

BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 03-0553

**Rebuttal Testimony of Brian Gillespie
On Behalf of SBC Illinois**

SBC Illinois Exhibit 1.1

March 10, 2004

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
II.	PURPOSE OF TESTIMONY	1
III.	THE BUSINESS MARKETPLACE IN ILLINOIS	2
IV.	STAFF'S VIEW ON SBC ILLINOIS' TERMINATION LIABILITY POLICIES	5
V.	STAFF'S VIEW OF TDS' PROPOSAL.....	13
VI.	STAFF'S PROPOSED RULEMAKING PROCEEDING	17
VII.	CONCLUSION	20

1 **REBUTTAL TESTIMONY OF BRIAN GILLESPIE**

2 **ON BEHALF OF SBC ILLINOIS**

3
4 **I. INTRODUCTION**

5 **Q. Please state your name and business address.**

6 A. My name is Brian Gillespie. My address is 2000 W. SBC Drive, Hoffman Estates, IL
7 60196.

8
9 **Q. Are you the same Brian Gillespie who submitted direct testimony in this**
10 **proceeding?**

11 A. Yes.

12
13 **II. PURPOSE OF TESTIMONY**

14 **Q. What is the purpose of your rebuttal testimony?**

15 A. The purpose of my rebuttal testimony is to respond to the direct testimony filed by Staff
16 witnesses Robert F. Koch and A. Olusanjo Omoniyi. Rebuttal testimony is also being
17 submitted by Dr. Alan Frankel and Ronald Flitsch.

18
19 **Q. Please summarize SBC Illinois' overall response to Staff's position in this**
20 **proceeding.**

21 A. As I understand their position, Staff witnesses Koch and Omoniyi are recommending that
22 the Commission not rule on TDS' complaint, but instead initiate a rulemaking proceeding
23 to adopt industry-wide policies on early termination liabilities. (Staff Ex. 1.0, pp. 14-15;

24 Staff Ex. 2.0, pp. 13-14). Staff apparently favors the approach used by TDS and
25 proposed in this proceeding. If the Commission does not initiate a rulemaking
26 proceeding, then Mr. Koch recommends that TDS' approach be imposed on SBC Illinois
27 alone. (Staff Ex. 2.0, pp. 14-15).

28
29 Staff's recommendation is not supported by the facts or the relevant economic policy
30 considerations. The marketplace for the business services at issue in this case is highly
31 competitive and has been for a considerable period of time. As Dr. Frankel explains, the
32 Commission should avoid dictating the practices of competitive companies absent a
33 compelling reason to do so. Staff has not presented such a case.

34
35 With respect to a rulemaking proceeding, SBC Illinois agrees with Staff that there is no
36 basis for imposing TDS' requested remedy on SBC Illinois alone and that it would have
37 to be applied even-handedly to the entire industry. However, initiation of a rulemaking
38 proceeding will create significant uncertainties for every carrier in the state (with the
39 possible exception of TDS). Therefore, the Commission should not embark on such a
40 proceeding lightly. SBC Illinois does not believe that Staff has provided a basis for
41 further action.

42

43 **III. THE BUSINESS MARKETPLACE IN ILLINOIS**

44 Q. Is it important that the Commission view the dispute between TDS and SBC Illinois in
45 light of current marketplace conditions?

46 A. Yes. Unfortunately, both TDS and Staff view this proceeding largely as an extension of
47 the dispute between SBC Illinois and Ascent in Docket No. 00-0024. However, as I
48 indicated in my direct testimony, the world is a different place in 2004 than it was in
49 2000 and the scope of the services at issue in this proceeding is much broader than it was
50 in the *Ascent* case. The CLECs now serve 35% of the market for business local exchange
51 service including usage, the only service at issue in the *Ascent* case. SBC Illinois has
52 faced significant competition for an even longer period of time for Centrex and transport
53 services, and, in many instances, does not even have a 50% market share. These are very
54 different circumstances from the *Ascent* case.

55

56 **Q. Does Staff take these different circumstances into account in its analyses?**

57 A. No, not as I read their testimony. In fact, Mr. Omoniyi states that the "...general
58 circumstances addressed in the *Ascent* order are similar to the issues in the instant
59 docket." (Staff Ex. 1.0, p. 11). In fact, they are not.

60

61 **Q. Mr. Omoniyi contends that there are several elements common to both the *Ascent***
62 **case and this one. (Staff Ex. 1.0, p. 14). Please comment.**

63 A. I agree with Mr. Omoniyi that both proceedings involved early termination liabilities
64 assessed under long-term agreements. Beyond that, Mr. Omoniyi is oversimplifying the
65 interrelationships.

66

67 For example, Mr. Omoniyi contends that the size of the early termination liabilities in
68 both cases "...can be enormous as they are based on percentages as high as 100%." This

69 is incorrect. Unlike the situation in the *Ascent* case, SBC Illinois has not used a 100%
70 termination liability for any major product or service category for several years.
71 Moreover, under SBC Illinois' *revised* policies, none will exceed 50%.

72
73 Mr. Omoniyi further contends that there is a "possibility" that the contracts in question
74 can result in "...locking up customers and, thus, adversely affecting the marketplace."
75 Whether or not any given termination liability practice has that effect requires an analysis
76 of marketplace dynamics – something which Mr. Omoniyi does not supply. SBC Illinois
77 has shown that its revised policies are reasonable and that customers are not being
78 "locked up." Furthermore, the key question is whether SBC Illinois' policy appropriately
79 reflects its losses when a customer terminates early. As the Commission noted in its
80 *Ascent* order, SBC Illinois had not presented an economic analysis supporting its 100%
81 approach. The Company has done so here.

82
83 In addition, the Commission's decision in the *Ascent* case was clearly influenced by the
84 fact that the Valuelink family of services had been introduced immediately following the
85 implementation of intraMSA presubscription, and had, in the Commission's view,
86 prematurely bound customers to long term agreements. No such facts exist in this case.
87 Centrex and transport services have been competitive for a long time (in the case of
88 Centrex, a *very* long time). Even usage has now been competitive for an additional four
89 years, and CLECs have gained a very significant share of the business local exchange
90 marketplace.

91

92 **Q. Has either Mr. Omoniyi or Mr. Koch presented an analysis that would warrant an**
93 ***Ascent* – like remedy in today’s marketplace?**

94 A. No.

95

96 **IV. STAFF’S VIEW ON SBC ILLINOIS’ TERMINATION LIABILITY POLICIES**

97 **Q. What is Staff’s view of SBC Illinois’ termination liability policy that was in effect**
98 **when TDS filed its complaint?**

99 A. Staff does not believe that it is reasonable. Mr. Omoniyi contends that the liability
100 resulting from policies that range as high as 100% are “ ...not proportional to the actual
101 loss that such customer caused SBC” and could have a “...chilling effect on customers”
102 that wish to change service providers. (Staff Ex. 1.0, pp. 8-9).

103

104 **Q. Is Staff’s position supported by the facts?**

105 A. No. SBC Illinois’ termination liability policy varied from product to product. For usage
106 products not subject to the *Ascent* rules, the termination liabilities have ranged from 35%
107 to 50%. As shown by Mr. Flitsch’s Direct Testimony, these amounts are supported by
108 his financial analysis. The majority of data transport products were subject to a “give
109 back the unearned discount” approach which Staff and TDS *support*. The remaining
110 services were subject to a 50% termination liability, which is also supported by Mr.
111 Flitsch’s analysis. The *only* major product whose termination liability exceeded 50% is
112 Centrex, which typically has been subject to an 85% termination liability but allowed
113 customers to disconnect up to 20% of their lines before the termination liability was
114 charged. Although SBC Illinois has proposed to lower this amount to 25% based on its

115 revised approach, the Centrex termination liability is justified in light of market
116 conditions over the last several years.

117

118 **Q. Please explain your prior statement.**

119 A. SBC Illinois revised termination liability policy assumes that all of the underlying
120 network costs are avoidable – in other words, reusable. This is likely to be an optimistic
121 assumption even on a going-forward basis and was not borne out over the last several
122 years. Attached is my Schedule BG-R1 is SBC Illinois' access line loss data for 2001-
123 2003. As shown in that schedule, lines (and profits) lost when customers migrated to
124 CLECs were not offset by new demand. In addition, facilities are often stranded when a
125 customer moves from a network solution like Centrex (which is very loop intensive) to a
126 premises solution like a PBX. In this case, SBC Illinois may not be able to redeploy the
127 underlying facilities, particularly where overall demand in the marketplace is stagnant
128 and lines are being lost to CLECs on top of that.

129

130 Thus, the Company could have legitimately included network costs in determining its
131 termination liability for Centrex service during that period, resulting in a higher
132 termination liability calculation. SBC Illinois has taken a much more conservative
133 approach with its 25% ETF calculation. I would also note that most CLECs offering
134 Centrex service charge 100% termination liabilities. (SBC Ill. Ex. 1.0, Sch. BG-3).

135

136 **Q. Is it necessary to resolve these issues relative to prior policies?**

137 A. No. Since they are being replaced with SBC Illinois' revised policies well before a
138 decision will be reached in this proceeding, there is no reason to address them.

139

140 **Q. What is Staff's view of SBC Illinois' revised early termination liability policies?**

141 A. Staff has ascribed positive and negative aspects to SBC Illinois' current termination
142 liability policies. On the positive side, Mr. Koch believes that SBC Illinois' approach
143 provides economic incentives to the Company to develop discounted offerings that are
144 attractive to customers (Staff Ex. 2.0, p. 5). Staff also acknowledges that SBC Illinois'
145 revised policies generally result in reduced termination liabilities and, as a result, will
146 have a positive impact on customers and competition, in that customers will be able to
147 change carriers more readily during the term of an agreement (Staff Ex. 2.0, p. 6).

148

149 On the other hand, Staff expresses concern that SBC Illinois' approach will produce
150 higher absolute termination liabilities in most cases than TDS' approach and, therefore,
151 will have a negative effect on a customer's ability to change carriers (Staff Ex. 1.0, pp. 8-
152 9; Staff Ex. 2.0, pp. 6-7).

153

154 **Q. Please comment on Staff's assessment.**

155 A. I agree that early termination liabilities are integrally related to a carrier's willingness
156 and/or ability to offer discounts to customers and that customers benefit from such
157 practices. I also agree that SBC Illinois' revised policies will significantly reduce early
158 termination liabilities for certain services, particularly Centrex. However, I do not agree

159 that they will necessarily produce higher termination liabilities than TDS' approach or
160 that they inappropriately chill customer migration between carriers.

161

162 **Q. Does Staff dispute SBC Illinois' contention that its revised policies are reflective of**
163 **the losses that SBC Illinois will incur if a customer breaches its agreement early?**

164 A. No. Neither Mr. Omoniyi nor Mr. Koch contends that SBC Illinois' approach of
165 recovering its losses if the customer breaches its agreement early is out-of-line with
166 contract principles or economic theory. Rather, Mr. Koch's preference for TDS'
167 approach appears to be based solely on his perception that SBC Illinois' approach would
168 produce "...a more significant termination liability...in almost all circumstances." (Staff
169 Ex. 2.0, p. 6).

170

171 **Q. Is that the relevant criteria?**

172 A. No. The question is whether SBC Illinois' approach appropriately reflects its losses
173 when a customer terminates early – not whether some other approach would produce a
174 lower number. If SBC Illinois' approach meets that standard, then the Commission's
175 inquiry should end. The mere fact that Staff might make a different decision, if the
176 decision was theirs to make, does not support a wholesale restructuring of SBC Illinois'
177 (or the industry's) termination liability policies.

178

179 **Q. Mr. Koch has raised questions about Mr. Flitsch's analysis (Staff Ex. 2.0, pp. 8-11).**
180 **Please comment.**

181 A. Generally, Mr. Koch contends that SBC Illinois' methodology is difficult to verify. Mr.
182 Flitsch is providing additional information responsive to Mr. Koch's concerns in his
183 rebuttal testimony.

184

185 **Q. Although Staff supports SBC Illinois' proposed modifications to its existing**
186 **termination liability policies, Mr. Omoniyi contends that "...it is simply impossible**
187 **to judge the cost and policy implications on competition until all details are known."**
188 **(Staff Ex. 1.0, p. 13). Do you agree?**

189 A. No. I provided extensive information on the changes SBC Illinois is making in its
190 termination liability policies in my Direct Testimony. Although these policies require
191 time to implement because changes must be made to internal SBC Illinois practices and
192 systems, conceptually they are very straightforward. It is not clear to me what other
193 information Mr. Omoniyi needed (and none was requested).

194

195 **Q. Mr. Koch provides a brief summary of Staff's investigation into CLEC termination**
196 **liability policies as required by the *Ascent* order. Please comment.**

197 A. As Mr. Koch explains, Staff held workshops pursuant to Finding (15) of the *Ascent* order
198 to review CLEC termination liability policies and to determine whether any further
199 Commission action was required (Staff Ex. 2.0, pp. 5-6). Although I was not personally
200 involved in the process, it is my understanding that Mr. Koch's summary is incomplete. It
201 is true that many of the CLECs then charged 100% termination liabilities. It is also true
202 that Staff's attempt to persuade the CLECs to reduce them on a voluntary basis was not
203 particularly successful. Circumstances have not changed significantly since then. My

204 Schedule BG-3, attached to my direct testimony, shows that AT&T uses a 35% or 50%
205 termination liability depending on the product, MCI uses 75% and most of the other
206 carriers are still at 100% (Allegiance's use of \$300/circuit for transport products is
207 roughly equivalent to a **50%** termination liability, based on its filed tariffs). Thus, Mr.
208 Koch's statement that Staff was successful in persuading even a "handful" of carriers to
209 reduce their early termination liabilities to 35% appears to overstate the case.
210 Furthermore, it is SBC Illinois' understanding that the CLECs were being urged by Staff
211 to move to a 50% termination liability, not 35%. No further Commission action was
212 initiated at that time relative to the CLECs' practices.

213

214 **Q. Did Staff at that time attempt to treat SBC Illinois and the other CLECs even-**
215 **handedly?**

216 A. Yes, to some degree. Because the *Ascent* case was limited to the ValueLink family of
217 services, SBC Illinois had to develop policies for other tariffed products and services
218 where term agreements were offered. Although competitive service tariffs and tariff
219 changes become effective on one day's notice under Section 13-502 of the Public
220 Utilities Act, Staff reviews these tariffs and, where appropriate, recommends that the
221 Commission open an investigation if significant policy issues are raised by the filing.
222 Staff also communicates regularly with the Company if it has objections to a competitive
223 tariff filing, so that SBC Illinois has an opportunity to withdraw or modify the tariff,
224 rather than subject itself to a formal investigation. Having just completed the *Ascent*
225 proceeding, SBC Illinois did not want to file any new tariffs or tariff revisions that would
226 trigger another investigation into these same issues.

227

228 Based on the workshop process and Staff's view that a 50% forward-looking termination
229 liability would be reasonable for the CLECs, SBC Illinois adopted a conservative 35%
230 approach for use in non-ValueLink tariffs while Staff worked with individual CLECs.
231 Given the CLECs' continued use of higher termination liabilities, however, SBC Illinois
232 eventually moved to a 50% termination liability policy in June of 2003, which is reflected
233 in a small number of tariffs.

234

235 **Q. Has Staff objected to any of these tariff filings?**

236 A. No. Since January, 2002, SBC Illinois has filed 22 tariffs or tariff revisions that contain
237 forward-looking termination liabilities at either 35% or 50%. These tariffs have gone
238 into effect and no recommendations have been made to the Commission that they be
239 investigated. My Schedule BG-R2 is a list of these tariff filings.

240

241 **Q. Did this history figure into SBC Illinois' revised termination liability proposal in
242 this proceeding?**

243 A. Most definitely. SBC Illinois' objective was to revise its policies consistent with contract
244 and economic theory, as well as its understanding of what would be acceptable to Staff.
245 All of the proposed termination liabilities are 50% or lower. As I indicated in my direct
246 testimony, the Company decided to continue using 35%, instead of 50%, for usage
247 agreements in Illinois because of the *Ascent* history. (SBC Ill. Ex. 1.0, p. 23). SBC
248 Illinois is now close to completing the work required to implement these changes, based

249 on its good faith assumption that they would fall well within Staff’s “range of
250 reasonableness.” Staff’s apparent change of heart is baffling to the Company.

251

252 **Q. Is Mr. Koch correct that SBC Illinois’ approach will produce “a more significant**
253 **termination liability than the TDS proposal in almost all circumstances” (Staff Ex.**
254 **2.0, p. 6).**

255 A. No. Specifically, Mr. Koch contends that TDS’ approach is better except in the “final
256 months of the contract term.” (Staff Ex. 2.0, p. 7). As part of my direct testimony, I
257 provided an analysis of the termination liability that would be produced by the SBC
258 Illinois and TDS termination liability methodologies respectively for a hypothetical five-
259 year contract. As shown in my Schedule BG-8, the cross-over point is at the 25-month
260 point in a 60-month agreement, *not* the “final months” of the agreement. In other words,
261 the customer pays *less* under SBC Illinois’ approach than under TDS’ approach in all
262 months after month 26 (except for month 36, where the TDS approach produces a
263 marginally lower result), which represents over 50% of the entire contract term.

264

265 **Q. Is this analysis atypical?**

266 A. No. Together with Mr. Frankel, SBC Illinois has prepared additional analyses, based on
267 term lengths and prices in SBC Illinois’ existing tariffs. I am including this termination
268 liability comparison for two of SBC Illinois’ products – Centrex and DS1 (Schedules
269 BG-R3 and BG-R4). Both of my analyses assume a 36-month term agreement. As
270 shown in these analyses, customers pay less under SBC Illinois’ approach than TDS’ well
271 before the “final months” of the contract term. In fact, in my examples, TDS’ approach

272 produces higher amounts than SBC Illinois' approach in over 60% of the months in the
273 given contract terms. In other words, from the standpoint of the issue raised by Mr.
274 Koch, TDS' approach is *not* superior to SBC Illinois'. I consider these to be
275 representative examples.

276

277 **Q. Is it pro-competitive for termination liabilities to be high at the end of a contract**
278 **term?**

279 A. No. Even Mr. Koch concedes that the TDS approach produces much higher termination
280 liabilities than SBC Illinois' toward the end of a contract term. As Dr. Frankel explains,
281 it makes no sense to compel use of a termination liability that increases to very high
282 levels in excess of total remaining revenues due under the contract as it approaches
283 expiration.

284

285 **V. STAFF'S VIEW OF TDS' PROPOSAL**

286 **Q. What is Staff's view of TDS' proposal?**

287 A. Staff also viewed TDS' proposal as having negative and positive attributes. On the one
288 hand, Mr. Koch acknowledges that restricting the termination liability which SBC Illinois
289 can use in its term agreements would reduce the Company's willingness to offer
290 customers attractive discounts. Mr. Koch also recognized that SBC Illinois alone should
291 not be precluded from engaging in competitive practices that Mr. Koch admits are
292 standard in the marketplace. (Staff Ex. 2.0, pp. 5-6).

293

294 On the other hand, Staff apparently prefers the “give back the unearned discount”
295 methodology to a forward-looking percentage of what remains on the contract.
296 According to Staff, TDS’ proposal is “reasonable to the customer” and would have a
297 “positive impact on competition in SBCI’s service territory.” (Staff Ex. 2.0, p. 4). As I
298 noted previously, Mr. Koch’s views are premised on the assumption that TDS’ approach
299 would produce smaller termination liabilities than SBC Illinois’ and, therefore, would
300 have a positive impact on the ability of competitive carriers to obtain the business of
301 customers on contract with SBCI.

302

303 **Q. Do you agree with Staff’s assessment?**

304 A. No. First, from a conceptual basis, Staff is looking at this issue from the wrong
305 perspective. Staff’s entire focus is on the impact that a termination liability has on a
306 business customer’s ability to “migrate” between carriers during the term of an
307 agreement. (Staff Ex. 2.0, pp. 12-13). Staff seems to be confusing the policy issue here
308 with “customer migration” concerns that have arisen in other contexts, where the
309 Commission has required that SBC Illinois’ operating systems (“OSS” systems) allow
310 end user customers to switch carriers seamlessly and without undue delay (e.g., the
311 Section 271 proceeding). However, these issues involved ordering, provisioning and
312 billing systems that are used by CLECs once they “win” the customer. They are entirely
313 separate from the question whether customers under long-term agreements should be
314 encouraged to breach them.

315

316 As a basic proposition, business customers under long-term agreements are not *supposed*
317 to be migrating back and forth between carriers during the terms of those agreements
318 (whether from SBC Illinois to a CLEC or from a CLEC back to SBC Illinois or between
319 CLECs). They are supposed to be living up to their contractual obligations and making
320 new vendor choices when their agreement terminates.

321 As I indicated in my direct testimony, termination liability policies should not be reverse-
322 engineered to produce the lowest possible cost of switching carriers. (SBC Ill. Ex. 1.0,
323 pp. 36-37).

324
325 Secondly, from a practical basis, the “payback the savings” methodology results in a
326 higher termination liability calculation in many instances, contrary to Mr. Koch’s
327 assumptions. Again, I refer back to the two real-world examples addressed earlier in my
328 testimony (SBC Illinois’ DS1 and Centrex services). As Schedules BG-R3 and BG-R4
329 show, the TDS-endorsed method results in a higher termination liability calculation the
330 majority of the time.

331
332 **Q. Could the TDS approach have an impact on the carrier’s willingness to discount its**
333 **rates?**

334 A. Mr. Koch recognizes this drawback at the outset of his testimony. (Staff Ex. 2.0, p. 5).
335 Staff asserts that the improved ability of customers to migrate between carriers offsets
336 this concern. To the extent that Staff’s position is based on an implicit assumption that
337 the customer can obtain as good a deal (both in terms of price and product) from another
338 carrier, that is not necessarily the case. First, as a factual matter, other carriers may not

339 offer the same service or the same level of discount. Second, forcing customers to take
340 service from another carrier disserves customers that prefer to look to SBC Illinois for
341 competitive products at attractive prices. Third, if *all* carriers are subjected to the “give
342 back the unearned discount” policy (as Staff suggests), then the overall level of
343 discounting in the Illinois business marketplace may decline. SBC Illinois is at a loss to
344 understand why this is a desirable result.

345

346 **Q. Does Staff address the situation where TDS’ approach cannot be used at all, e.g., in**
347 **a contract for a customer-specific network?**

348 A. No, Staff completely ignores this problem. As I explained in my testimony, “give back
349 the unearned discount” methodologies are unworkable where SBC Illinois installs
350 facilities solely for the use of one customer and those facilities cannot be reused for
351 another customer. (SBC Ill. Ex. 1.0, pp. 42-43). For this kind of arrangement, there also
352 is no alternative scenario where the network is priced based on a shorter term and at a
353 lower level of discount. Therefore, it is not possible to calculate the “unearned discount.”
354 In short, the TDS approach cannot be considered without resolving this issue and Staff
355 does not do so.

356

357 **Q. Has Staff considered the administrative complexities associated with TDS’**
358 **approach? (SBC Ill. Ex. 1.0, pp. 44-45).**

359 A. There is no mention of them in Mr. Koch’s testimony.

360

361 **Q. Has Staff considered the fact that the TDS approach produces counter-intuitive**
362 **results? (SBC Ill. Ex. 1.0, pp. 40-41).**

363 A. There is no mention of this issue in Mr. Koch's testimony.

364

365 **Q. Is SBC Illinois taking the position that TDS' approach should not be permitted?**

366 A. No. My point is that TDS' approach has its own drawbacks and should not be imposed
367 on SBC Illinois (or anyone else). TDS, however, is certainly entitled to make its own
368 business decisions in this area. If TDS concludes that "give back the unearned discount"
369 makes sense to it from a business and competitive perspective, then it should be free to
370 use this approach. That is a far cry, however, from asking the Commission to impose this
371 approach on other carriers to which it does not make business or competitive sense.

372

373 **VI. STAFF'S PROPOSED RULEMAKING PROCEEDING**

374 **Q. Staff's principal recommendation is that the Commission conduct a rulemaking**
375 **proceeding to establish consistent termination liability policies for the entire**
376 **industry. (Staff Ex. 1.0, pp. 15-16; Staff Ex. 2.0, pp. 13-14). What is the basis for**
377 **Staff's proposal?**

378 A. Staff proposes a rulemaking proceeding because it believes that there are offsetting policy
379 concerns here. Mr. Koch acknowledges that SBC Illinois should not be held to a "higher
380 standard" than its competitors in the business marketplace. (Staff Ex. 2.0, pp. 5-6, 12,
381 13). Therefore, Staff recommends that the Commission establish guidelines applicable to
382 all carriers.

383

384 **Q. Does SBC Illinois support the initiation of a rulemaking proceeding?**

385 A. Only in one circumstance. As I indicated in my Direct Testimony, if the Commission
386 concludes that only TDS' approach to termination liabilities is lawful, then it should be
387 imposed in an even-handed manner on all carriers in Illinois. (SBC Ill. Ex. 1.0, p. 45). I
388 agree with Mr. Koch that a rulemaking proceeding would be the appropriate means of
389 achieving that result.

390

391 **Q. Has either Staff or TDS demonstrated that only the TDS approach is lawful?**

392 A. No. At most, TDS and Staff have demonstrated that "give back the unearned discount" is
393 an approach that *could* be used by a carrier in Illinois. They have not demonstrated that it
394 *must* be used.

395

396 **Q. Should the Commission embark on a rulemaking proceeding before evaluating both
397 the likely outcome and the impact it will have on carriers in the interim?**

398 A. No. As I will explain in more detail, the mere fact of a rulemaking will disrupt
399 competitive behavior in the Illinois marketplace. Given the fact that Staff favors the TDS
400 approach --- and would presumably propose it in the rulemaking proceeding --- the
401 record in this complaint provides a reasonable proxy for what would likely result from
402 the rulemaking proceeding. The only difference is that other CLECs would also weigh in
403 on the issues.

404

405 **Q. What is the likely response of the other CLECs in Illinois?**

406 A. My judgment is that every CLEC in Illinois other than TDS would object violently to any
407 effort by the Commission to impose TDS' approach on them by regulatory fiat. As Mr.
408 Koch explained, most of the CLECs refused to even *reduce* the amount of their forward-
409 looking early termination liability policies during the workshops in 2001. To my
410 knowledge, Staff never attempted to persuade the carriers to restructure them along the
411 lines of the *Ascent* decision. As a result, the rulemaking record would consist of (at least)
412 seven major CLECs and SBC Illinois arrayed in favor of forward-looking termination
413 liabilities and TDS as the sole CLEC supporting the "give back the unearned discount"
414 approach. (SBC Ill. Ex. 1.0, Sch. 36-3).

415
416 Unless the Commission, based on the record developed in this proceeding, believes that it
417 is likely to adopt TDS' approach over the opposition of virtually the entire
418 telecommunications industry in Illinois, then a rulemaking proceeding would be a costly
419 and unproductive exercise.

420
421 **Q. Is regulation of the industry's termination liability practices necessary or**
422 **appropriate?**

423 A. No. As Mr. Koch acknowledges, there is an integral relationship between the prices that
424 carriers offer customers (i.e., the level of discount) and the termination liability policy
425 that it can apply. As I discussed previously, there is also an integral relationship between
426 a carrier's ability to even provide customers with custom solutions and termination
427 liabilities that allow them to recoup losses in the event of early termination.

428

429 The Commission should be extremely cautious about regulating carrier conduct that
430 directly affects both *prices* and *service*. Pricing is at the heart of the competitive
431 marketplace. Customers will not benefit if carriers in Illinois are disincented from
432 providing attractive prices under long-term agreements. Customers will not benefit if
433 carriers in Illinois are disincented (or effectively precluded) from offering the custom
434 network solutions that are increasingly demanded by larger business customers. Thus, a
435 high burden should be placed on both Staff and TDS to make the case that regulatory
436 intervention is required to correct a failure in the marketplace – a burden they have not
437 met.

438

439 **Q. Has the Commission previously attempted to regulate competitive prices or price-**
440 **related practices on an industry-wide basis?**

441 A. Only in one very limited circumstance. In the late 1990's, there was public outrage over
442 price gouging by operator services providers at certain payphones. In response, this
443 Commission (as well as Congress and the FCC) took action, including the “unblocking”
444 of private payphones so that customers could reach other operator services providers;
445 mandatory disclosure of the operator services provider and its rates; and presumptive
446 tests of “reasonableness” for operator services rates.. This was a unique circumstance,
447 however, because consumers did not have the information necessary to make an informed
448 choice and were not being given choices between providers.

449

450 No such special circumstances exist here. Business customers are sophisticated and
451 understand the vendor choices available to them. Business customers understand that

452 long-term agreements impose liabilities on them if they terminate prematurely. The
453 marketplace is fully capable of disciplining carriers that adopt policies that customers
454 find unreasonable. Adopting industry-wide guidelines in this area would run counter to
455 this Commission's long-standing, procompetitive policies.

456

457 **Q. Does the Illinois Public Utilities Act contemplate regulatory intervention into**
458 **carriers' contracting practices for the reasons suggested by Staff?**

459 A. I do not believe so. Section 13-509 allows companies to enter into contracts on an "off
460 tariff" basis for competitive services. It provides as follows:

461 "...Upon submitting notice to the Commission of any such agreement, the
462 telecommunications carrier shall thereafter provide service according to the terms
463 thereof, unless the Commission finds, after notice and hearing, that the continued
464 provision of service pursuant to such agreement would substantially and adversely affect
465 the financial integrity of the telecommunications carrier or would violate any other
466 provision of this Act."

467

468 Although I am not an attorney, and this issue will be addressed in more detail in the
469 Company's brief, this section suggests that contract terms can be altered by the
470 Commission only in the event of severe financial risk to the carrier or unlawfulness. In
471 my view, it does not contemplate regulation merely to achieve a "better" competitive
472 result, which is what Staff is proposing.

473

474 **Q. Are there costs associated with a rulemaking proceedings?**

475 A. Yes. By their nature, rulemaking proceedings are time-consuming and resource-
476 intensive. As I understand it, the Commission typically conducts a contested hearing
477 proceeding to develop a proposed rule and then goes through standard rulemaking

478 proceedings to adopt the rule. Even Staff concedes that this rulemaking would be a
479 “large scale endeavor.” (Staff Ex. 2.0, p. 13).

480
481 Moreover, there are other “costs” that are more difficult to quantify, but are potentially
482 even more serious. As I indicated earlier, the mere fact of a rulemaking will cast a cloud
483 over the contracting policies of every carrier in this state (other than TDS). Carriers will
484 not know whether they can rely on their existing termination liability policies when
485 developing customer discounts or pricing a customer-specific network. Since rulemaking
486 proceedings in Illinois can take years, most carriers will find the situation difficult. For
487 example, assume hypothetically that the Commission were to invalidate all forward-
488 looking termination liability policies at the conclusion of the rulemaking proceeding on
489 both a prospective and retroactive basis (as TDS proposes in this case for SBC Illinois).
490 Carriers could then find themselves locked into contracts that are financially unattractive
491 if the customer breaches and without any means to cure the problem (e.g. the discounts
492 have already been given or the network has already been constructed). If carriers are
493 forced to play it “safe” from a financial perspective during the period that the rulemaking
494 proceeding is pending, customers will be the losers.

495
496 On the other hand, assume that the Commission applies its new rules on a prospective
497 basis only. This would reduce the level of uncertainty. However, the breadth of the
498 relief granted in the rules would be also more circumscribed than what TDS is asking in
499 its complaint.

500

501 **Q. Both Mr. Omoniyi and Mr. Koch suggest that a rulemaking is necessary to avoid**
502 **further litigation. (Staff Ex. 1.0, p. 15; Staff Ex. 2.0, pp. 13-14). Do you agree?**

503 A. No. I believe that TDS filed its complaint because the *Ascent* decision seemed to signal a
504 willingness on the Commission's part to micromanage SBC Illinois' termination liability
505 policies. Unlike the *Ascent* complaint, however, TDS' complaint covers *all* of the
506 products and services that SBC Illinois offers to business customers under term
507 agreements. If the Commission makes clear in this proceeding that the *Ascent* order was
508 specific to the ValueLink family of services and was specific to the time and the facts of
509 that case (i.e., term agreements offered immediately after the implementation of
510 intraMSA presubscription, a 100% termination liability policy, less developed local
511 exchange competition and so forth), and that it will not be extended to other products and
512 services, SBC Illinois believes the likelihood of future litigation is small.

513

514 **VII. CONCLUSION**

515 **Q. Does this conclude your rebuttal testimony?**

516 A. Yes.