regulatory relief, and subject to our further review if no such order has been issued by October 1, 1998, this Commission shall relax its [*sic*] jurisdiction to review Ameritech Indiana's earnings." R.2732 (emphasis added); App. 113.

Thus, what the Commission really did was take the *quid* without granting the *quo*. It reduced rates but retained jurisdiction to conduct a traditional earnings review in Cause No. 41058. This exception created by the Commission nullifies the relaxed earnings jurisdiction which the Commission was appearing to provide in exchange for the BLS price reduction. It is only necessary to have one proceeding to conduct a traditional earnings review.

This action was arbitrary and capricious and contrary to law. It is arbitrary and capricious because the findings -- that relaxation of jurisdiction over earnings and the appropriate level of a price cap are inextricably linked -- do not support the conclusions which (1) order a reduction in the BLS price cap, but (2) allow a traditional earnings investigation to continue. The action is also contrary to law because it violates the plain intent of the Alternative Regulation Statute, which is to allow the Commission in appropriate circumstances to *replace* regulation under the traditional regulatory statutes with no regulation (Section 2) or alternative regulation (Section 3). *See* Ind. Code § 8-1-2.6-2 (Commission may decline to exercise its jurisdiction “[n]otwithstanding any other statute”); Ind. Code § 8-1-2.6-3 (Commission may develop and use regulatory procedures and generic standards “[n]otwithstanding any other statute”); *Telecommunications Ass’n of Indiana*, 580 N.E.2d at 715-16 (Alternative Regulation Statute “allow[s] the Commission to act in contravention of [rule provided by traditional regulatory statute]”). Here the Commission in substance has improperly used the Alternative Regulation Statute to reduce rates while also *leaving in place* regulation of Ameritech’s rates under traditional earnings standards. The Alternative Regulation Statute does not authorize the Commission to engage in such inconsistent actions. The portion of the Final Order reducing BLS rates is unlawful for this reason as well.

E. Ameritech's Earnings And/Or Productivity Gains During The Settlement Period Are Not A Legal Basis For Ordering BLS Rates Reduced During The Interim Period.

Although ostensibly based on the "productivity factor" offset, it is apparent that the Commission's real reason for reducing BLS rates was Ameritech's earnings during the Settlement Period -- specifically, its reported "38.8 percent return on average equity" for 1996. R.2727; App. 108. Indeed, in what might be characterized as a "Freudian slip," the Commission said that under price cap alternative regulation, the utility "keeps *some* or all of the profit which might otherwise be deemed excessive during the term of the price cap." R.2724 (emphasis added); App. 105. As previously argued, the 1996 earnings figure, which the Commission found "highly probative," in fact includes both interstate and intrastate service, and both unregulated and regulated services, and was not shown to have any relationship to the price versus cost of intrastate BLS (let alone residential BLS). Even beyond this fundamental gap in the findings and evidence, however, Ameritech's earnings during the Settlement Period are not a proper basis for cutting rates. Under the Settlement approved by the Commission in the Opportunity Indiana proceeding, the Commission relinquished its exercise of all jurisdiction over financial matters and earnings during the Settlement Period. The Settlement also contained no earnings sharing mechanism and no price cap index.

This was not a one-sided bargain. In contrast to a price cap index plan where future prices may go up or down by an unspecified amount depending on the future economy, in the Settlement Ameritech accepted the risk and agreed to guaranteed rate decreases. SR.29 (¶ 8); App. 27. Furthermore, the largest of those rate decreases were loaded at the front end. *See id.* Ameritech also agreed to other tangible benefits for consumers, many or most of which could not have been ordered

by the Commission under the traditional regulation statutes.¹⁷ The Settlement also required Ameritech to bear all losses which occurred during the Settlement Period. SR.30 (§ 11b); App. 28. In return, the Settlement gave Ameritech the absolute right to keep all profit, not just some profit, which it earned during the Settlement Period. *Id.* (§ 11a).

The Commission's suggestion that Ameritech could keep only "some" of the profits during the Settlement Period would breach this bargain. There is no legal basis for the Commission to rewrite the Settlement after-the-fact. Given the terms of that Settlement, approved by the Commission, the Indiana Supreme Court's comments on the prohibition on retroactive ratemaking under traditional regulation apply with added force here:

Past losses of a utility cannot be recovered from consumers nor can consumers claim a return of profits and earnings which may appear excessive.

The chances of a loss or profit from operations is one of the risks a business enterprise must take. The Company must bear the loss and is entitled to the gain depending upon the efficiency of its management and the economic uncertainties of the future after a rate is fixed.

Public Service Comm'n v. City of Indianapolis, 235 Ind. 70, 88, 131 N.E.2d 308, 315 (1956). See also *Indiana Tel. Corp. v. Indiana Bell Tel. Co., Inc.*, 171 Ind. App. 616, 624-27, 358 N.E.2d 218, 224-26 (1976) (while long distance service "settlements" contract was subject to Commission jurisdiction and modification, any Commission-ordered modification could only be "prospective" in effect), *mod. in part on other grounds*, 171 Ind. App. 616, 638, 360 N.E.2d 610 (1977).

¹⁷These included a limitation on toll prices, free subscription periods, introduction of new services, promotions, and infrastructure investments. SR.27 (§ 7d(ii)), 29-30 (§§ 9-10); App. 25, 27-28.

In sum, there is no proper basis for the Commission to look backwards and recapture prior Ameritech earnings. For this reason as well, Ameritech's total earnings during 1996 cannot be a valid legal basis for ordering BLS rates reduced in 1998.

The Commission's findings on productivity also have an entirely retrospective cast. They focus on Ameritech's supposed "impressive prosperity under Opportunity Indiana," and supposed "greater usage of its installed plant" during that period. *See* R.2726; App. 107. Apart from the other deficiencies of this analysis, addressed above, the plain fact is that any supposed productivity gains during the Settlement Period were already offset by the guaranteed rate decreases.

In contrast, any post-Opportunity Indiana reductions in BLS rates based on "productivity gains" may not properly be premised on the same supposed *past* productivity gains, which would both be double counting and again breach the bargain. A productivity index is an estimate of how much growth in productivity can be achieved on a forward-looking basis. Historical productivity data can be used if it is representative of productivity which the utility may be expected to achieve in the future. However, there is no record evidence that any net productivity gains during the Settlement Period are predictive of such gains post-Opportunity Indiana. The Final Order likewise fails to explain why productivity which the Commission presumed occurred in the past is predictive of future productivity. Again the Commission's focus was retrospective, not prospective. Again the Final Order reducing BLS rates cannot be justified on a retrospective basis.

III. THE COMMISSION'S ORDER REWRITING AMERITECH'S INFRASTRUCTURE INVESTMENT OBLIGATIONS UNDER THE SETTLEMENT IS CONTRARY TO LAW.

Under paragraph 10(b) of the Settlement, Ameritech agreed to “provide digital switching and transport facilities including, where appropriate, fiber optic facilities, to every *interested* school, hospital and major government center in the Company’s service area on a non-discriminatory basis.” SR.30 (¶ 10(b)) (emphasis added); App. 28. The maximum infrastructure investment obligation was \$20 million per year for 1994 through 1999. *Id.*¹⁸ As set forth in the Statement of Facts, *supra* at 16, Ameritech undertook extensive efforts to interest all schools, hospitals and major government centers in this infrastructure program. However, the Settlement had overestimated the amount of immediate interest in using this infrastructure, and through June 1997 all interested schools, hospitals and major government centers required only \$15.6 million in direct infrastructure investment.

Based solely on the amount of infrastructure investment actually required to date by interested entities compared to the \$20 million maximum investment amounts per year, the Commission found that Ameritech “has failed to live up to its infrastructure investment obligation.” R.2730; App. 111. The Commission then directed that “[i]f [Ameritech] has trouble generating sufficient interest it should try harder . . . to generate interest in its provision of digital switching and transport facilities, or to otherwise propose *some other means* for its shareholders to provide infrastructure improvements consistent with paragraph 10(b).” R.2731 (emphasis added); App. 112.

¹⁸Under Settlement paragraph 10(a), Ameritech further agreed to contribute an additional \$5 million per year to a non-profit corporation to fund elementary and secondary school equipment purchases and training necessary to take advantage of the type of infrastructure involved.

There is no basis in the evidence for finding that Ameritech “failed to live up to its infrastructure investment obligation.” The Settlement explicitly provides that this infrastructure investment will be made for “*interested*” schools, hospitals and major government centers. The evidence is *uncontradicted* that Ameritech conducted a major program to interest all such entities in its service area. The evidence is *uncontradicted* that to date interested entities nevertheless required less direct infrastructure investment than the maximum per year amounts set forth in the Settlement.

Furthermore, there is no legal basis for the Commission to require Ameritech to use “*other means*” to expend the full infrastructure investment amounts -- *i.e.*, to spend otherwise unused amounts for something *other than* providing “digital switching and transport facilities . . . to every interested school, hospital and major government center in [its] service area” SR30 (¶ 10b); App. 28. The *only* basis for the Commission to require Ameritech to undertake this sort of investment at all is *enforcement* of the terms of the Settlement which the Commission previously approved. The Commission’s apparent effort now to *change* the obligation under the Settlement, and thereby compel Ameritech to spend unabsorbed investment amounts some other way, is simply contrary to law. The Commission has no legal authority to rewrite the Settlement after-the-fact to require Ameritech now to spend or invest part of the contractually-agreed paragraph 10(b) amounts in some “*other*” way or for some “*other*” purpose.¹⁹

¹⁹The Commission would have no independent authority under either the traditional regulatory statutes or under the Alternative Regulation Statute to compel this infrastructure investment -- and particularly not where, as under the Settlement here, the investment is ineligible for recovery in regulated rates. See SR.29 (¶ 10); App. 27. Nothing in the Final Order purports to conclude that the Commission has any legal authority to order this infrastructure investment obligation other than the Settlement itself. See also *Indiana Tel. Corp.*, 171 Ind. App. at 224-226, 358 N.E.2d at 624-627 (even where Commission has jurisdiction to modify a contract, it may do so only *prospectively*).

There is also no basis in the evidence even for the Commission's direction for Ameritech to "try harder" to interest the relevant entities. There is *zero* evidence in the record that Ameritech's efforts in this regard were deficient, or that there was anything more it reasonably could or should have done to stimulate interest.

Finally, there is no basis for the Commission's pejorative suggestion that Ameritech has "pocket[ed]" any part of the infrastructure investment amounts which have not been required to date for interested entities. The evidence is *uncontradicted* that, over the pertinent period, Ameritech's total infrastructure investments were greater than the total amounts projected in the Opportunity Indiana proceeding, *including* the investments provided in the Settlement. See Statement of Facts, *supra* at 16-17.²⁰

²⁰Equally indefensible is the Commission's pejorative and gratuitous misstatement of Ameritech's position concerning the infrastructure obligations for 1998 and 1999. According to the Commission, Ameritech's witness Cubellis' opinion was that "if the rest of Opportunity Indiana ends as scheduled on December 31, 1997, then so does the infrastructure commitment." R.2731; App. 112. In fact, Mr. Cubellis said that was his view "*unless interim relief is granted . . .*" R.3782 (emphasis added). The Commission then describes Ameritech's position in its "Omnibus Motion at 10" as being that Ameritech "is not required as a matter of law or agreement to comply with paragraph 10." R.2731, App. 112. In fact, that selectively quoted portion of Ameritech's filing was specifically addressed to the situation where no interim relief was ordered and prior regulation resumed "until an order is issued at the conclusion of this proceeding . . ." R.1461. Having so misdescribed Ameritech's position, the Commission then says "[t]he legal justification for [it] . . . has yet to be provided." R.2731, App. 112. In fact, Ameritech specifically pointed out paragraph 13 of the Settlement. R.2607-2608. Paragraph 13 explicitly states that, if no order is entered by December 31, 1997 in the future Commission proceeding contemplated by that paragraph (*i.e.*, on the regulatory structure to govern Ameritech after December 31, 1997), "this agreement *shall have no further legal force and effect with respect to the Settling Parties' rights and obligations.*" SR.32 (emphasis added); App. 30. In professing an inability to find "legal justification" for Ameritech's position, the Commission does not so much as mention this provision of the Settlement it approved. Finally, the Commission indicates it was necessary to address this non-issue because Ameritech supposedly had only "signaled its willingness to continue its infrastructure investments . . ." R.2731; App. 112. In fact, even with respect to the circumstance Ameritech was actually addressing -- *i.e.*, one where no

(continued...)

CONCLUSION

This Court "may set aside [an] . . . order of the Commission, in whole or in part, or remand the proceeding to the Commission with instructions." Ind. Code § 8-1-3-7(a). For the foregoing reasons, the Court should set aside the parts of the Final Order which (1) adopt a price cap index (productivity and inflation factors) form of alternative regulation ratemaking standard; (2) order a reduction in BLS rates; and (3) require Ameritech to propose "some other means" of spending the infrastructure investment amounts provided by paragraph 10(b) of the Settlement. The Court may also remand to the Commission for consideration whether other changes should be made to the interim regulatory structure in light of the parts which the Court orders set aside.

Respectfully submitted,



Sue E. Stemen (1988-49)
AMERITECH INDIANA
240 North Meridian Street, Room 1826
Indianapolis, Indiana 46204
Telephone: (317) 265-3676

Teresa E. Morton (14044-49)
Stanley C. Fickle (8039-49)
Mark A. Lindsey (19458-32)
BARNES & THORNBURG
11 South Meridian Street, Suite 1313
Indianapolis, Indiana 46204
Telephone: (317) 231-7716

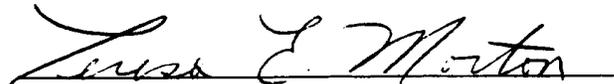
Attorneys for Appellant Indiana Bell
Telephone Company, Incorporated
d/b/a Ameritech Indiana

²⁰(...continued)

order for interim relief would be entered by December 31, 1997 (a circumstance that in fact did not occur) -- Ameritech had explicitly told the Commission that "Ameritech Indiana will continue to make the infrastructure investments set forth in paragraph 10 of the Opportunity Indiana Settlement Agreement while the main case is pending before the Commission." R.1461.

CERTIFICATE OF WORD COUNT

Pursuant to Ind. Appellate Rule 8.2(A)(4), I hereby affirm, under the penalties for perjury, that the foregoing "Brief of Appellant Indiana Bell Telephone Company, Incorporated d/b/a Ameritech Indiana" (exclusive of App. R. 8.3(A)(1) items, this Certificate and the Certificate of Service) has 13,988 words, as determined by the word processing system used to prepare the Brief (Word Perfect Version 6.1).


Teresa E. Morton