

# Real Competition? Proposed Deregulation of Local Telephone Service in Illinois

Shirley T. Chiu  
Student Fellow, Institute for Consumer Antitrust Studies  
Loyola University Chicago School of Law

## Introduction

Prompted by the rise of phone service provided by cable television companies and the popularity of mobile phones, local phone providers have sought deregulation approval from their state regulators.<sup>1</sup> States such as Indiana, Wisconsin, Michigan, Ohio, Missouri, and others have approved deregulation of residential phone service to allow significant pricing flexibility for the incumbent carrier.<sup>2</sup> In Illinois, AT&T and the Citizens Utility Board (“CUB”) recently agreed to a proposal deregulating retail rates in the Chicago area, which is currently awaiting approval by the Illinois Commerce Commission (“ICC”).<sup>3</sup> However, the sentiment over the proposal is mixed. On the one hand, Ill. Attorney General, Lisa Madigan, called the proposal “a step backward for consumers” and a move that would “add \$275 million in extra revenue for the phone company.”<sup>4</sup> On the other hand, AT&T Illinois views deregulation as the next logical step in the evolution of already existing telecommunications competition.<sup>5</sup>

## History of Federal and State Deregulation

Opening local phone providers to competition is old news. Not only has Illinois attempted to promote entry to the local residential telephone market over the course of the last 20 years, but so has the federal government. Through the Telecommunications Act of 1996

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<sup>1</sup> Jon Van, *AT&T, CUB Agree on Pact: Basic Rates Frozen in Deregulation Deal*, Chicago Tribune, May 11, 2006.

<sup>2</sup> *Id.*

<sup>3</sup> *State Telephone Regulation Report*, Section: State Notebook, Illinois, June 2, 2006.

<sup>4</sup> Michael D. Sorkin, *Phone Rates Draw Scrutiny*, St. Louis Post-Dispatch, May 26, 2006.

<sup>5</sup> Initial Brief of AT&T Illinois at 5, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

Congress sought to deregulate and promote competition so that telecoms could compete head to head.<sup>6</sup> The Act aimed to secure lower prices and higher quality services for telecommunications consumers and encourage the development of new technology. Essentially, the Act sought to end the monopolies that states have historically granted to local exchange carriers, while subjecting the incumbent local exchange carriers to a number of duties intended to facilitate market entry, including the responsibility to share their networks with competitors.

In Illinois, telecommunications is currently regulated under the Illinois Public Utilities Act.<sup>7</sup> Based on the principle of regulated monopoly rather than unrestrained competition, the Act attempts to assure the provision of efficient and adequate utility service to the public at a reasonable cost.<sup>8</sup> The Act pertains to public utilities rates and services, including those of noncompetitive telecommunications.<sup>9</sup> Section 13-502 of the Act also defines competition, providing that it is not enough to show the presence of other service providers in the marketplace to classify services as competitive.<sup>10</sup> Rather, these other service providers must provide functionally equivalent or substitute services, that current consumers would consider switching to, in order to classify the services as competitive.

Illinois first moved to introduce competition into the state's price capped telecommunications marketplace long before the Telecommunications Act of 1996. In 1985, the Illinois General Assembly enacted the Universal Telephone Service Protection Law, which recognized as a matter of state policy that competition ensures "better services, terms and

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<sup>6</sup> Pub. L. No. 104-104, 110 Stat. 56 (1996) (codified as amended in scattered sections of 47 U.S.C.).

<sup>7</sup> 220 ILL. COMP. STAT. ANN. 5/13-101 (West 2006).

<sup>8</sup> Illinois Commerce Commission v. Chicago Rys. Co., 1 N.E.2d 65 (Ill. 1936).

<sup>9</sup> 220 ILL. COMP. STAT. ANN. 5/13-101 (West 2006).

<sup>10</sup> 220 ILL. COMP. STAT. ANN. 5/13-502 (West 2006).

conditions for customers and disciplines the prices that can be charged.”<sup>11</sup> In an effort to promote local residential competition, the ICC in 1994 ordered Illinois Bell to make its residential services available for resale to competitive carriers that were certified to provide local exchange services.<sup>12</sup> However, large carriers found it difficult to compete for local residential services through such resale.<sup>13</sup> To counteract this problem, the ICC in 1996 authorized competing telecommunications carriers to lease the facilities of Illinois Bell and use those facilities for the provision of competitive local services.<sup>14</sup> When local competition continued to be lacking, the Illinois General Assembly in 2001 enacted Public Act 92-0022 requiring Illinois Bell to make its unbundled network element platform (“UNE-P”)<sup>15</sup> facilities available to competing carriers to promote local competition.<sup>16</sup> Growth in competition followed the 2001 codification, but was set back in 2004 when the Federal Communications Commission (“FCC”) announced the termination of competitive carriers’ rights to access the UNE-P under the Telecommunications Act of 1996.<sup>17</sup> Independent competitive corporations, such as AT&T and MCI were then acquired by incumbent local exchange monopolies, SBC and Verizon, respectively.<sup>18</sup> Furthermore, the FCC’s Triennial Review and Remand Order (“TRRO”) in February 2005 removed the obligation of the incumbent carrier to provide UNE-P and its

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<sup>11</sup> 220 ILL. COMP. STAT. ANN. 5/13-103(b) (West 2006).

<sup>12</sup> Illinois Bell Telephone Company Proposed Introduction of a Trial of Ameritech’s Customers First Plan, ICC Docket No. 94-0096, Order, April 7, 1995, pp. 66-67.

<sup>13</sup> Initial Brief of Data Net Systems, L.L.C. and Trucomm Corporation at 4, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 17, 2006).

<sup>14</sup> AT&T Communications of Illinois, Inc., ICC Docket No. 95-0458/95-0531, Order, June 26, 1996.

<sup>15</sup> The underlying copper and port space on the local switch of the network that incumbent local exchange carriers are required to offer on an unbundled basis to competitive local exchange carriers who can then deliver service without laying network infrastructure.

<sup>16</sup> Initial Brief of Data Net Systems, L.L.C. and Trucomm Corporation at 4, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 17, 2006).

<sup>17</sup> In the Matter of Unbundled Access to Network Elements, Order on Remand, 20 F.C.C.R. 2533, Released February 4, 2005.

<sup>18</sup> Initial Brief of Data Net Systems, L.L.C. and Trucomm Corporation at 5, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 17, 2006).

unbundled network element (“UNE”)<sup>19</sup>-switching component to competitive local exchange carriers.

### The Current Proposal

The current proposal negotiated between CUB and AT&T Illinois allows for the deregulation of local residential telephone service in the Chicago. Access line and local usage charges on AT&T Illinois’ residential basic services for three calling plans would be frozen for four years, while other non-basic services are priced to the market.<sup>20</sup> In return, AT&T Illinois is required to make DSL available on 99% of access lines in the Chicago area by 2010, and set up a \$2.5 million consumer education fund to be run by CUB for customer education regarding rate increases and the new proposed calling plans.<sup>21</sup> At the end of the four years, AT&T Illinois will not be allowed to increase its rates by more than 3.6 percent.<sup>22</sup> Furthermore, as part of the consumer education fund’s initiative, AT&T Illinois and CUB will design seven messages and supplements to be inserted into customer bills, educating customers of opportunities to reduce their telephone bills.<sup>23</sup>

The three proposed calling plans are considered “safe harbor” provisions because the lower, frozen rates for access lines and local usage will remain exempt from further increases for three packages for four years until 2010.<sup>24</sup> These three packages are created to meet the needs of consumers with different levels of phone usage. The first package, Super Saver 30, offers thirty

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<sup>19</sup> A facility or equipment used in the provision of a telecommunications service.

<sup>20</sup> Initial Brief of AT&T Illinois at 9, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>21</sup> Initial Brief of the Citizens Utility Board at 2, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>22</sup> *Id.*

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* at 5.

calls per month for \$0.50 plus the current network access charge, which varies depending on the network area.<sup>25</sup> The price of additional calls will be reduced from \$0.10 to \$0.06, and such rate will remain in effect for four years.<sup>26</sup> The second package, Residence Saver Pack Unlimited, provides customers with the network access line and unlimited calls for a flat fee per month.<sup>27</sup> The flat rates will be reduced and will remain in effect for four years, and subscribers will not be affected by any increase in the network access line rate.<sup>28</sup> Finally, the third package, the Flat Rate Package, will provide not only the network access line and unlimited calls for a flat fee, but also a choice of two optional calling features at a reduced rate for the next four years.<sup>29</sup> After the freeze period, ICC will automatically investigate the rate increases for these three packages when the proposed rate increase exceeds a certain level.<sup>30</sup>

### Consumer Impact

Government and consumer groups are divided on the impact of the AT&T/ CUB proposal. The primary concern by the City of Chicago is that the region which the proposal will impact has not “reached a sustainable level of competition” adequate enough to protect the customers who pay for measured service, or purchase only an access line and pay for only those local telephone calls that they make.<sup>31</sup> According to the City of Chicago, 33 percent of the current telephone consumers in the impacted region use local measured service, and AT&T

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<sup>25</sup> *Id.* at 5-6.

<sup>26</sup> Initial Brief of the Citizens Utility Board at 6, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 6-7 (stating that the rate for Area A will be reduced from \$12.05 to \$10.00, the rate for area B from \$15.03 to \$13.00, and Area C from \$18.50 to \$16.00).

<sup>29</sup> Initial Brief of the Citizens Utility Board at 6, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>30</sup> *Id.*

<sup>31</sup> Initial Brief of the City of Chicago at 7, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

Illinois is the only party to this hearing that believes there are competitors that offer a service at a price comparable to the current measured service offered.<sup>32</sup> On the other hand, CUB contends that the customers who use local measure service will be protected by the proposal's limited rate increases on the network access line and usage.<sup>33</sup> Additionally, AT&T asserts that the purpose of the safe harbor packages is to provide customers who want "price protection with alternatives" in the event that stand-alone network access line and usage rates increase.<sup>34</sup>

The true answer to whether customers who make few local phone calls benefit from this proposal really depends on the number of phone calls made per month. According to experts, customers making between 17 and 43 calls per month will pay less for the Saver Pack 30 and a network access line ("NAL"), than for measured service and a NAL.<sup>35</sup> Currently customers making between 0 and 16 calls and customers that make between 43 and 60 calls per month pay less for measured service and a NAL, than Saver Pack 30 and a NAL.<sup>36</sup> However, if AT&T Illinois increased its NAL rate by \$1 as permitted in 2007 under the new proposal, then all such customers will pay less switching to Saver Pack 30 and a NAL.<sup>37</sup>

The majority of customers who do not use measured service will be better off under the new proposal. Although the state is justified in its immediate concerns regarding low level measured usage customers, we need to keep in mind that the \$2.5 million consumer education

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<sup>32</sup> *Id.* at 2.

<sup>33</sup> Initial Brief of the Citizens Utility Board at 11, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>34</sup> Initial Brief of AT&T Illinois at 80, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>35</sup> Testimony of Dr. James Zolnierek at 9, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (May 24, 2006).

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

fund will be put in place for the specific purpose of educating consumers when rates change to enable them to reap the benefits of switching to one of the three plans.<sup>38</sup>

Another major concern by the City of Chicago is that following the FCC's TRRO in 2005, AT&T Illinois was relieved of its obligation to provide UNE-P and its UNE-switching component.<sup>39</sup> The City fears competitive local exchange carriers will in the future lose the vast majority of the residential access lines that they serve, and that AT&T Illinois will recapture those lost lines, making it more expensive for competitive local exchange carriers to provide the same services.<sup>40</sup> As a result, the City believes that under the new proposal it will be impractical economically for the competitive local exchange carriers to offer residential services at a price that will be able to constrain AT&T Illinois' own basic service rates.<sup>41</sup>

However, most competitors of AT&T Illinois are already competing with the incumbent carrier using platforms other than the UNE-P.<sup>42</sup> In fact, all wireless and independent Voice over Internet Protocol ("VoIP") providers, and some cable companies, rely on their own network facilities or facilities of a third party, while less than 10 percent of competitive local exchange carriers purchase UNE loops from AT&T Illinois on an independent basis in conjunction with their own switching, or through resale.<sup>43</sup>

Despite the state's concerns, the AT&T and CUB proposal still offers more protection to consumers by virtue of the four year rate freeze under the three safe harbor plans, than

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<sup>38</sup> Initial Brief of the Citizens Utility Board at 8, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>39</sup> Initial Brief of the City of Chicago at 13, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> Initial Brief of AT&T Illinois at 53-4, Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, ICC Docket No. 06-0027 (June 16, 2006).

<sup>43</sup> *Id.* (consumers view wireless and VoIP service as substitutes for long distance telephone service, despite the City's view that the three are not substitutes.)

deregulation proposals offered by other states in the Midwest. Furthermore, allowing competition without state regulated price caps will lower rates in areas where they are now substantially above costs.<sup>44</sup> In the current situation, the incumbent local phone providers will have to rely on transfers from funds created by federal and state taxes on telecommunications carriers because state regulators are unwilling to let the below-cost retail rates rise significantly. If these taxes are assessed in proportion to providers' revenues, they will be passed on to consumers in the form of usage charges in long distance calls, Internet connections, or new services, as they have in the past. Clearly, the inefficiencies of the telecommunications industry cannot be changed overnight. However, a proposal such as that awaiting approval by the ICC forcing some consumers in the short run to switch to a new package that is cost-efficient is a step towards a more efficient telecommunications industry for both providers and consumers in the long run.

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<sup>44</sup> Robert W. Crandall, *Are We Deregulating Telephone Services? Think Again*, Policy Brief, The Brookings Institution, 1997. (making argument that local phone companies are forced by state regulators to offer local services to many of their customers (particularly residences in small towns and rural areas at rates that are substantially below their own costs) while charging others (particularly business customers and residences in large cities) rates that are substantially above costs).