BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 03-0553

Direct Testimony of Brian Gillespie
On Behalf of SBC Illinois

SBC Illinois Exhibit 1.0

PUBLIC VERSION

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DIRECT TESTIMONY OF BRIAN GILLESPIE

ON BEHALF OF SBC ILLINOIS

I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Brian Gillespie. My address is 2000 W. SBC Drive, Hoffman Estates, IL 60196.

Q. What is your current position?

A. I am Director, SBC Business Pricing in the SBC Product Management and Development organization. I have responsibility for tariff and promotional pricing of specific regulated products and services, including Centrex, ISDN PRI, and Transport Services (e.g. DS1, DS3). This responsibility includes providing recommendations on permanent price changes, permanent price structure changes (e.g. adding additional term plans), new product pricing and temporary promotional pricing (e.g. NRC waivers).

Q. Please describe your professional experience.

A. I have worked in telecommunications industry since joining Ameritech Corporation in October 1988. I have held various positions of increasing responsibility in different organizations of the company including Cost Accounting, Budgeting, Financial Analysis, Financial Systems Development, Product Management and Business Pricing. Since December 1999, I have worked in the SBC Business Pricing organization.

Q. Please describe your educational background.

A. I have a Bachelor of Science degree in Finance from Northern Illinois University (1985) and a Masters in Business Administration from DePaul University (1996).

II. PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to demonstrate that, contrary to allegations made by TDS Metrocom, LLC ("TDS"), SBC Illinois' early termination liability policies are reasonable and should not be changed. I will summarize the Commission's decision in the Ascent case and explain how SBC Illinois implemented it. I will then describe SBC Illinois' early termination liability policies, which have recently been modified. I will demonstrate that these policies are reasonable, are consistent with the practices of competitors in the marketplace, and are not anticompetitive. I will show that the marketplace for business services in Illinois is competitive and that the Commission should allow the marketplace to determine competitive practices in this area. Finally, I will address TDS' proposal and demonstrate that it should not be adopted.

SBC Illinois' position will be presented through my testimony and that of three other witnesses. Dr. Alan Frankel will address termination liabilities from an economic perspective and assess the reasonableness of SBC Illinois' current policies. Ron Flitsch will present the cost analysis used by SBC Illinois to develop its current liability policies. Jim Longua will present data on the competitive nature of the business telecommunications marketplace in Illinois.

III. SBC ILLINOIS' OFFERINGS TO BUSINESS CUSTOMERS

Q. Please describe SBC Illinois' offerings to business customers, insofar as they are relevant to this proceeding.

A. SBC Illinois offers a wide variety of telecommunications services to business customers. They range from basic local exchange service (which I would define as a network access line, usage and central office features) to more specialized arrangements such as Centrex, which provides features such as intercom dialing between employees served by a single system and sophisticated routing options. The Company offers more sophisticated network connections for data transmissions, which substitute for conventional network access lines (e.g ISDN-Prime). SBC Illinois also offers customers dedicated or "point-to-point" services that connect two or more customer locations over facilities that do not transverse the public switched network and can only be used by the subscribing customer (e.g. DS-1s, DS-3s, Sonet and GigaMAN). These dedicated offerings can be economic for customers with high volumes of traffic (whether voice or data) between specific locations (e.g. between branch offices of the same business or between an office and a warehouse facility). These products and services are described in more detail in my Schedule BG-1.

Q. What pricing options are available to customers that purchase these business products?

A. Customers generally have two options. The vast majority of SBC Illinois' products and services are offered on what are generally referred to as "month-to-month" pricing plans.

Under this option, the customer makes no commitment to SBC Illinois to retain the service for any specified period of time. Instead, the customer pays for each month that the service is utilized and may terminate service at any time without termination fees. These month-to-month pricing plans are generally offered pursuant to SBC Illinois' tariffs on file with this Commission. Tariff rates may be changed at any time, subject to the requirements of the Illinois Public Utilities Act.

Customers also have the option of selecting to take service under a term arrangement. Under term plans, the customer commits to retaining the service for a prescribed period of time and, in return for that commitment, receives discounted rates for the commitment term. Term plans are available under tariff for the products and services described above. In addition, under Section 13-509 of the Public Utilities Act, SBC Illinois may go off tariff and negotiate customer-specific deals that are provided pursuant to contract. The contracts are often referred to as "Individual Case Basis" arrangements or "ICBs". In ICBs, the parties may agree on prices, terms or conditions that are different from those contained in the tariffs. All term plans (both tariff and ICB) contain liability provisions that apply if the customer terminates service before the expiration of the contract.

Q. What are the most common types of early termination liabilities?

A. Early termination liabilities come in several forms. For products and services that are provided under pricing structures where the monthly amount due is fixed, a typical early liability provision would require the customer terminating early to pay a percentage of the charges remaining on the contract. As I will discuss later in my testimony, however, this approach is not used universally in SBC Illinois' term plans today. Some plans use a "give back the discount" approach similar to what TDS is proposing in this proceeding and some plans give customers choices between different early termination liability options. These forms of early termination liability described above are generally found in agreements for Centrex and dedicated services, both tariff and ICB.

A somewhat different approach is required for services where the customer commits to a minimum spend for a period of time. In these cases, customers are given discounts each month based on a commitment to spend a minimum amount in an annual period. In this situation, the customer agrees to a "Minimum Annual Revenue Commitment" or "MARC", which represents an obligation on the customer's part to make a minimum spend each year of the agreement. If the customer does not meet the MARC in any given year, the customer is subject to so-called "true-up" or underutilization charges for that year. In addition, the MARC would be used to determine the amount of the early termination liability if the customer were to terminate service early. Generally, the early termination liability for these types of offers are calculated as a percentage of the MARC for each year remaining on the contract.

IV. THE COMMISSION'S <u>ASCENT</u> DECISION AND SBC ILLINOIS' IMPLEMENTATION OF THAT DECISION

Q. Please describe the Commission's decision in the <u>Ascent</u> proceeding.

A. On January 11, 2000, the Association of Communication Enterprises ("ASCENT)", a trade association representing resellers, filed a complaint charging that the termination liabilities charged by SBC Illinois in certain term plans, referred to in the Order as the "ValueLink" tariffs, were unreasonable and anticompetitive. The tariffs at issue were specifically enumerated in the complaint and included the ValueLink family of plans (ValueLink Extra, ValueLink Extra Select, ValueLink Illinois-Option F, ValueLink Illinois Option F Preferred and Enhanced Ameritech ValueLink Plus), CompleteLink and the Straight Rate plans (Order, p. 1, n. 1). At the time that the complaint was filed, SBC Illinois' standard practice was to charge 100% of the amount remaining on the contract. Although this percentage was reduced to 50% before the close of the proceeding (Order, p. 31), the Commission's analysis was based on the 100% policy (Order, pp. 31-32).

Based on the record developed in that proceeding, the Commission concluded that SBC Illinois' 100% policy for the "ValueLink" tariffs was unreasonable and had been an impediment to the development of competition (Order, p. 17). In reaching that conclusion, the Commission noted that the initial ValueLink tariffs had taken effect literally within days or weeks of the implementation of intraMSA equal access in 1996. The Commission concluded that:

> "Sustainable competition for Band C calls could not have developed in a single day or in three weeks. Rather, these facts indicate that the termination penalties associated with the forgoing ValueLink services were introduced to lock in customers and thereby thwart the emergence of competition. " (Order, p. 17).

With respect to the 100% policy, the Commission concluded as follows:

> "…it inherently exceeds actual damages. Whatever Ameritech's actual damages may be when a ValueLink agreement is terminated, it is something less than expected revenues, because the subject services cost something to provide." (Order, p. 17).

Q. What relief did the Commission order?

A. The Commission ordered SBC Illinois to modify the tariffs at issue in the proceeding to include a different early termination liability provision. Based on proposals advanced by ASCENT and the Commission Staff, the Commission ordered SBC Illinois to replace the tariffed provision with a early termination liability that requires the customer to give back the unearned portion of the discount (limited to 12 months): that is, the customer's rate is recalculated based on the discount that would have applied to the term that the customer actually completed. To use a specific example, if a customer has completed 3 years of a 5-year agreement, the Company calculates what the customer would have paid under the higher rates that would have applied to a 3-year term and the customer owes the difference between what he actually paid and what he would have/should have paid. In response to SBC Illinois' argument that this amount could actually exceed what the customer would pay under its early termination liability policy (i.e. where the customer is approaching the end of the term), the Commission also capped the liability at one year's worth of unearned savings (Order, p. 28).

Q. How did SBC Illinois implement this Order?

A. SBC Illinois implemented it according to its terms. The Commission's Order was directed to the specific *family of services* that ASCENT named in its Complaint and which were the subject of the proceeding and the *tariffs* under which those services were offered. For example, Finding (9) provides as follows:

> "Ameritech should revise the *tariffed calling plans described in Finding (5)* to provide for termination charges calculated by subtracting the discounted charges the customer actually incurred during its term of service from the charges the

> customer should have incurred, based on its actual term of service, under the pertinent tariffed calling plan; further, Ameritech should be prohibited from including earned discounts, as described in this Order, in such termination charges; and further, Ameritech should be prohibited from including in such termination charges any unearned discounts associated with ValueLink services provided more than 12 months before service termination." (emphasis added).

Finding (5) referenced in Finding (9) lists the ValueLink services I described above. SBC Illinois made the required modifications in these tariffs in a timely fashion and has been calculating termination liabilities in accordance with the Order since then. I do not believe there is any dispute over this issue.

Although the Order did not require SBC Illinois to make changes in *other* usage-based products or in *non-tariffed* offerings, SBC Illinois did so anyway. The 50% early termination liability that SBC Illinois filed during the proceeding was initially used for other usage-based tariff products and ICBs that included the ValueLink family of services. Subsequently, Staff sponsored workshops in compliance with the Order to assess the practices of CLECs with regard to termination liabilities (Order, p. 36). Although it was clear that the CLECs used a variety of different early termination liability practices, many of them higher than SBC Illinois' 50%, SBC Illinois adopted a 35% policy for all new usage-based tariffs that were filed thereafter with the Commission. The 50% policy continued to be used in ICBs. Although, as TDS points out (Lock, pp. 20-21), SBC Illinois marketing staff can make errors in calculating termination liabilities for contracts entered into prior to full implementation of the Ascent Order (i.e. after completion of the workshops), SBC Illinois *policy* is what I have stated in my testimony.

Q. TDS suggests that the Ascent decision applies to all of the services that SBC Illinois offers under term agreements. Please comment.

A. Although I am not an attorney, I do not find any basis for TDS' position in the Ascent Order. Ascent's Complaint and the proceeding itself were directed to SBC Illinois' tariffs for a specific family of services, namely the ValueLink services. The reasonableness of SBC Illinois' early termination liability policy in those tariffs was analyzed based on the level competition for usage services at the particular point in time when those plans were introduced and on the 100% policy that was in place at that time. As I will demonstrate later in my testimony, TDS' complaint presents very different issues. A much wider range of products and services is involved, the term agreements in place today are much more recent, the market is much more competitive today than it was in 1996 (or even in 2000, when the Ascent Complaint was filed) and the level of SBC Illinois' termination liabilities are a far cry from 100%--particularly on a going forward basis. I see no basis for assuming that the Commission's Order would automatically apply to the services at issue here.

V. SBC ILLINOIS' CURRENT EARLY TERMINATION LIABILITY POLICIES

Q. Please describe SBC Illinois' current early termination liability policies.

A. As I indicated above, SBC Illinois' tariffs and ICBs contain termination liabilities that vary significantly by product and service. Some provisions are what I would call "forward-looking", in that the early termination liability is based on some percentage of what is left on the contract. Some are "backwards-looking", in that the early termination liability is calculated based on the savings the customer has earned for the period that has already been completed. Even within the category of forward-looking liabilities, the level of the liability as a percentage of what remains on the contract varies by product. I will describe these policies in more detail later in my testimony. The examples presented by TDS in its direct testimony are fairly typical of the forward-looking variety.

Q. Are these policies the relevant ones to be examining in this proceeding?

A. No. As SBC Illinois indicated in its Amended Answer to TDS' Complaint and as TDS acknowledges in its testimony, SBC Illinois is in the process of modifying its early termination liability policies across-the-board. These modified policies will apply to all products and services offered under term agreements (whether tariffs or ICBs), and to both new and existing customers (although customers on term agreements today will only be charged the *lesser* of the early termination liability that applies under their existing agreement and the amount that would result from the new policy). Since these new policies will be in effect in the near future, they should be the focus of this proceeding, not the old policies that are being replaced.

Q. Please describe the new policies that SBC Illinois has adopted.

A. First, SBC Illinois is replacing the mixture of forward-looking and backwards-looking provisions in its tariffs and ICBs with a purely forward-looking approach: that is, all termination liabilities will be based on a percentage of the monthly charges remaining in the customer's term commitment. The only exception to this statement is for products covered by the Ascent order, which will not be changed.

Second, the Company has significantly revised the percentage amounts that are applied to develop the early termination liability based on a new and comprehensive analysis of its expected losses where a customer terminates service early. In adopting these new percentages, SBC Illinois has attempted to balance simplicity and ease of administration with precision of calculation. Based on the analysis I referred to above, SBC Illinois has concluded that its products and services can be placed into three groups: (1) Centrex; (2) Usage (including network access lines); and (3) Transport Services/Other. The percentage termination liabilities that will apply to each group is as follows:

- Centrex--25% of the amount remaining.
- Usage (including network access lines)--35% of the amount remaining.
- Transport Services/Other--50% of the amount remaining.

Q. How do these new policies compare with what is in place today?

A. For Centrex, the new approach represents a significant reduction. Today, the termination liabilities for Centrex are generally in the 75%-85% range. For usage services, termination liabilities range from 35%-50%. Therefore, the new policy will represent either a reduction in or a continuation of the status quo. For the Transport and Other category, the impact will vary by individual product and service and by customer (e.g. for customers under term agreements with backwards-looking termination liabilities, the new approach will produce higher amounts if the customer terminates early in the term of the agreement and lower amounts if the customer terminates later).

Q. Can you provide a more detailed comparison of existing early termination liability policies with SBC Illinois' new proposal?

A. Yes. My Schedule BG-2 provides a summary of the current early termination liability practices by product, and how these will be modified on a going-forward basis.

Q. Is SBC Illinois proposing to change the early termination liability policy required by the Ascent decision for the Completelink/Valuelink, etc. family of products?

A. No. The Company will continue to abide by the requirement of the Ascent decision. However, for the reasons stated in my testimony, I do not believe that the Ascent approach can be justified any longer and should certainly not be used as the early termination liability model for other products and services.

Q. Could you provide a more detailed list of which products and services fall into which of your three categories?

A. Yes. My Schedule BG-2 explains how SBC Illinois' products and services have been assigned to the three categories listed above. As a single product, with only limited numbers of service arrangements, Centrex is fairly self-explanatory and self-defining. The Usage category contains products such as traditional calling plans (e.g. CompleteLink), as well as newer packages that include access lines, usage, and vertical services (e.g. Custom BizSaver). The Transport Services/Other category includes network products such as ISDN PRI, dedicated services such as DS1 and DS3, and sophisticated private network offerings like GigaMAN, and SONET services.

Q. Will these policies apply to *all* service arrangements provided under term agreements?

A. In general terms, yes. A forward-looking approach (i.e. where the early termination liability is calculated as a percentage of what remains under the contract) will be applied to all term agreements for all products and services. The tariff percentages I described above will also apply to all term plans offered under tariff and the vast majority of term plans offered under ICBs, namely where SBC Illinois can provide service primarily using existing facilities.

However, there will be exceptions. In some situations, large business customers request specialized serving arrangements that require SBC Illinois to specially construct what is, for all intents and purposes, a network that cannot be used by any other customer. These are typically sophisticated arrangements based on cutting-edge technologies and which are designed to transport substantial amount of voice and data traffic between the customer's various locations. In these cases, the facilities installed by SBC Illinois are likely to be stranded if the customer terminates the agreement early and the percentages outlined above will not recover SBC Illinois' costs. Therefore, in negotiating these ICBs, SBC Illinois will determine an appropriate (and higher) termination liability with the customer. Since these kinds of networks typically require substantial investments on both the Company's part *and* the customer's part (e.g. sophisticated terminal equipment at the customer's premises), both parties enter into such agreements for the long haul and the use of higher termination liabilities are not likely, in and of themselves, to discourage "carrier shopping" that would otherwise take place.

Q. How are these new policies being implemented?

A. The new early termination liability policies were finalized in early December. Unfortunately, changes such as these cannot be implemented immediately, as they require both external communications and internal SBC Illinois systems and process changes. For example, under SBC Illinois' interconnection agreements with CLECs, it must provide 45 days advance notice of changes to its retail rates. Examples of changes that have to be made to internal systems and processes include: (1) the development, distribution, and communication of new Methods and Procedures to sales force personnel, including service representatives, account teams and contract management personnel who are involved in preparing ICBs; (2) the upgrading of centralized sales tools to allow the new calculations to take place accurately and without delay; (3) changes to the systems that bill termination charges; and (4) revisions to all of the tariffs and internal documents that describe the terms and conditions applicable to SBC Illinois' products and services.

Based on the implementation work that has been completed to date, SBC Illinois expects the new termination policies to become effective in March of this year. Although the major work will be completed by this time (e.g. the filing of revised tariffs and the development of new ICB templates), changes in tools that require software modifications may take longer. For example, SBC Sales personnel currently use a calculator tool that compares termination liabilities under different approaches for those products that have such "either/or" options in them today. This capability will have to be expanded significantly to cover the wider array of products for which SBC Illinois will now have to be making alternative calculations (mostly in the Transport/Other category). This work effort will take several months and, in the interim, the alternative calculations will have to be performed manually. In addition, certain mass market products (e.g. Custom Biz Saver) have the early termination liability calculation "hard-coded" into the billing system. The billing system changes required to adjust those calculations are complex and will take a considerable period of time. The Company will either delay the tariff changes for these products until the billing system has been modified or develop a manual process for the interim period. This issue is still being analyzed.

Q. How will embedded base customers be treated?

A. As indicated above, although SBC Illinois' new early termination policies generally are equal to or lower than its existing policies, in some instances (particularly for customers under backwards-looking term plans who terminate at the front end of an agreement) it may produce higher amounts. Therefore, to maintain the integrity of the bargain with those customers, existing customers will be subject to either the early termination approach provided for in their contract or the tariff, as it exists today, or the new early termination policy, whichever is *lower*.

Q. What kind of notice will be provided to customers and CLECs?

A. Customers will be notified of the changes in SBC Illinois' early termination liability policies in Bill Page Messages. This will take place shortly after the tariff changes become effective. Alternatively, any customer calling into an SBC Illinois Service

Center or Account Representative will also be able to discuss these changes. As I indicated previously, the Company is required to provide 45 days advance notice to CLEC wholesale customers of proposed changes in its retail rates. The initial CLEC notices for all the early termination liability changes outlined in Schedule BG-2 have already been issued.

Q. Why is SBC Illinois modifying its early termination liability policies across the board?

A. As I indicated previously, SBC Illinois' early termination liability policies vary widely from product group to product group and often within product groups. These differences are not related to the characteristics of the product, the economic consequences of early termination or any other objective criteria. Historically, SBC Illinois has not centralized decisions on product terms and conditions, including termination liabilities. As a result, the Company's tariffs (and ICBs) reflect the accumulation of individual decisions, made by many different product managers over a fairly long period time. For example, the language has not changed for some products since the rate plans were first introduced, in some instances 10-20 years ago. Newer products contain termination liabilities that are closer in structure to what SBC Illinois believes to be current practices in the market place.

Q. Is this situation unusual?

A. No. I have reviewed the tariffs of other ILECs outside the SBC Midwest region in the course of my job responsibilities and they too seem to have a mixed bag of different termination liabilities for different products.

Q. Does it make sense from a business and marketing perspective to replace these varying early termination liability provisions with one consistent approach?

A. Yes. The current situation is difficult for our own sales personnel to administer and can be confusing to customers who subscribe to term plans for multiple services. Implementing a consistent policy, so that the same contract language can be used when customers enter into term plans for multiple services, will also simplify the contract negotiation process. Additionally, it will be easier to calculate termination liabilities under the new approach and a consistent, across-the-board policy will reduce the potential for errors, as was evidenced in some of the contract calculations cited by TDS.

For that reason, most of the newer tariffs filed by SBC Illinois have reflected a forward-looking early termination liability approach on a product-by-product basis. Older tariffs have been updated as other changes are made. For example, the Illinois ISDN PRI early termination liability language was changed from a backwards-looking approach to a forward-looking approach effective July 1, 2003. However, the Company has not previously undertaken a comprehensive review of its existing tariffs with the intent to put them all on a consistent basis.

Q. Mr. Loch suggests that "we seem to be in some sort of bidding process in which SBC Illinois continues to slowly reduce the percentage factor . . . until it reaches the level at which competitors stop complaining." (Loch, p. 23). Please comment.

A. I do not dispute that fact that the filing of the TDS' Complaint prompted SBC Illinois to take a hard look at its existing tariff and ICB practices. However, as mentioned above, the Company was well aware that its policies were inconsistent and was already taking incremental steps to correct the situation. The TDS complaint simply accelerated a process that would have been undertaken at some point anyway, because it makes business and competitive sense. I would note that, although the TDS Complaint is pending only in Illinois, early termination liability policies will be standardized across the rest of the 5-state SBC Midwest region as well, once Illinois is completed

Q. Previously, you explained the difference between termination liabilities based on contracted monthly charges and those based on MARCS. Is SBC Illinois making the same changes for both types of agreements?

A. Yes. The same percentage termination liabilities will be applied to both types of agreements. I would note, however, that "true-up" charges will continue to apply in the same manner they do today as long the customer retains service under the agreement. These plans are optional and work well for customers that may incur a dip in their telecommunications spending in a given year, but are not trying to breach their contract. Customers with seasonal calling patterns also like term plans with a MARC, because the discount does not vary month-to-month. If the MARC ever becomes unworkable (e.g. if the customer's spending levels change dramatically from what was anticipated when the agreement was entered into), the customer always has the option of terminating the contract altogether. As noted in the Adams Stairworks example cited by TDS, the customer's liability was much less once the agreement was terminated.

There are also agreements where the MARC can be met by a variety of "contributory services", separate and apart from the service on which the discount is received. These types of agreements were developed in response to customers who wanted more flexibility to change their underlying (i.e. "contributory") services as their business needs changed without having to renegotiate the discounts they were receiving under their agreement. For example, originally, usage agreements reflected some percentage of customers' average usage over a period of time (typically the Company recommends that customers limit their commitment to 80% of historical spending levels to allow for seasonality and downturns in business demands). However, customers demanded, and the Company was willing to offer, larger discounts if the customer would commit to a higher MARC based not only on usage spending but also on spending for other services offered by SBC Illinois. These types of agreements produce the relatively high termination liabilities in absolute dollars shown for certain contracts in the table in Mr. Loch's testimony (p. 16). They will continue to produce relatively high termination liabilities, albeit lower than what is shown in his table (which is based on SBC Illinois' current policies), when the 35% policy is applied to ICBs. However, customers want and *like* these MARC plans and the Commission should not second-guess customer decision-making here.

I would note, moreover, that customers are not required to commit all their services to SBC Illinois to qualify for these plans; customers may choose to have some of their telecommunications services with SBC Illinois and some with other providers.

VI. BASIS FOR SBC ILLINOIS' MODIFIED EARLY TERMINATION LIABILITY POLICY

Q. What is the basis for SBC Illinois' modified early termination liability policy?

A. In developing its new policies, SBC Illinois followed the general principle that an early termination liability is a substitute for calculating damages at the point in time that the customer actually breaches the agreement. Although I am not an attorney, it is my understanding that these kinds of provisions should reflect a reasonable estimate of the economic harm that SBC Illinois would suffer. In the Ascent case, SBC Illinois took the position that, under contract law, it is entitled to "the revenues the Company loses, less any avoidable costs, plus any incremental expenses it incurs" (p. 23). To me, this standard translates into SBC Illinois foregone profit for the remainder of the contract. One of the Commission's major objections to the 100% early termination liability policy in that case was the fact that the Company was demanding all of the revenues "without regard for avoidable expenses" (p. 23). SBC Illinois developed its new model taking these concerns into account.

Q. How were the percentages you described earlier developed?

A. SBC Illinois conducted a through analysis of all of the products and services it offers under term agreements, identifying both the revenues received and the costs avoided.

This analysis was conducted for each product under both tariff arrangements and under ICBs (typically profit margins are lower in agreements that have been negotiated with customers than in "off-the-shelf" tariffed term plans). For each product and service, avoided costs were calculated using the LRSIC methodology that the PUA requires be used as a cost floor for pricing competitive services. The Company did not attempt to determine any additional "incremental expenses" it incurs that could have been added on to the margins between LRSIC costs and revenues. Thus, the Company's model comports with the contract standard I described earlier, addresses the Commission's concerns in the Ascent case and is, if anything, conservative. Mr. Flitsch explains how the analysis was performed in detail in his testimony and provides the results on a product-by-product basis.

As Dr. Frankel explains in his testimony, this approach is also consistent with basic economic principles.

Q. How were the three percentages (i.e. 25%, 35% and 50%) then developed?

A. SBC Illinois cumulated the various product and service-specific percentages determined by Mr. Flitsch and determined logical groupings of products and product families based on those percentages. SBC Illinois then adopted a percentage value that was equal to or lower than the lowest of the various cost analyses.

Q. How will non-recurring charges be treated under the new policy?

A. Although TDS' proposed early termination liability policy would allow SBC Illinois to recover NRCs or installation charges that were waived when a customer initially signed the term agreement, SBC Illinois does not propose to do so under its approach. Since SBC Illinois agreed to forego these amounts when the agreement was entered into, and as long as SBC Illinois is permitted to recover its lost profits as proposed, the Company considers the NRC waiver part of the bargain. The only exceptions to this policy would be when special construction costs are involved, or if signing or other cash bonuses were negotiated as part of an ICB contract. (This would not apply to the $50 or $75 payments for switching carriers that are common in the industry for mass market offerings and which are contained in certain SBC Illinois plans as well).

Q. Does SBC Illinois' approach essentially assume that all of the facilities used to provide service to the customer are immediately reusable?

A. Yes. Mr. Flitsch's methodology essentially reflects that assumption. In fact, the facilities freed up when a customer terminates an agreement early may not be immediately reused. They may remain idle for some period of time until another customer in that geographic area or along that route demands the same service. Therefore, for this reason too, SBC Illinois' approach is conservative and biased in favor of the customer. Because the methodology assumes immediate facility reuse, these percentages cannot be applied where the Company has to construct new facilities for a specific customer that are likely to be stranded if the customer terminates early, as discussed previously.

Q. The early termination liability for Usage products is substantially lower than what Mr. Flitsch's analysis would support. Please comment.

A. It is true that the early termination liability we are using for Usage products is substantially lower than what Mr. Flitsch's analysis would support. Based on Mr. Flitsch's analysis, it would be logical for SBC to target at least a 50% percentage for all Usage-based products. However, as I described earlier, there is considerable "history" in Illinois connected with implementing the Ascent decision and the discount levels that would be used for other tariffed Usage term plans that do not fall within the four corners of that Order. The Company has used a 35% early termination liability for the vast majority of those filings, and none of these filings have resulted in investigations or other actions by the Commission. To minimize the areas of potential dispute, therefore, SBC Illinois decided to simply continue the existing 35% policy for Usage tariffs and to expand that policy to ICBs.

Q. TDS contends that SBC Illinois' early termination liability policies "bear no reasonable relationship to any loss or damage that SBC Illinois experiences if a customer terminates a multi-year contract prior to its expiration . . ." (Loch, p. 7). Please comment.

A. I disagree. The Company's new "forward-looking" early termination liability model was developed to address precisely that question (i.e. what are SBC Illinois' losses or damages if a customer terminates the agreement early).

Q. Are there benefits to both customers and SBC Illinois from multi-year agreements?

A. Yes. As Dr. Frankel explains, it is standard practice across most industries for companies to offer customers rate stability and/or lower rates where the customer is willing to enter into longer term commitments and/or larger volume commitments. The telecommunications industry in general, and SBC Illinois in particular, is no different in that respect. Both the Company and the customer benefit from these arrangements.

From a customer perspective, they receive a committed lower price for the contracted period, with the associated guarantee of network and service stability. Business customers are sophisticated and negotiate arrangements for the "best" pricing and other terms to meet their needs. Customers have requested various options for the pricing of their services. Some customers are only willing to commit to 1 or 2 year terms, because they may be contemplating changes to their business or they may intend to shop for a new telecommunications provider in the near term. Other customers are satisfied with SBC Illinois' services and are willing to commit to a longer term to receive a higher discount.

From SBC Illinois' perspective, the Company receives a guaranteed revenue and associated profit stream over the contract period. To the extent that these agreements in aggregate contribute to more stable demand being placed on SBC Illinois' network, they assist in the network planning and facility placement process.

Q. Is SBC Illinois' early termination liability policy consistent with the practices of other competitors in the marketplace?

A. Yes. Virtually all competitors use forward-looking contract termination policies in their term plans. To provide a comprehensive overview, SBC Illinois commissioned an independent analysis of the early termination liability practices of eight of the major CLEC competitors in Illinois for the products and services at issue in this proceeding based on their filed tariffs. The CLECs were: McLeodUSA, XO, Focal, AT&T, MCI, Allegiance, Mpower, and TDS MetroCom. The results of that study are attached as my Schedule BG-3. As is obvious from this data, TDS is the *only* CLEC that uses the "give back the unearned discount" approach. The termination liabilities of all of the other CLECs are structured like SBC Illinois'.

Q. How do the CLECs' percentage amounts compare with SBC Illinois'?

A. Generally speaking, SBC Illinois' proposed percentage amounts are either comparable to or much *lower* than what the competitors charge.

Q. What about Centrex service?

A. Centrex presents special circumstances because the principle competitive alternative to network-based Centrex service is a PBX—i.e. customer premises equipment that performs all of the same intra-office 4-digit dialing functions and contains most of the same routing functionality as Centrex. Customers purchased PBXs from equipment vendors (or enter into long term lease arrangements that are the financial equivalent of a purchase). As Dr. Frankel explains, purchases of durable goods—like a PBX in this situation—have all the economic attributes of a contract with an early termination liability because of the decline in value once the good has been purchased. It is generally assumed that the average life for PBX equipment is 7 years. Therefore, PBXs have a "virtual early termination liability" given the decline in market prices for used equipment.

Q. Are TDS' policies uniform in this regard?

A. No, not as between various TDS entities. SBC Illinois served data requests on TDS seeking information on its early termination liability policies in Illinois and other states. As shown in my Schedule BG-4, TDS responded that it universally employs the same early termination liability in all states in which it operates and has done so for a long period of time. However, TDS also operates as an incumbent local exchange company ("ILEC") in Wisconsin. It appears that TDS the ILEC views termination liabilities much the way SBC Illinois does. Attached as my Schedule BG-5 is a copy of TDS Telecom of Wisconsin's Dedicated DS1 tariff which imposes a early termination liability of 100% of what remains on the contract–precisely the kind of early termination liability that TDS the CLEC is complaining about in this proceeding (see page 22 of Schedule BG-5).

Q. Are term plans where termination liabilities are based on a MARC revenue commitment common in the marketplace as well?

A. Yes. MARCs are very common in the industry, especially for usage-based services. Examples of tariffed term plans offered by CLECs that utilize a MARC as part of their basic offer include the following:

- Allegiance Telecom of Illinois' Independence Plan
- AT&T's Business Network Services
- MCI's On-Net
- Sprint's Voice Solutions

Q. Do you have information available to you regarding the CLECs' early termination liability policies in ICBs?

A. This information is more difficult to obtain, because ICBs would be considered proprietary by the CLECs (as they are by SBC Illinois) and are not publicly available. However, based on customer feedback to the SBC Sales organization on specific deals we are competing against, most competitors utilize the "forward-looking" language even on ICB's. It is my judgment that termination liabilities imposed by the CLECs in ICBs would be structured in the same way as their tariff provisions (i.e. they are forward-looking, not backwards-looking). However, I would expect the percentage amounts to be the same as or *higher* than what is in their tariffs for those products and services.

VII. THE BUSINESS MARKETPLACE IS COMPETITIVE IN ILLINOIS

Q. What is the level of competition in the business marketplace in Illinois?

A. There is a substantial level of competition in Illinois for business customers. As discussed in Mr. Longua's testimony, approximately 79 CLECs provide local business services in SBC Illinois' local service territory, approximately 56 of which provided service exclusively or predominately over their own facilities or over UNEs leased from SBC Illinois.

Moreover, not all competitors are regulated and the choices available to customers are not just between like-for-like products, but for substitute products as well. For example, as I indicated before, the principle competitive alternative to network-based Centrex is an unregulated PBX. Any customer could choose to migrate from Centrex to a traditional voice-based PBX solution, or, today, to one of the newer internet(IP)-enabled PBX solutions, or to a completely IP-based solution (as offered by Verizon/GoBeam in Chicago).

Q. What are the current market shares for the various products and services at issue in this proceeding?

A. Based on the information available to me, the current market shares are approximately as follows:

- Centrex: Centrex customers account for an estimated 20% of the overall premises equipment market, with PBX solutions serving the remaining 80%. CLECs provide *****BEGIN CONFIDENTIAL***XXXXXXXXX***END CONFIDENTIAL***** of the network-based Centrex service, so SBC Illinois' Centrex service accounts for approximately *****BEGIN CONFIDENTIAL***XXXX***END CONFIDENTIAL***** of the overall market.
- Usage: As demonstrated by Mr. Longua, CLECs today serve approximately 35% of the business lines in SBC Illinois' serving territory. In most cases, the company providing the network access line (i.e. the "dial tone provider")

also provides local calling services. Therefore, the 35% figure is a reasonable proxy for the CLECs' share of the local calling on a line basis. Since the CLECs typically target larger customers or customers with heavy calling needs, I would expect their share on a revenue basis to be higher. Because intraMSA toll calls can be separately presubscribed to IXCs providing long distance service (and who are *not* the dial tone provider) and the IXCs have competed for these toll calls, the competitors' share of the intraMSA toll market is estimated to be higher.

- <u>Transport services/Other</u>: The CLECs' share of the principal transport service markets varies somewhat by product and service. However, for the principal service categories, CLEC market share ranges from *****BEGIN CONFIDENTIAL***XXXXXX***END CONFIDENTIAL***** (DS1s) to *****BEGIN CONFIDENTIAL***XXXXX***END CONFIDENTIAL***** (ISDN Prime) and *****BEGIN CONFIDENTIAL***XXXXXXXX***END CONFIDENTIAL***** (GigaMAN). SBC Illinois itself sells relatively few SONET and MON systems in any given year.

Q. Have these services been competitive for a considerable period of time?

A. Yes. Competition in the premises systems marketplace dates all the way back to the 1970's. Even by divestiture in 1984, SBC Illinois had substantially less than 50% of this market. When the PUA was amended effective January 1, 1986, to allow the "competitive" classification of services (with the attendant pricing flexibility and the ability to enter into off-tariff contracts), Centrex was reclassified as competitive immediately.

Although the competitive *network* provision of Centrex service by CLECs is a more recent development, it does not change the fact that this market is highly competitive and has been so for a long period of time. In fact, in one of the original proceedings opening up the Illinois local exchange marketplace to competition (which, in fact, predated TA 96), the Commission rejected a CLEC proposal that a "fresh look" requirement be imposed on SBC Illinois' term Centrex agreements, accepting SBC Illinois' argument that the service was competitive and that customers had had ample alternatives when entering into these agreements (Order in Docket No. 94-0096, p. 123).

Q. Has the business usage marketplace become more competitive since the rate plans at issue in the <u>Ascent</u> decision were introduced?

A. Yes. As demonstrated by Mr. Longua, the CLEC market share has grown from 20% in 3rd Quarter 2000, to 35% in 3rd Quarter 2003. Competition for intraMSA toll services dates back well before the advent of the CLECs. In the late 1980's and early 1990's, the IXCs actively competed for business customers' intraMSA toll calling along with their long distance business. The dialing and routing features in PBXs allowed customers to make both interMSA and intraMSA calls on a seven-digit or 1+ basis. On April 1, 1996, SBC Illinois implemented intraMSA presubscription that permitted all customers, residence and business, to make intraMSA calls using the facilities of an IXC using conventional dialing arrangements.

Q. How long has there been competition for Transport products?

A. Transport falls in between Centrex and local usage. Transport services like DS-1s, DS-3s and their carrier access equivalents were some of the first services provided by CLECs when they entered the Illinois marketplace in the early-to-mid 1990s. That is because they are point-to-point services that are relatively easy to provide on a stand-alone basis. A CLEC providing a DS1 or DS3 circuit to a customer needs the requisite rights of way between the two points and installation and maintenance personnel experienced with these kinds of facilities but they do not need a full service network with switching capability, nor do they need to interconnect with SBC Illinois. SBC Illinois' share of this marketplace started to decline significantly in the mid-1990's, well before the CLECs began to offer local exchange ("dial tone") service on a broad scale and it has continued to decline.

Q. Do customers today have an adequate array of alternatives in the marketplace when they make purchasing decisions for telecommunications services?

A. Definitely. Customers have, and have had for a considerable period of time, competitive alternatives for all of the products at issue in this proceeding. Customers can elect service from a wide variety of vendors and choose between an equally wide variety of price, term (including early termination policies) and service arrangements. If customers do not like SBC Illinois' offerings on any of these scores, they can take service from another provider.

Q. The Commission was concerned in the Ascent decision that the customers who had signed up originally for the ValueLink family of services may not have had adequate choices in the marketplace. Is that concern valid in this proceeding?

A. No. First, this case involves a much wider range of products and services, most of which have been competitive for a long time. It is also now 2004. As indicated by the market share data, customers clearly have choices for all of these services and they are just as clearly exercising those choices.

Second, even with respect to the ValueLink customers, there is no longer a competitive "problem". SBC Illinois disagreed with the Commission's conclusions even at the time of the Ascent case. Be that as it may, there is no issue today. The Commission was primarily concerned about customers signing ValueLink agreements in 1996 and 1997, the period right after intraMSA presubscription was implemented. Those contracts have expired and the customers have entered into new contracts at least once and maybe twice in the 7 intervening years, with each contract providing an opportunity for the customer to make a new vendor decision and for the CLECs to persuade the customer to change carriers. There is no policy reason to require continued application of the Ascent approach to the ValueLink products, much less to the other products at issue in this proceeding.

Q. Have policy makers recognized that SBC Illinois' business services are now competitive?

A. Yes, there is no question that policy makers agree that SBC Illinois' business services are competitive. In 2001, the Illinois General Assembly approved legislation that declared all of SBC Illinois' business services competitive. The Illinois Commerce Commission on May 13, 2003, and the FCC on October 15, 2003, concluded that SBC Illinois' markets were "irreversibly open" when they granted SBC Illinois' 271 application to provide long distance services.

Q. TDS contends that SBC Illinois' early termination liability policies make it difficult for TDS to persuade SBC Illinois' customers to switch to TDS' services and that these customers are, therefore, "removed from the competitive marketplace." (Loch, pp. 5-6). Do you agree?

A. No. First, a significant percentage of SBC Illinois' business customers are not on term agreements at all.

Second, as shown in Dr. Frankel's analysis, a steady portion of the business customer base that is currently under term agreements regularly rolls off those contracts during any given time period. Generally speaking, term agreements are for three years or less. Most customers are unwilling to commit for a longer period of time, in view of changing technology and changes in their own operation or business conditions in general that could alter the amount or types of telecommunications services that they need. These customers, of course, are not subject to any early termination liability.

In addition, under SBC Illinois' resale policies, CLECs may assume end user term agreements with no penalty to the customer. This provision permits transition of the customer at any point in their contract. The Commission recognized this fact in the Ascent decision. On the other hand, if the best decision for the customer is to terminate their contract, the customer may do so at any point and incur the early termination liability. This amount is typically small as the customer approaches the end of the term of the agreement.

Q. Does Centrex service present special circumstances?

A. Yes. As the market share information I presented earlier demonstrates, PBX vendors dominate the marketplace for premises systems, not network providers of Centrex service. Since customers purchase PBX systems, they view these decisions as long-term in nature. Typically, customers are only in the market for new premises systems every five to seven years. Therefore, if any supplier is "removing" customers from this marketplace, it is the PBX vendors. Nothing the Commission can do in this proceeding will change that fact of life.

Furthermore, there is only limited competition between network-based providers. TDS is somewhat unusual in even offering this product. Many CLECs, including AT&T and Allegiance, do not offer Centrex service at all.

Q. TDS presents examples of termination liabilities that would have been assessed to Customers A, B, and C. Please comment.

A. The early termination liability calculations provided to TDS represented the "old" policy that is being changed. The new policy that is currently being implemented will result in lower early termination liability calculations for Customers A and B, as shown in my Schedule BG-6.

I have not updated the calculations for Customer C, because that involved a "true-up" or shortfall calculation that assumes that the customer intends to continue with the term agreement. When the customer had decided to terminate its contract, the early termination liability was much lower.

Q. Please explain the circumstances surrounding the Customer C situation.

A. As TDS acknowledges (Stearn, p. 8), TDS had requested that SBC Illinois calculate the amount of the early termination fees that Customer C would incur if it terminated its CompleteLink agreement at that time. The amount was calculated in accordance with the Ascent methodology and was approximately $333 (a little over 10% of Customer C's MARC commitment).

The customer then proceeded to disconnect two SBC Illinois voice lines and switch them to TDS in July-August 2002, leaving only the single line for its DSL service (which does not generate usage charges). For some reason, Customer C did not terminate its CompleteLink agreement at that time. As a result, SBC Illinois' systems showed Customer C as a continuing CompleteLink customer. With the removal of its two SBC Illinois voice lines, not surprisingly, Customer C did not meet its MARC commitment and was duly assessed a true-up charge a year later. Customer C could have avoided the true-up charge if it had requested early termination of the CompleteLink agreement or, alternatively, if TDS had assumed the contract. In other words, the problem here stemmed from actions (or rather inaction) by the customer and TDS, not from SBC Illinois' policies. TDS was obviously aware of the need to cancel the CompleteLink plan and the costs associated with doing so. Not having been privy to the negotiations between TDS and Customer C, I do not know whether TDS advised the customer to cancel and the customer forgot, or whether TDS was supposed to take care of cancellation and forgot, or whether TDS failed to advise the customer at all as to what needed to be done. Obviously, *someone* let the ball drop.

Q. TDS provides a list of termination charges that would be applicable to a selection of the contracts that SBC Illinois provided to it in discovery and contends that they are "too large." (Loch, pp. 15-16). Please comment.

A. First, the concept of "too large" is very subjective. As I will explain below, TDS appears to be viewing this issue from the wrong perspective. Second, these calculations were performed using SBC Illinois' "old" early termination liability policies. As outlined above, the early termination liability calculations will change. I have supplied as my Schedule BG-6, a recalculation of these amounts based on the new policies. These amounts are reasonable given the size of the contracts signed.

Q. TDS contends that the reasonableness of SBC Illinois' termination policy should be determined based on whether customers can switch carriers at little cost. Is that the right analytical framework?

A. No. As I previously discussed in my prior testimony and as Dr. Frankel explains, termination liabilities should reflect the damages SBC Illinois incurs when a customer terminates an agreement early. It is not reasonable or appropriate to "reverse engineer" these policies with the intent of allowing customers to breach their agreements with carriers at minimal cost—whether the customer wants to switch from SBC Illinois to a CLEC or vice versa. SBC Illinois faces CLEC termination liabilities when it attempts to win back customers—and will see them even more starkly as the Company approaches business customers that the CLECs placed under contract when they had the advantage of being able to provide total service packages that included long distance services (and SBC Illinois did not). SBC Illinois understands, however, that termination charges are part and parcel of the competitive landscape and it will manage its marketing and sales activities accordingly.

Q. TDS contends that the data provided by SBC Illinois regarding the number of contracts terminated supports, "at least anecdotally," its contention that the size of the early termination liability discourages customers from terminating agreements prior to their expiration (Loch, p. 17).

A. TDS is drawing an improper conclusion from this data. First, as indicated previously, a large number of SBC Illinois' business customers are not under term agreements at all. For those that are on term agreements, the majority of them probably investigated competitive alternatives before making a purchase decision and intend to live up to the terms of those agreements. The data suggests that these customers are generally pleased with the service they receive from SBC Illinois. For those customers that are not satisfied, like any customer who purchases any product or service in the economy that requires a long term commitment (by contract or investment), they can explore competitive alternatives when the term is up. As Dr. Frankel explains, breaching contracts is the exception, rather than the rule, in competitive markets.

Q. Given the current state of competition in Illinois, is TDS' request for relief appropriate?

A. No. As I indicted previously, there are numerous certificated local exchange providers in Illinois today. Whatever the competitive landscape might have been for usage services when the Ascent decision was made, the business marketplace is unquestionably competitive for the broader range of products and services in this proceeding and at this point in time. As Dr. Frankel explains, termination liabilities are precisely the kind of contractual term or condition that marketplace forces will discipline. If any carrier attempts to impose conditions on customers that they consider unreasonable, they will take their business elsewhere. Customers *do* have choices today and market forces should be allowed to determine early termination liability policies, not the regulatory process.

VIII. TDS' PROPOSAL

Q. TDS has proposed that SBC Illinois be required to use the Ascent approach for termination liabilities for all products and services. What is your understanding of TDS' proposal?

A. As I understand it, TDS is proposing that SBC Illinois be required to use the same methodology it uses: that is, that the customer must pay back any unearned discounts it received over the term of the agreement that it completed. For example, assume that a customer enters into a 5-year agreement for Centrex service and breaches in month 37 (i.e. just after completing 3 of the 5 years). SBC Illinois' Centrex tariff provides different discount levels depending on the term selected by the customer: rates for a 1-year term are somewhat lower that month-to-month rates, rates for a 3-year terms are lower than the 1-year rates and rates for a 5-year term are lower than the 3-year rates (most SBC Illinois term plans offer 1, 3 and 5-year options). Since the customer had been paying the low 5-year rates, but only completed a 3-year term, the total charges to the customer in this example would be recalculated based on 3-year rates and the customer would owe SBC Illinois the difference between what it paid and what it should have paid over that 37-month period. TDS also states that SBC Illinois would be entitled to recoup any nonrecurring charges ("NRCs") that were waived at the front end of the agreement.

Q. TDS contends that this approach is identical to what the Commission ordered in the Ascent case. Is that completely accurate?

A. No. It is true that the decision in the Ascent proceeding required SBC Illinois to change its ValueLink tariffs based on a "give-back-the-unearned-discount" methodology. However, the Commission also imposed a one-year cap on the amount of the unearned discount which SBC Illinois was permitted to recoup (Order, pp. 28, 35). TDS does not cap its termination liabilities in this fashion. As shown in my Schedule BG-7, TDS has confirmed that it is not proposing a one-year cap in this proceeding.

I would also note that the Ascent Order did not specifically address the question of NRCs. However, SBC Illinois agrees with TDS that, under a "pay-back-the-unearned-discount" approach, carriers should be allowed to recover any waived or deferred NRCs.

Q. Is this "give-back-the-unearned discount" approach standard in the marketplace?

A. No. In fact, as shown in my Schedule BG-3, TDS is the *only* carrier among the major competitors in Illinois to use this approach. All other major competitors use the "forward-looking" percentage of what remains on the contract approach. It would be more than a little strange for the Commission to impose on SBC Illinois, for use in *all* of its term plans for *all* of its products and services, an approach to termination liabilities that almost no competitive carrier uses.

Q. Does the structure of TDS' approach comport with common notices of contractual obligation and equity?

A. No. Generally speaking, one would expect a TL liability to decline over the period of a contract. That is, the more of the contract that the customer completes, the lower the early termination liability would be expected to be. This is how SBC Illinois' approach works. A customer's early termination liability is high early in the term of the agreement and declines linearly over the rest of the term, becoming quite small towards the end.

TDS' approach works in the opposite direction. Under its methodology, the early termination liability is lowest if the customer breaches early in the term of the contract. It then rises and falls as customers approach and pass the 1, 3 and 5-year milestones when different discount levels are satisfied. However, a customer will always pay a higher early termination liability towards the end of the agreement under TDS' approach than under SBC Illinois'.

My Schedule BG-8 provides an illustration of this counterintuitive, roller coaster effect using a hypothetical example. As shown in that Schedule, customers pay more in term liabilities if they leave in month 33 of a 60-month contract than if they leave in month 15. Even more illogical is that a customer would pay more in termination liabilities if they leave in month 59 of a 60-month contract than if they leave in month 2.

Q. Does TDS' approach reflect a reasonable balancing of the risks associated with long-term agreements between the Company and the customer?

A. No. Under the TDS approach, customers are automatically given the best possible "deal" in terms of the rates the customer pays. There is no scenario in which a customer would be worse off entering into a term plan with SBC Illinois than subscribing to service on a month-to-month basis. My Schedule BG-9 demonstrates this point. As Dr. Frankel explains, there is normally risk on both sides when parties enter into long-term agreements and this sharing of the risks is what induces both parties to do so.

Q. What impact would the TDS approach have on customer decision-making?

A. Sophisticated customers (or even unsophisticated customers) would quickly figure out that SBC Illinois' term agreements are risk-free propositions. If I were a customer, I commit to the longest possible term offered by SBC Illinois, regardless how long I actually intend to stay. Since I would obtain the lowest available rates and I would only have to pay back the unearned discount if I breach the agreement, I am no worse off financially than if I make a commitment based on a realistic assessment of my future plans and needs. It also does not appear that TDS charges interest on the amounts paid back. As a result, TDS is effectively providing an interest-free loan to the customer for the difference between the rates the customer actually pays and the rates the customer should have paid. SBC Illinois does not normally provide its customers with interest-free loans. Business and residence customers, for example, are assessed late payment charges when their bills are not paid on a timely basis.

Q. Is TDS' approach workable where SBC Illinois has to make customer-specific investments in facilities?

A. No. As I explained earlier, some customers require custom networks to be constructed and, if they were to terminate their contracts early, SBC Illinois would have no other use for some or all of the facilities. These arrangements are negotiated by SBC Illinois on an individual case basis. To ensure complete cost recovery, the financial analysis must be able to assume a set term so that the associated capital cost of the project and the ongoing maintenance cost can be determined and recovery spread over the appropriate time period.

In this situation, TDS' approach presents (at least) two problems. First, it would make construction of specialized networks unworkable from both SBC Illinois' perspective and the customers. If a customer can terminate a contract essentially at will (subject only to having to give back unearned savings), SBC Illinois cannot make any assumption at to the likely term of the arrangement in developing a rate proposal for the customer. Given the large amounts of capital typically required to build these systems, prudence would demand that all sunk costs be recovered quickly at the front end of the contract. Such a pricing policy would make these kinds of systems prohibitively expensive. Most customers do not want to (or cannot) absorb the up-front costs of a special construction project in a one-time NRC charge. They prefer to spread that cost over the term of the agreement as part of their monthly recurring charge. The net result is that the customer would simply not buy the system from SBC Illinois (or at all, if no CLEC wants to undertake the project). SBC Illinois cannot imagine what legitimate policy objective would be accomplished by making it effectively impossible for SBC Illinois to meet the needs of its more sophisticated business customers.

Second, these kinds of networks are not purchased under tariffs that establish alternative rates for alternative term periods—they are individually negotiated. Therefore, there is literally no way to compute a "payback the savings" early termination liability, because there is no "next lower completed term" for this particular customer.

Q. Could the TDS approach actually be counterproductive to TDS' concerns?

A. Yes. The TDS approach encourages customers to sign up for the longest term possible, regardless of their business needs. For example, a customer may plan to keep a particular service for the next 36 months. Under the TDS approach, the customer has every incentive to sign up for a 60-month term. There is always the possibility that the customer's plans could change, and the 60-month period could be appropriate. Even if the customer has no intention of completing more than 36 months, the customer is no worse off financially.

Q. Are there administrative problems associated with TDS' approach?

A. Yes. For all services with term plans, the TDS approach is cumbersome as it requires manual adjustments of bills and is not intuitively easy for customers to understand. For usage-based services, the TDS approach is extremely onerous as a customers' usage can vary significantly from month-to-month. Larger customers can make hundreds of thousands of calls annually, and the underlying price for these calls can vary based upon the time of day, day of week, and call duration The "payback the savings" approach requires that each of these calls be re-rated for the period of time that the customer has been under contract. Re-rating hundreds of thousands of calls over multiple years is incredibly burdensome both for SBC Illinois and the customer. As noted above, this is one of the reasons that customers like to sign-up for plans with annual commitment levels that are simple to understand.

Q. Are there administrative advantages to using SBC Illinois' forward-looking, percentage-based approach instead?

A. Yes. First and foremost, this language is easy and intuitive for customers to understand as it follows standard contract principles. Secondly, it is simple for carriers to calculate internally. The "payback the savings" approach endorsed by TDS requires customers to have an in-depth knowledge of the rate schedules to know the price points the customer signed up for, as well as the price points for the completed term.

Q. If the Commission determines that TDS' complaint has any merit, is it appropriate to impose TDS' methodology on SBC Illinois alone?

A. No. As I have demonstrated, TDS' complaint does not have merit. However, if the Commission were to determine that use of TDS' termination liability methodology is required, it should be imposed on the entire marketplace. There is no basis for singling SBC Illinois out for special treatment, given the level of competition that exists today. Under these circumstances, this complaint proceeding would be terminated and the Commission would initiate a rulemaking proceeding to develop a statewide, carrier-wide rule on early termination liability policies.

IX. CONCLUSION

Q. Does this conclude your testimony?

A. Yes.