

**BEFORE THE ILLINOIS COMMERCE COMMISSION**

**Docket No. 08-0569**

**Direct Testimony of William E. Taylor  
On Behalf of AT&T Illinois**

**AT&T Illinois Exhibit 3.0**

**October 20, 2008**

**TABLE OF CONTENTS**

I. INTRODUCTION .....1

II. PURPOSE AND SUMMARY OF TESTIMONY .....2

III. STATUTORY GUIDELINES FOR RECLASSIFYING TELECOMMUNICATIONS SERVICES IN ILLINOIS .....4

IV. APPLICATION OF STATUTORY STANDARDS IN SUPPORT OF AT&T ILLINOIS’ PETITION .....6

    A. Definition of the Relevant Market .....6

    B. Examination of the Five Statutory Factors .....15

        1. The number, size, and geographic distribution of other providers of the service .....15

            A. WIRELINE CLEC COMPETITION .....21

            B. WIRELESS PROVIDERS .....23

            C. INTERNET TELEPHONY PROVIDERS .....25

        2. The availability of functionally equivalent services in the relevant geographic area and the ability of telecommunications carriers or other persons to make the same, equivalent, or substitutable service readily available in the relevant market at comparable rates, terms, and conditions .....28

        3. The existence of economic, technological, or any other barriers to entry into, or exit from, the relevant market. ....33

        4. The extent to which other telecommunications companies must rely upon the service of another telecommunications carrier to provide telecommunications service. ....36

        5. Any other factors that may affect competition and the public interest that the Commission deems appropriate. ....38

V. CONCLUSION.....40

1 **I. INTRODUCTION**

2 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND CURRENT POSITION.

3 A. My name is William E. Taylor. I am Senior Vice President of NERA Economic Consulting  
4 (“NERA”), head of its Communications Practice, and head of its Boston office located at  
5 200 Clarendon Street, Boston, Massachusetts 02116.

6 Q. PLEASE DESCRIBE YOUR EDUCATIONAL, PROFESSIONAL, AND BUSINESS  
7 EXPERIENCE.

8 A. I have been an economist for over thirty years. I earned a Bachelor of Arts degree from  
9 Harvard College in 1968, a Master of Arts degree in Statistics from the University of  
10 California at Berkeley in 1970, and a Ph.D. from Berkeley in 1974, specializing in  
11 Industrial Organization and Econometrics. For the past twenty-five years, I have taught and  
12 published research in the areas of microeconomics, theoretical and applied econometrics,  
13 and telecommunications policy at academic and research institutions. Specifically, I have  
14 taught at the Economics Departments of Cornell University, the Catholic University of  
15 Louvain in Belgium, and the Massachusetts Institute of Technology. I have also conducted  
16 research at Bell Laboratories and Bell Communications Research, Inc.

17 I have testified on telecommunications economics concerning incentive regulation, price  
18 cap regulation, productivity, access charges, local competition, interLATA competition,  
19 interconnection and pricing for economic efficiency before numerous state regulatory  
20 authorities, the Federal Communications Commission, the Canadian Radio-Television and  
21 Telecommunications Commission, the New Zealand Commerce Commission, federal and  
22 state congressional committees and courts. I have been chosen twice by the Mexican  
23 Federal Telecommunications Commission and Telefonos de Mexico (“Telmex”) to arbitrate  
24 the renewals of the Telmex price cap plan in Mexico. I testified previously before this  
25 Commission in Docket No. 06-0027 regarding the reclassification of residential telephone  
26 services in the Chicago LATA, in Docket No. 88-0412 regarding efficient pricing for  
27 payphone access lines and in Docket No. 03-0595 regarding the scope of the geographic  
28 markets for unbundled network elements.

29 My curriculum vita is attached as Schedule WET-1.

30 **II. PURPOSE AND SUMMARY OF TESTIMONY**

31 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

32 A. I have been asked by Illinois Bell Telephone Company (“AT&T Illinois”) to explain the  
33 economic theory and the data on market activity relevant to the determination of whether  
34 AT&T Illinois’ residential basic exchange services in six Greater Illinois LATAs<sup>1</sup> should  
35 be classified as competitive.<sup>2</sup> Using updated data, I apply the methods I used to analyze  
36 residential competition in the Chicago LATA in Docket No. 06-0027<sup>3</sup> to AT&T Illinois’  
37 residential services in the Greater Illinois LATAs. Specifically, I define the relevant  
38 geographic and product markets, outline the extent of competition in AT&T Illinois’  
39 service territory for residential basic exchange services in these LATAs and show that  
40 classification of those services as competitive under Section 13-502 of the Public Utilities  
41 Act would be in the public interest.

42 Q. PLEASE SUMMARIZE YOUR TESTIMONY AND YOUR PRINCIPAL  
43 CONCLUSIONS.

44 A. Current evidence in AT&T Illinois’ service territory in the Greater Illinois LATAs shows  
45 that the markets for its residential local exchange services meet the statutory requirements  
46 for reclassification in these geographic areas and that the services should be reclassified as  
47 competitive. Applying Section 13-502 of the Illinois Public Utilities Act (including the five  
48 statutory factors) leads me to conclude that competition already exists in the relevant  
49 economic markets in question and is sufficiently developed that it meets the criteria  
50 specified in the statute. This competition takes two forms: (i) existing competition from

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<sup>1</sup> Champaign, Davenport, Peoria, Rockford, Springfield and St. Louis, collectively the “Greater Illinois LATAs.”

<sup>2</sup> By “residential basic exchange services” I mean the local exchange services that were classified as competitive on November 10, 2005, including network access, local usage, central office features such as call waiting and caller ID, and those miscellaneous services that are sold together with the network access line.

<sup>3</sup> *Illinois Commerce Commission On Its Own Motion v. Illinois Bell Telephone Company, Investigation of specified tariffs declaring certain services to be competitive telecommunications services*, Docket No. 06—0027, Direct Testimony of William E. Taylor, AT&T Illinois Exhibit 3.0, January 23, 2006.

51 wireline telephone companies (including cable companies) and from other competitors such  
52 as wireless carriers and stand-alone VoIP providers<sup>4</sup> and (ii) existing competition from  
53 firms that do not currently serve customers in an exchange but which nonetheless discipline  
54 prices in that exchange because—thanks to the Telecommunications Act of 1996—they can  
55 quickly and profitably enter in response to a price increase without incurring significant  
56 sunk costs.

57 My testimony:

58     ▪ Defines the relevant service and geographic markets for AT&T Illinois’ residential local  
59 exchange services.

60     Following standard economic principles, relevant economic markets are defined in  
61 terms of their product and geographic dimensions. For the purposes of this analysis, the  
62 product markets include local exchange services supplied to residential mass-market  
63 customers. These services are linked by demand and supply substitution relationships  
64 and are provided by (i) AT&T Illinois, the incumbent local exchange carrier (“ILEC”),  
65 (ii) many wireline CLECs, including cable companies, (iii) wireless carriers, and (iv)  
66 independent VoIP providers. The relevant services are listed in Schedule ELP-1 of Mr.  
67 Panfil’s testimony, AT&T Illinois Exhibit 2.0. The six geographic markets in which  
68 these services are sold are the aggregate of the exchanges in AT&T Illinois’ service  
69 territories in each of the Greater Illinois LATAs in Illinois.

70     ▪ Applies the statutory criteria (including the five statutory factors) to the data in Illinois.

71     Current data on alternatives to AT&T Illinois’ residential local exchange service  
72 throughout AT&T Illinois’ service territory in each of the Greater Illinois LATAs in  
73 Illinois shows that identical wireline residential local exchange services are readily  
74 available from numerous wireline (and cable) telephone competitors. In addition,  
75 functionally equivalent and substitute services are widely available from wireless and  
76 standalone VoIP providers. Moreover, to the extent that these findings focus solely on  
77 the incumbent carrier’s current market share, they are conservative for assessing the  
78 statutory criteria because (i) CLECs can enter and expand capacity without incurring  
79 fixed network costs, (ii) cable and wireless companies have already constructed their  
80 networks and can add additional telephony customers at low incremental cost and (iii)

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<sup>4</sup> Telephone service using the Voice over Internet Protocol is provided by two different types of carriers. Some facilities-based carriers — including many cable companies — provide loops and network facilities and carry traffic using VoIP. Other carriers — standalone, voice over broadband “VoBB,” “pure play” or “over-the-top” VoIP providers — use the customer’s broadband connection together with the public Internet or private network facilities to complete calls.

81 over-the-top VoIP providers can provide local exchange service throughout the Greater  
82 Illinois LATAs using customers' existing broadband connections.

- 83     ▪ Shows that the reclassification of AT&T Illinois' residential local exchange services is  
84 consistent with the public interest.

85     As the Commission found in Docket No. 06-0027, the public interest is served by  
86 increasing the pricing flexibility permitted AT&T Illinois' residential local exchange  
87 services. Competitive pressure leads all carriers (including AT&T Illinois) to offer  
88 innovative services and service bundles under competitive rates, terms and conditions,  
89 and continued price regulation of AT&T Illinois would only distort those market  
90 outcomes. Superfluous and asymmetric regulation of one supplier in these markets is  
91 not benign. In competitive markets characterized by fixed costs, market conditions  
92 determine the relative markups of prices over incremental costs for different services,  
93 and regulatory price ceilings for particular services will distort that pattern of efficient  
94 mark-ups. Competitive forces may cause some prices to rise from their current levels  
95 and some to fall, but this movement may be delayed or distorted by regulatory  
96 constraints that allow price reductions but prevent subsequent price increases. Prices  
97 set by regulation may, in fact, actually deter competitive entry if they are not at market  
98 levels, as explained in the Commission's Order in Docket No. 06-0027 [at 94-95]. In  
99 economic terms, consumer welfare is enhanced by reducing the level of regulation  
100 whenever that can be done without permitting exploitation of customers or dependent  
101 competitors. Because residential local exchange services meet the Section 13-502 test  
102 for competitiveness, reclassifying AT&T Illinois' residential local exchange services as  
103 competitive would strengthen the competitive process and thus serve the public interest.

104 **III. STATUTORY GUIDELINES FOR RECLASSIFYING TELECOMMUNICATIONS**  
105 **SERVICES IN ILLINOIS**

106 Q. WHAT ARE THE CRITERIA FOR CLASSIFYING A SERVICE AS COMPETITIVE  
107 UNDER THE ILLINOIS PUBLIC UTILITIES ACT?

108 A. Section 13-502 of the Illinois Public Utilities Act specifies the criteria the Commission  
109 must consider in determining whether to classify a telecommunications service as  
110 competitive. This section of the statute states, in relevant parts:

111     Section 13-502(b) A service shall be classified as competitive only if, and only  
112 to the extent that, for some identifiable class or group of customers in an  
113 exchange, group of exchanges, or some other clearly defined geographical area,  
114 such service, or its functional equivalent, or a substitute service, is reasonably  
115 available from more than one provider, whether or not any such provider is a  
116 telecommunications carrier subject to regulation under this Act...

117 Section 13-502(c) In determining whether a service should be reclassified as  
118 competitive, the Commission shall, at a minimum, consider the following  
119 factors:

- 120 1. the number, size, and geographic distribution of other providers of the service;
- 121 2. the availability of functionally equivalent services in the relevant geographic area  
122 and the ability of telecommunications carriers or other persons to make the same,  
123 equivalent, or substitutable service readily available in the relevant market at  
124 comparable rates, terms, and conditions;
- 125 3. the existence of economic, technological, or any other barriers to entry into, or exit  
126 from, the relevant market;
- 127 4. the extent to which other telecommunications companies must rely upon the service  
128 of another telecommunications carrier to provider telecommunications service; and
- 129 5. any other factors that may affect competition and the public interest that the  
130 Commission deems appropriate,

131 Q. FROM AN ECONOMIC PERSPECTIVE, WHAT DO THESE CRITERIA REQUIRE?

132 A. First, the statute references an individual “service” and asks whether that service, a  
133 functionally equivalent service or a substitute service is available from other suppliers.  
134 Thus, we are required to identify the services provided by other carriers that are the same  
135 as, “functionally equivalent” to or “substitutable” for each service for which AT&T Illinois  
136 is applying for reclassification as competitive. In economic terms, this requirement calls  
137 for identifying the product market in which the relevant AT&T Illinois services compete.

138 Second, the statute discusses customers in “an exchange, group of exchanges, or some other  
139 clearly defined geographical area” and asks about the availability of functionally equivalent  
140 services “in the relevant geographic area.” These elements of the statute require that we  
141 identify the geographic market for these services.

142 Third, the statute explicitly considers competition from sources other than regulated  
143 wireline telecommunications carriers, implying that wireless and stand-alone VoIP services  
144 should be considered. In addition, three of the statutory factors address the presence of  
145 sources of competitive pressure on AT&T Illinois’ prices: (1) the number, size and

146 distribution of other providers of the services, (2) the availability of functionally equivalent  
147 services and (3) the absence of barriers to entry and exit.

148 Fourth, the growth of facilities-based competitors that make little use of AT&T Illinois'  
149 network means that there are relevant carriers that do not depend on the services of AT&T  
150 Illinois to provide their own retail services. Thus, potential competition is not constrained  
151 by any necessity to use AT&T Illinois' wholesale services (other than interconnection) to  
152 compete against its retail services.

153 Fifth, when these requirements are satisfied, residential customers can choose among  
154 alternative providers for their local exchange services. From an economic perspective, the  
155 public interest is then best served by regulating carriers' services as symmetrically as  
156 possible, so that competitive forces rather than regulatory asymmetries dictate market  
157 outcomes.

158 **IV. APPLICATION OF STATUTORY STANDARDS IN SUPPORT OF AT&T**  
159 **ILLINOIS' PETITION**

160 **A. Definition of the Relevant Market**

161 Q. WHAT IS THE ECONOMIC FUNCTION OF A RELEVANT MARKET DEFINITION?

162 A. A competitive analysis (intended to test the degree of competition) is conducted within the  
163 context of a market because:

- 164     ▪ competition occurs within a market,
- 165     ▪ prices are formed by supply and demand conditions within a market,
- 166     ▪ the effects of pricing flexibility for consumers and competitors arise within a market,  
167     and
- 168     ▪ the public interest is easier to evaluate when viewed as the welfare of consumers within  
169     a market.

170 Within a market, economists can analyze the fundamental demand and supply relationships  
171 that determine the prospects for competition, the opportunity for particular firms to acquire

172 and exercise control over market prices, and the implications of additional pricing  
173 flexibility for consumer welfare.

174 Q. PLEASE EXPLAIN HOW STANDARD ANTITRUST PRINCIPLES ARE USED TO  
175 DEFINE THE RELEVANT MARKET FOR ANTITRUST PURPOSES.

176 A. Antitrust principles (particularly those embodied in the *Horizontal Merger Guidelines*)  
177 define an economic market in terms of its product and geographic dimensions. A textbook  
178 statement of that definition is as follows:

179 The *Horizontal Merger Guidelines* specify that a market is the smallest group of  
180 products and the smallest geographical area such that a hypothetical monopoly  
181 of all those products in the area could raise price by a certain amount (for  
182 example, 5 or 10 percent) above any prevailing or likely future levels.<sup>5</sup>

183 This definition has several implications. First, an economic market does not concern solely  
184 the product (or service) of interest. Second, an economic market is not an arbitrarily chosen  
185 geographic location in which the product (or service) of interest is bought and sold.

186 Q. PLEASE EXPLAIN HOW THE PRODUCT DIMENSION OF AN ECONOMIC  
187 MARKET IS DETERMINED.

188 A. Suppose residential local exchange service is the service of interest. The economic market  
189 for residential local exchange service should include all other products that are demand  
190 substitutes for AT&T Illinois' services.<sup>6</sup> These demand substitutes are included in order to  
191 take account of their role in influencing (and tempering) the price of residential local  
192 exchange service in the market. As the definition of an economic market above implies, a  
193 hypothetical sole provider of the service is unlikely to be able to raise its price above  
194 market levels if potential substitutes are supplied to consumers by different firms. That is  
195 because, when substitutes are available from other sources, any attempt by AT&T Illinois

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<sup>5</sup> Dennis W. Carlton and Jeffrey M. Perloff, *Modern Industrial Organization*, 3<sup>rd</sup> Edition, Reading, MA: Addison-Wesley, 2000, at 613.

<sup>6</sup> Consider two products (or services) X and Y. Y is a *demand* substitute for X if any increase in the price of X induces *consumers* of X to reduce their consumption of X and increase their consumption of Y. On the other hand, Y is a *supply* substitute for X if any increase in the price of X induces *suppliers* of Y to supply less of Y and switch to supplying X instead.

196 to raise its price above that level would likely cause customers to shift consumption  
197 (partially or wholly) away from AT&T Illinois' local exchange service towards demand  
198 substitutes supplied by other firms and induce providers of supply substitutes to increase  
199 their output of competing services as well. If the net effect of these market adjustments  
200 would be to render AT&T Illinois' price increase unprofitable, then the smallest set of such  
201 substitutes to which customers shift would constitute the relevant economic product market  
202 for the AT&T Illinois service.<sup>7</sup>

203 Q. SHOULD WE DEFINE SEPARATE PRODUCT MARKETS FOR EACH AT&T  
204 ILLINOIS SERVICE THAT HAS BEEN PROPOSED FOR RECLASSIFICATION?

205 A. No. A separate market definition analysis for each service is not necessary because most of  
206 these residential local exchange services are purchased from the carrier that supplies the  
207 access line, if they are purchased at all. For example, a customer that wants call waiting or  
208 caller ID will buy that service from the supplier of its local exchange service and cannot  
209 substitute another carrier's call waiting or caller ID service in response to a price increase  
210 for those services. A hypothetical monopolist of standalone call waiting service would  
211 have no customers, so it would make no sense to ask what would happen if it raised its  
212 price. On the other hand, if a hypothetical monopolist of residential local exchange service  
213 and call waiting were to raise its price, there would be many alternative carriers that  
214 currently supply both of those services in Illinois to which AT&T Illinois customers could  
215 substitute.

216 Q. HOW DID THE COMMISSION DEFINE THE RELEVANT PRODUCT MARKET IN  
217 ITS ORDER IN DOCKET NO. 06-0027?

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<sup>7</sup> The product dimension of the market is based on the notion of substitutability. Economists have long observed that how substitutable one product is for another (whether in demand or in supply) depends on the current level of prices for the product and its potential substitutes. Typically, price elasticity (or sensitivity) of demand is higher not only when more substitutes are available for a product but also when the price of that product is itself "high." On the other hand, when a product's price is perceived to be "low," a small increase in that price may elicit little substitution away from that product, whether by reducing consumption of the product or switching to potential substitutes. This means that how broadly the product dimension of the relevant economic market is defined depends, at least in part, on the level of prices.

218 A. The Commission’s Order discusses AT&T Illinois’ *packaged* local residential services and  
219 concludes [at 93] that “there is sufficient evidence of competition for AT&T’s flat rate  
220 residential package service offerings to sustain their competitive classification.” The Order  
221 separately addresses AT&T’s *measured* service offerings but concludes that they too are  
222 properly classified as competitive because competitors’ packaged services are functionally  
223 equivalent, reasonable substitutes that are readily available [at 94]. In economic terms, the  
224 Commission Order treats all of AT&T’s local residential service offerings — packaged and  
225 measured — as elements of the relevant product market.

226 Q. HOW DO ECONOMISTS DEFINE A GEOGRAPHIC MARKET?

227 A. It is a geographic area in which sellers provide products or services that customers treat as  
228 substitutes for one another and thus which compete against one another. As a leading text  
229 describes the concept:

230       The geographic limit of a market is determined by answering the question of  
231       whether an increase in price in one location substantially affects the price in  
232       another. If so, then both locations are in the same market.<sup>8</sup>

233 For example, consider mass-market local exchange services, which are offered using mass-  
234 media marketing throughout the geographic reach of radio, television and newspapers.

235 With respect to demand, carriers tend to offer mass-market services using the same price  
236 structures throughout this area because customers expect to pay the advertised prices. On  
237 the supply side, since carriers can serve customers throughout this area using their existing  
238 switches and customer care facilities, any attempt by one carrier to raise prices in an area  
239 where it had a large proportion of customers would induce entry at lower prices from other  
240 carriers which could render the price increase unprofitable.

241 Q. DOES THE ANALYSIS OF THE GEOGRAPHIC SCOPE OF THE RELEVANT  
242 MARKET IN THE CASE OF TELECOMMUNICATIONS DIFFER IN DETAIL FROM

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<sup>8</sup> D.W. Carlton and J.M. Perloff, *Modern Industrial Organization*, Second edition, (1994), New York: Harper Collins, at 807. Similarly, the *Horizontal Merger Guidelines* (Section 1.2.1) consider firms at different locations to be in the same market when a potential price increase by one firm (assuming other firms maintain their current prices) would be unprofitable, because customers would shift to the products of firms at other locations in the same geographic market.

243 THE TYPICAL DELINEATION OF THE GEOGRAPHIC DIMENSIONS OF A  
244 PRODUCT?

245 A. To some extent. The typical case poses the question of whether customers would shift to  
246 the products of firms at other locations in the event of a price increase by the reference  
247 firm(s). That is, firms are viewed as having precise locations; consequently, considerations  
248 such as transportation costs come into play when determining whether customers would  
249 shift their purchases to the competing firms. In contrast, telecommunications carriers have  
250 switches that can reach major portions of the geographic market area and market their  
251 services throughout the geographic market. For example, in the competition between cable  
252 modems and DSL for broadband services, both the cable television company and the  
253 telephone company would typically have facilities that covered a large portion of the  
254 relevant area. Similarly, CLECs frequently offer service (using resale, UNEs or  
255 commercial agreements) in geographic areas where they have no facilities, so the notion of  
256 identifying a firm with a location at which it provides service makes less sense for  
257 telecommunications carriers than (for example) cement manufacturers.

258 Q. HOW WOULD YOU DEFINE THE GEOGRAPHIC MARKET FOR THE PURPOSES  
259 OF THIS PROCEEDING?

260 A. Three predefined geographic areas that reflect somewhat different aspects of the economic  
261 definition of a relevant geographic market are commonly used in telecommunications  
262 market definition: the LATA, the MSA and the DMA. In the current case, AT&T Illinois'  
263 service territories in each of these three areas are the same, so I would reach the same  
264 conclusions regarding competition using any one of these market concepts.

265 Q. WHAT IS A LATA?

266 A. The LATAs (Local Access and Transport Areas) were defined by the Department of Justice  
267 as a component of the divestiture of the Bell System in 1984. Conceptually, they  
268 represented the areas within which telecommunications was considered to be local rather  
269 than long distance. The LATA boundaries were drawn with reference to calling patterns,  
270 which, in turn, reflected the communities of interest within which there were large amounts

271 of reciprocal calling. LATA boundaries also reflected the architecture of the wireline local  
272 exchange telephone network as it existed in 1984. Thus, ILECs and CLECs compete  
273 geographically in a LATA because carriers that use the ILEC's network can generally  
274 provide service to customers anywhere in the LATA. Of course, as competition from cable  
275 and wireless carriers has become important, the ILEC's network has become less important  
276 in defining the area in which local competition takes place.

277 Q. WHAT IS AN MSA?

278 A. In concept, an MSA (Metropolitan Statistical Area) is a county or group of counties having  
279 a large clustered population, including adjacent areas having a high degree of community of  
280 interest with the core population center. Specifically, the Office of Management and  
281 Budget (OMB) defines MSAs as a county or group of counties with (1) a city of population  
282 50,000 or more or (2) an urbanized area (as defined by the Census Bureau) of population of  
283 at least 50,000 consisting of one or more counties. According to the OMB:

284 The general concept of a Metropolitan Statistical Area or a Micropolitan  
285 Statistical Area is that of an area containing a recognized population nucleus and  
286 adjacent communities that have a high degree of integration with that nucleus.

287 Metropolitan Statistical Area.—A Core Based Statistical Area associated with at  
288 least one urbanized area that has a population of at least 50,000. The  
289 Metropolitan Statistical Area comprises the central county or counties  
290 containing the core, plus adjacent outlying counties having a high degree of  
291 social and economic integration with the central county as measured through  
292 commuting. [Currently defined metropolitan and micropolitan statistical areas  
293 are based on application of the 2000 standards (which appeared in the Federal  
294 Register on December 27, 2000) to Census 2000 data and were announced by  
295 OMB effective June 6, 2003.]

296 Specifically, MSAs are carefully developed to reflect demographic and  
297 commercial reality based on the application of OMB standards to census data  
298 (including commuting patterns). MSAs have a "high degree of integration" with  
299 a recognized population nucleus and recognize "economic linkages between  
300 urban cores and outlying, integrated areas." [65 Fed. Reg. 82228 (2000)]

301 Q. WHAT IS A DMA?

302 A. Designated Market Areas or “DMAs” are calculated to measure the reach of television and  
303 radio broadcasts. These areas are determined yearly by the Nielson Company and are  
304 widely used in the marketing business to plan advertising campaigns and to set advertising  
305 rates. DMAs consist of groups of contiguous counties, and every county is part of one  
306 DMA. Thus, DMAs are generally somewhat larger than MSAs, as DMAs include the rural  
307 areas surrounding urban centers, which are not included in an MSA unless the rural county  
308 depends on the central city for commerce.

309 Q. HOW HAVE THESE AREAS BEEN USED TO DEFINE GEOGRAPHIC MARKETS  
310 FOR RESIDENTIAL LOCAL EXCHANGE SERVICES?

311 A. Determining which geographic area best meets the economic criteria for a geographic  
312 market is a matter of judgment. The FCC, for example, has used a variety of different  
313 approaches in its various orders that have assessed competition. At the highest level of  
314 aggregation, the FCC used the subject carrier’s entire service territory in its Section 271  
315 orders finding that the RBOCs had complied with the market opening requirements of the  
316 Telecommunications Act.

317 MSAs can be appropriate because mass-market consumers in any two central offices in the  
318 same MSA generally face similar competitive conditions and have access to similar  
319 competitive alternatives. As the FCC observed in its Pricing Flexibility Order [at ¶ 72], the  
320 MSA reflects a workable geographic scope of competitive entry from the competitor’s  
321 perspective, because the entry decision is generally undertaken first at the level of the MSA.

322 The DMA is a media-based refinement of the MSA for market definition purposes. The  
323 FCC has used DMAs to measure the geographic scope of local exchange  
324 telecommunications markets<sup>9</sup> and broadcasting markets in which to apply its ownership  
325 regulations. For example,

326 we conclude that in the case of broadcast television programming, it is  
327 reasonable to use DMAs to define the relevant geographic market for each

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<sup>9</sup> *Applications of NYNEX Corporation Transferor, and Bell Atlantic Corporation Transferee, For Consent to Transfer Control of NYNEX Corporation and Its Subsidiaries*, File No. NSD-L-96-10, *Memorandum Opinion and Order*, 12 FCC Rcd 199985 (1997) (“*Bell Atlantic-NYNEX Order*”) at ¶¶ 55-56.

328 individual broadcast station. Contracts between broadcast stations and the  
329 providers of programming, as well as FCC regulations and broadcasting  
330 technology, limit the extent to which broadcast station signals can be distributed  
331 outside of the assigned market area. [footnote] DMAs are widely used to  
332 represent these areas, so we will use them as reasonable approximations.<sup>10</sup>

333 Most recently, the FCC again used a state-wide analysis of competition to evaluate the  
334 competitive effects of the SBC/AT&T merger. However, it indicated that it would have  
335 preferred to use an area smaller than the state, had the requisite data been available (§ 99).

336 Finally, in its Order in Docket No. 06-0027, the Commission effectively adopted AT&T  
337 Illinois' service territory in MSA-1 as a relevant geographic market:

338 ▪ “taking into account the full range of competition in MSA-1, . . . , we find that affirming  
339 the competitive status of AT&T's package offerings is consistent with the public  
340 interest.” [at 93-94]

341 ▪ “the Commission finds that the market for measured service is properly classified as  
342 competitive in MSA-1.” [at 96]

343 Q. WHAT ILLINOIS MSAS ARE RELEVANT TO THIS PROCEEDING?

344 A. AT&T Illinois has classified local exchange service as competitive in its service territories  
345 in six Greater Illinois LATAs. These areas correspond to parts of six MSAs as shown in  
346 Table 1. AT&T Illinois serves only portions of each of these MSAs.

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<sup>10</sup> *In the Matter of General Motors Corporation and Hughes Electronics Corporation, Transferors and the News Corporation Limited, Transferee, For Authority to Transfer Control*, Memorandum Opinion and Order (MB Docket No. 03-124), released January 14, 2004) at ¶ 65.

**Table 1.  
 Relevant Illinois MSAs**

<b>Champaign-Urbana, IL</b>	<b>St. Louis, MO-IL</b>
Champaign County	Bond County, IL
Ford County	Calhoun County, IL
Piatt County	Clinton County, IL
	Franklin County, MO
	Jefferson County, MO
<b>Davenport-Moline-Rock Island, IA-IL</b>	Jersey County, IL
Henry County, IL	Lincoln County, MO
Mercer County, IL	Macoupin County, IL
Rock Island County, IL	Madison County, IL
Scott County, IA	Monroe County, IL
<b>Peoria, IL</b>	St. Charles County, MO
Marshall County	St. Clair County, IL
Peoria County	St. Louis County, MO
Stark County	St. Louis city, MO
Tazewell County	Warren County, MO
Woodford County	Washington County
<b>Rockford, IL</b>	<b>Springfield, IL</b>
Boone County	Menard County
Winnebago County	Sangamon County

Source: Bureau of Labor Statistics, September 23, 2008

- 347 Q. HOW WOULD YOU DEFINE THE RELEVANT GEOGRAPHIC MARKET FOR THE  
 348 PURPOSE OF IMPLEMENTING SECTION 13-502 OF THE ILLINOIS  
 349 TELECOMMUNICATIONS ACT?
- 350 A. The geographic dimension of the economic market for AT&T Illinois' residential local  
 351 exchange services must include, at a minimum, the geographic area within which customers  
 352 are able to seek and purchase local exchange services — or feasible substitutes for them —  
 353 from AT&T Illinois or competitors providing services through any or all of the means  
 354 identified above. On the demand side, it is important that the geographic market be defined  
 355 as an area within which customers perceive an ability to obtain substitute services from  
 356 competing carriers. On the supply side, that area should be big enough to make entry

357 economically worthwhile for competitors, *i.e.*, offer them a reasonable prospect of being  
358 able to recover their fixed costs and to achieve the efficiencies that accrue from economies  
359 of scale and/or scope.<sup>11</sup> Finally, from a practical perspective, the geographic market must  
360 be an area for which data are available and one for which it is feasible to implement a  
361 distinct regulatory reclassification of services. AT&T Illinois' service territories in the six  
362 MSAs in Table 1 best meet these considerations.

363 **B. Examination of the Five Statutory Factors**

364 Q. WHAT INFORMATION MUST BE SHOWN TO CLASSIFY A SERVICE AS  
365 COMPETITIVE UNDER SECTION 13-502 OF THE ILLINOIS PUBLIC UTILITIES  
366 ACT?

367 A. According to the Act, a service is classified as competitive under this section if the service  
368 is "reasonably available from more than one provider" having considered the five factors  
369 described below. From an economic perspective, a service that is "reasonably available"  
370 means that customers can substitute it for the incumbent's service if the incumbent attempts  
371 to raise price above the competitive market level.

372 **1. The number, size, and geographic distribution of other providers of the service**

373 Q. FROM AN ECONOMIC PERSPECTIVE, HOW WOULD YOU DEFINE THE TERM  
374 "OTHER PROVIDERS?"

375 A. In this context, "other providers" means firms that supply services that act as substitutes for  
376 "the service" in question. All such services belong in the same relevant product market as  
377 the service in question. As long as they meet the substitutability test, the precise  
378 characteristics of the services or even their technological platforms (wireline, broadband,  
379 wireless) are not relevant. Similarly, if the services were initially marketed to particular

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<sup>11</sup> Economies of scale arise as the unit cost of production falls with increasing scale or volume of production. Thus, a firm with a larger scale can produce at a lower unit cost than two or more firms that between them have the same total scale as the larger firm. Economies of scope arise when it is cheaper (and more efficient) to produce several different products out of a common plant or facility than to have to each product produced out of a separate plant or facility. These arise whenever the different products have significant shared fixed costs so that the firm that produces them out of a common facility incurs those fixed costs only once.

380 customers with particular requirements (*e.g.*, wireless phones for mobile customers),  
381 customer use of these technologies can change over time. In today's marketplace, they  
382 clearly constitute substitutes and the carriers count as "other providers" if wireline  
383 customers would shift to them when wireline prices exceeded a competitive market level.

384 Q. IF MULTIPLE CARRIERS PROVIDE SERVICES THAT HAVE CHARACTERISTICS  
385 THAT DIFFER IN SOME RESPECTS FROM AT&T ILLINOIS' LOCAL EXCHANGE  
386 SERVICE, DO THOSE CARRIERS CONSTITUTE "PROVIDERS OF THE SERVICE"  
387 THAT MEET THE REQUIREMENTS OF THE ACT?

388 A. Yes, provided the services in question are the same, functionally equivalent or substitutable  
389 services. Two services that possess exactly the same attributes and provide exactly the  
390 same functionality on comparable terms (with respect to prices, supply or delivery  
391 arrangements, or contractual obligations) would be considered the "same", even if they  
392 were supplied by different carriers. Two services that do not possess exactly the same  
393 attributes, but provide approximately the similar functionality on comparable terms, would  
394 be considered "equivalent" even if they were supplied by different carriers. Two services  
395 would be considered "substitutable" if they provide the same or similar functionality, and  
396 an increase in the price of one would likely induce the consumer to switch to the other  
397 provided that its price has not changed. Taken together, "same, equivalent or substitutable  
398 services" refers to the fundamental underlying properties required of the product dimension  
399 of an economic market, namely, reasonable interchangeability of use and demand  
400 substitutability. In other words, all same, equivalent or substitutable services belong in the  
401 same economic market. For present purposes, all local exchange services (whether  
402 provided by AT&T Illinois, CLECs using any of the three different supply options, or other  
403 competitors) fit the description of same, equivalent or substitutable services.

404 Q. WHAT CONSTITUTES "FUNCTIONALLY EQUIVALENT" OR "SUBSTITUTATBLE"  
405 SERVICES FOR AT&T ILLINOIS' RESIDENTIAL LOCAL EXCHANGE SERVICE?

406 A. Services that actually or potentially compete with AT&T Illinois' residential local exchange  
407 service constitute "functionally equivalent" or "substitutable" services, including demand

408 substitutes which need not be identical to AT&T Illinois' tariffed offerings. The Supreme  
409 Court's "reasonable interchangeability of use" standard<sup>12</sup> also argues in favor of  
410 considering services that perform the same or similar functions as AT&T Illinois' local  
411 exchange services. This standard does *not* require either that the competing services be  
412 identical or that they be produced or provided under identical terms or by identical technical  
413 means. Whether a CLEC offers a competing service by resale of AT&T Illinois' retail local  
414 exchange service or by relying on leased or owned facilities makes no difference to a  
415 residential customer seeking a feasible alternative to AT&T Illinois' local exchange  
416 services. In addition, competing services offered by completely different technological  
417 means (such as wireless or VoIP systems) would also constitute functionally equivalent or  
418 substitutable for AT&T Illinois' residential local exchange services as long as those  
419 services are demand substitutes from the perspective of the customer.

420 Q. DOES THIS SECTION (13-502(C)(1)) REQUIRE THAT COMPETITORS ACHIEVE  
421 ANY PARTICULAR SHARE OF THE MARKET?

422 A. No. The standard for reclassification — of which this section is one of five  
423 "considerations" — is the *availability* of a substitute service from more than one provider.  
424 The standard asks the Commission to consider the number, size and geographic distribution  
425 of competitors; it does not — and should not — determine a benchmark level of current  
426 competition.

427 Q. WHAT ARE THE NUMBER, SIZE AND GEOGRAPHIC DISTRIBUTION OF  
428 COMPETITORS IN AT&T ILLINOIS' SERVICE TERRITORY?

429 A. The first general indicator of the ubiquity of local exchange competitors in Illinois is the  
430 history over time of the residential demand served by CLECs and the reduction in  
431 residential access lines served by AT&T Illinois. According to the FCC's survey of

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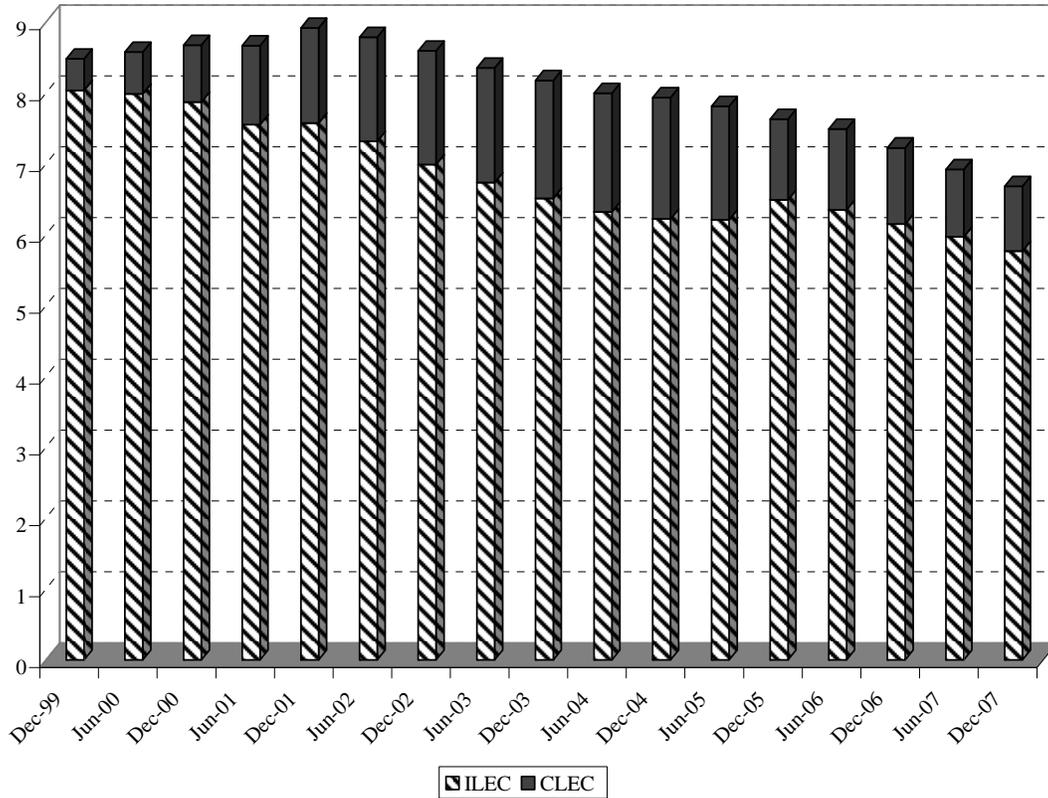
<sup>12</sup> *Brown Shoe Company v. United States*, 370 U.S. 294, 1962: "The outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand between the product itself and substitutes for it."

432 telecommunications competition in Illinois,<sup>13</sup> the total number of access lines in Illinois has  
433 fallen by about 2.5 percent per year since December 1999, while ILECs in Illinois have lost  
434 lines at a 3.6 percent annual rate. In contrast, CLEC access lines have increased  
435 significantly since 1999, despite bankruptcies and an industry meltdown in 2000, and  
436 increased at an average rate of 10 percent per year. Figure 1 shows this FCC survey data.  
437 By the end of the period, CLECs provided about 14 percent of the access lines in Illinois.  
438 Note that these figures do not consider network access services provided by wireless  
439 carriers or (either facilities-based or pure-play) VoIP providers, so that they omit a large  
440 portion of the expansion of cable companies into telephony. Including wireless and VoIP  
441 services in the calculation would bolster the conclusion that ILEC access lines have been  
442 falling rapidly in relation to the entire market.

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<sup>13</sup> *Local Telephone Competition, Status as of December 31, 2007*, Federal Communications Commission, Industry Analysis and Technology Division, Wireline Competition Bureau, September 2008 (*Local Competition Report*).

**Figure 1.**  
**Illinois Total Switched Access Lines (Millions)**



Source: FCC Local Competition Report as of December 31, 2007. Tables 9 and 10.

443 An important feature in these data is the fact that total switched access lines in Illinois have  
 444 fallen steadily since 1999, despite the fact that Illinois' population has increased.<sup>14</sup> While  
 445 other explanations for this reduction are possible, it is certainly consistent with the  
 446 substitution, discussed below, of wireless, cable and VoIP telephony.

447 Similar stories are told in the six Greater Illinois LATAs by the Illinois Commerce  
 448 Commission's annual telecommunications reports, which show that ILEC residential access  
 449 lines in the Greater Illinois LATAs have decreased at average annual rates of 6.9 percent.  
 450 CLEC residential lines increased sharply through the end of 2003, but then gradually

<sup>14</sup> According to U.S. Census Bureau the number of households in Illinois has steadily increased from 4,540,397 in 2000 to 4,759,579 in 2007. See U.S. Census Bureau, *American Community Surveys*, accessed on October 1, 2008.

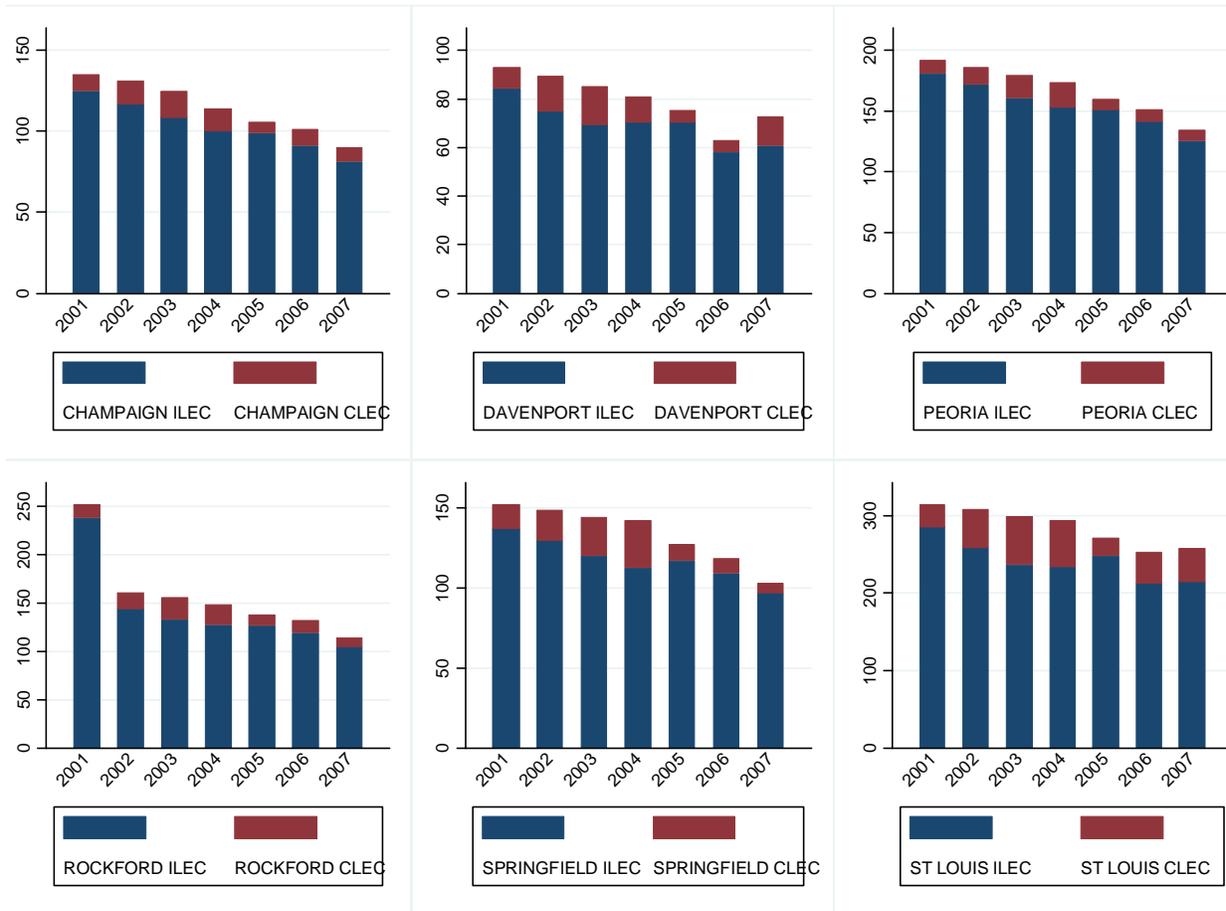
451 declined to their 2001 levels by the end of 2007, Despite the recent decline in CLEC lines,  
452 however, the data from the Commission's own survey of market condition provide  
453 compelling evidence of competition for residential local exchange services in the Greater  
454 Illinois LATAs, as other modes of communication have become increasingly prevalent. In  
455 fact, the Commission report states:

456 It is clear that some consumers are substituting mobile wireless phone service or  
457 unreported voice-over-internet-protocol ("VoIP") service for POTS service. The  
458 more consumers turn to such alternatives to POTS services, the less accurate an  
459 examination based solely on CLEC POTS market shares will be as a gauge of  
460 competition in local telephone markets.<sup>15</sup>

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<sup>15</sup> Illinois Commerce Commission. Annual Report on Telecommunications Markets in Illinois, Sep 10, 2008 at 29

**Figure 2.**  
**Residential Access Lines by LATA (Thousands)**



Source: ICC Annual Reports on Telecommunications in Illinois, 2001 – 2007.

461 **a. Wireline CLEC Competition**

462 Q. IS RESIDENTIAL LOCAL EXCHANGE SERVICE AVAILABLE FROM MORE THAN  
 463 ONE UNAFFILIATED PROVIDER, INCLUDING FACILITIES-BASED PROVIDERS?

464 A. Yes. The testimony of Mr. Wardin shows that CLECs are active throughout AT&T  
 465 Illinois’ service territories, using their own facilities, unbundled loops (“UNE-L”),  
 466 unbundled loops and switching (Local Wholesale Complete “LWC”), and resale. There  
 467 are many CLECs that compete with AT&T Illinois for residential customers, and they are  
 468 listed in Mr. Wardin’s testimony. Multiple CLECs are also providing residential access

469 services across the exchanges within AT&T Illinois' territory in the Greater Illinois  
 470 LATAs, again, as shown in Mr. Wardin's testimony. Table 2 below shows that 36 percent  
 471 of the exchanges are served by at least 10 CLECs.

**Table 2.**  
**Number of CLECs Providing Residential Service in Each LATA**

	Champaign	Davenport	Peoria	Rockford	Springfield	St. Louis
Total Number of Exchanges	12	5	11	1	11	35
Average CLECs per Exchange	7	10	7	29	8	9
Exchanges w/ 10 or Less CLECs	10	1	9	0	9	19
Exchanges w/ 10 to 19 CLECs	1	4	1	0	1	14
Exchanges w/ 20 or More CLECs	1	0	1	1	1	2

Source: AT&T Illinois

472 Q. DO THE CLECS OPERATING IN ILLINOIS INCLUDE CABLE COMPANIES?

473 A. Yes. Cable companies are actively competing for residential customers in Illinois. Cable  
 474 operators directly compete with AT&T Illinois by providing telephony services. The cable  
 475 companies' telephony service is not listed in the count of UNE-L and LWC providers  
 476 because those companies use their own loops as well as its own switch. However, cable  
 477 telephony customers are included in the data based on entries in E911 database. Besides  
 478 Comcast, Mediacom, Charter Communications and US Sonet also offer voice telephony  
 479 service in the six Greater Illinois LATAs. According to data reported by the cable  
 480 companies and published in the Television & Cable Factbook, 92 percent of the 607  
 481 thousand homes passed by cable systems in the Greater Illinois LATAs have broadband  
 482 telephony service available, as shown in Table 3.

483

**Table 3.**  
**Homes Passed With Broadband Availability, by LATA**

LATA	Homes Passed		% of Homes Passed Broadband Telephony Ready
	Total	Broadband Telephony Ready	
Champaign	77,122	55,437	71.9%
Davenport	56,195	56,195	100.0%
Peoria	114,541	104,487	91.2%
Rockford	83,936	83,878	99.9%
Springfield	67,539	64,672	95.8%
St. Louis	207,554	193,123	93.0%
<b>Total</b>	<b>606,887</b>	<b>557,792</b>	<b>91.9%</b>

Source: NERA Analysis

484 Because cable telephony uses the same network as broadband services, cable companies  
 485 can potentially offer voice services to almost all customers passed in the Greater Illinois  
 486 LATAs. In its second quarter 2008 earnings reports to investors, Comcast announced it was  
 487 the country's fourth largest residential telephone company, providing digital voice service  
 488 to 5.6 million households out of the approximately 45 million households passed.<sup>16</sup>

489 **b. Wireless Providers**

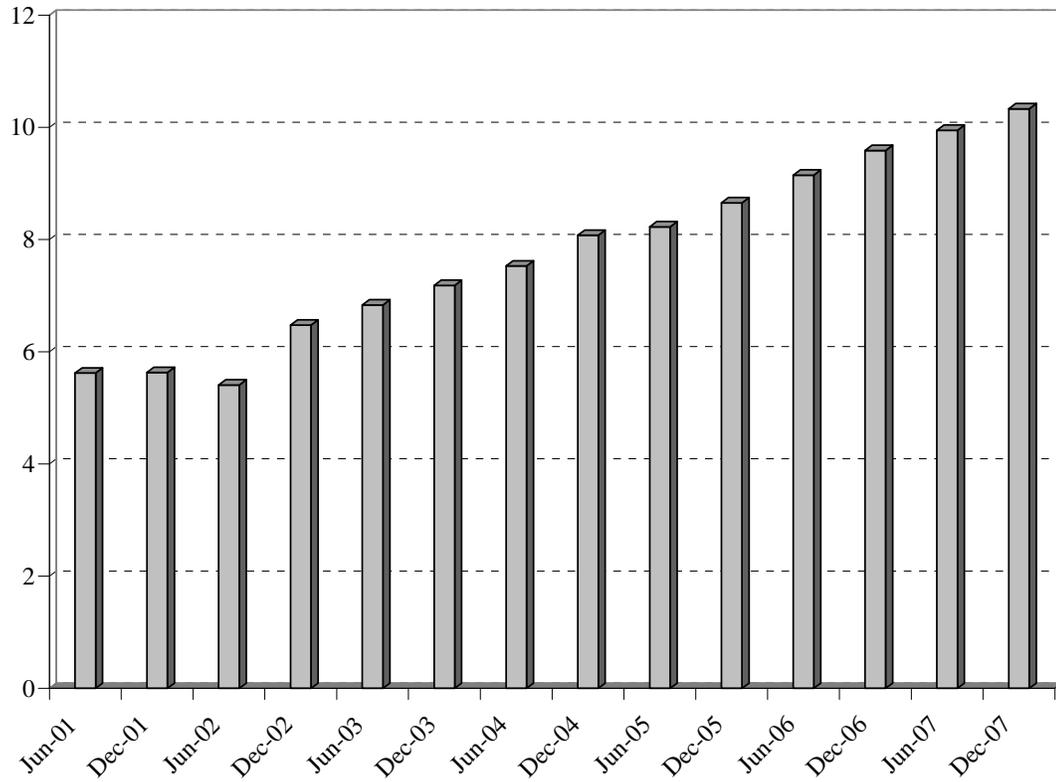
490 Q. ARE THERE OTHER PROVIDERS, NOT NECESSARILY TRADITIONAL WIRELINE  
 491 CLECS, THAT ARE OFFERING LOCAL EXCHANGE SERVICES IN ILLINOIS?

492 A. Yes. At least nine wireless companies<sup>17</sup> currently offer local exchange services that  
 493 compete with AT&T Illinois' residential local exchange services in Illinois.  
 494 Subscribership in Illinois has been growing steadily since 2000 at nearly 10.6 percent per  
 495 year, which contrasts sharply with the minus 2.5 percent annual growth of wireline  
 496 subscribership over the same period. Compare Figure 1 with Figure 3 below.

<sup>16</sup> Comcast, 2<sup>nd</sup> Quarter Results, July 30, 2008. [http://media.corporate-ir.net/media\\_files/irol/11/118591/Earnings\\_2Q08/2Q08\\_slides.pdf](http://media.corporate-ir.net/media_files/irol/11/118591/Earnings_2Q08/2Q08_slides.pdf), slide 15, accessed 10/3/2008.

<sup>17</sup> FCC Local Telephone Competition Report: Status as of December 31, 2007, Table 14. Released in Sep. 2008.

**Figure 3.**  
**Illinois Wireless Subscribers (Millions)**



Source: FCC Local Competition Report as of December 31, 2007. Table 14.

497 In addition, the areas served by wireless carriers are not restricted to high density urban  
498 areas. For example, Table 4 shows that at least 99 percent of households in every LATA in  
499 question have at least three wireless alternatives available to them; and over 99 percent of  
500 total households in the six Greater Illinois LATAs have access to four or more wireless  
501 providers. Thus, wireless carriers provide actual competition for residential local exchange  
502 and long distance services in Illinois and that is a source of competition that has grown  
503 rapidly over time.

**Table 4**  
**Wireless Availability in Greater Illinois LATAs**

LATA	Percent of households				
	1 or more Carrier	2 or more Carriers	3 or more Carriers	4 or more Carriers	5 or more Carriers
Champaign	100%	100%	100%	99%	68%
Davenport	100%	100%	100%	100%	99%
Peoria	100%	100%	100%	98%	89%
Rockford	100%	100%	100%	100%	100%
Springfield	100%	100%	99%	99%	88%
St. Louis	100%	100%	100%	100%	90%
Total	100%	100%	100%	99%	89%

Source: NERA Analysis.

504 Q. IS WIRELESS SERVICE A REASONABLE SUBSTITUTE FOR STANDARD  
 505 WIRELINE CIRCUIT-SWITCHED TELEPHONE SERVICE?

506 A. Yes, as Dr. Scott Taylor and Mr. Shooshan describe in more detail. Though the services are  
 507 not identical, increasing wireline prices significantly above the competitive level would  
 508 induce some fraction of wireline consumers to switch to wireless service for network  
 509 access, network usage or both. Hence, any competitive analysis of the wireline telephone  
 510 service must take the presence of wireless carriers into account.

511 **c. Internet Telephony Providers**

512 Q. IS LOCAL EXCHANGE SERVICE USING VOIP TECHNOLOGY CURRENTLY  
 513 “AVAILABLE” TO CONSUMERS IN ILLINOIS?

514 A. Yes. I am aware of many vendors now offering standalone VoIP telephony to consumers in  
 515 Illinois, including the following ten in Table 5 below.

**Table 5.**  
**VoIP Providers**

BroadVoice	Phone Power
FonVantage	QuantumVoice
magicJack	VoicePulse
MyPhoneCompany	Vonage
Packet8	ZingoTel

516 Examples of VoIP plans currently available to Illinois local exchange customers are shown  
517 in Schedule WET-2.

518 Q. IS STANDALONE VOIP SERVICE A REASONABLE SUBSTITUTE FOR STANDARD  
519 WIRELINE CIRCUIT SWITCHED TELEPHONY?

520 A. Yes, from the perspective of the customer. As Mr. Shooshan describes in more detail,  
521 standalone VoIP technology allows customers who have some form of broadband  
522 connection to the Internet to make and receive local and long distance calls using ordinary  
523 telephone equipment and ordinary dialing patterns. Service quality is similar between  
524 packet-switched and circuit-switched platforms, and while circuit-switched and packet-  
525 switched services may have some different characteristics (*e.g.*, different arrangements for  
526 E911 service and different dependence on local electrical power), the growth of the service  
527 indicates that these characteristics are not so important that customers are unwilling to  
528 substitute away from circuit-switched services.

529 Q. HOW MANY ILLINOIS CUSTOMERS ARE CURRENTLY USING STANDALONE  
530 VOIP SERVICES AS A SUBSTITUTE FOR ORDINARY WIRELINE LOCAL EXCHANGE  
531 AND LONG DISTANCE SERVICES?

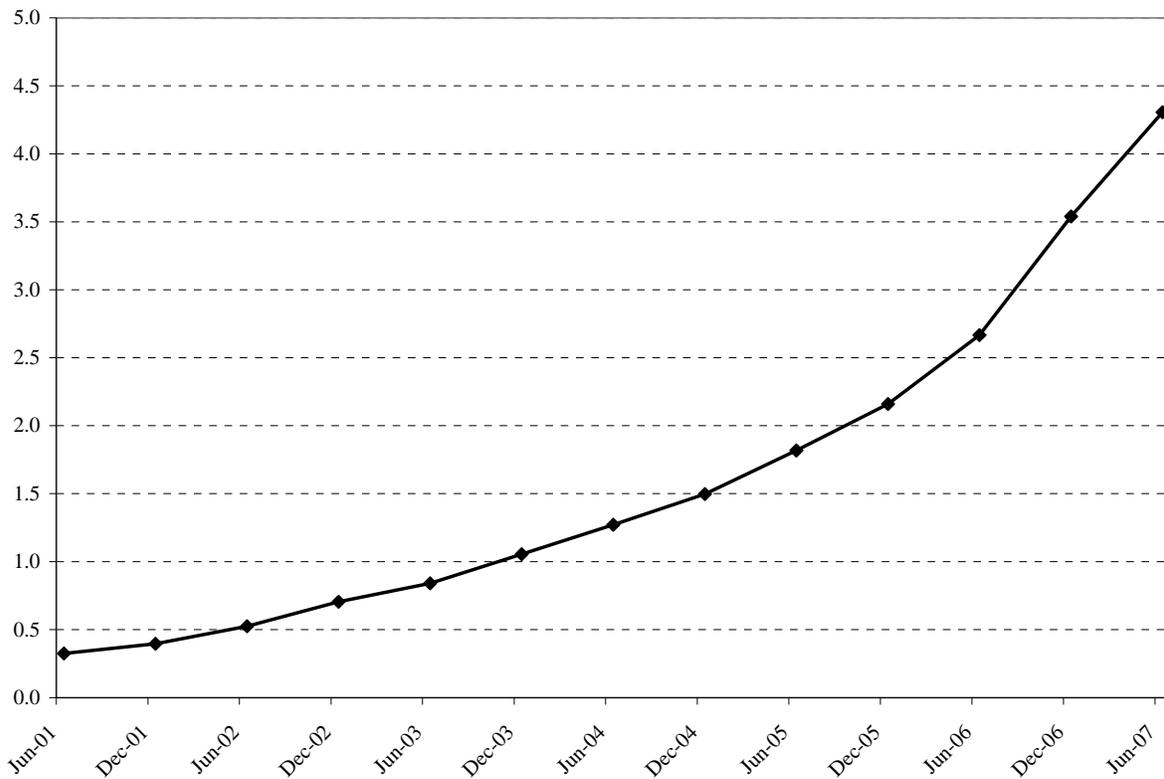
532 A. The number of such customers is not known, and, since the VoIP providers are not required  
533 to report the size and composition of their customer bases, I have no direct means of  
534 measuring the number of local exchange customers served by VoIP providers. As shown  
535 in Mr. Shooshan's testimony, however, national data can help to size the current demand  
536 for the service. For example, Vonage, a leading national standalone VoIP provider

537 finished the second quarter of 2008 with 2.6 million lines, making it comparable in terms  
538 of access lines to the largest independent wireline telephone companies.<sup>18</sup>

539 Q. HOW RAPIDLY IS BROADBAND INTERNET ACCESS GROWING IN ILLINOIS?

540 A. According to the latest FCC data, Illinois had over 4.3 million high-speed access lines in  
541 June 2007, of which about 2.9 million correspond to residential customers. From  
542 December 2000 to June 2007, these lines have grown at about 53.2 percent per year, in  
543 sharp contrast to total access lines, which have fallen. Figure 4 shows this pattern of rapid  
544 and persistent growth.

**Figure 4.**  
**Illinois Broadband Access Lines (Millions)**



Source: FCC Report on High Speed Services as of June 30, 2007. Table 10.

<sup>18</sup> "Vonage Holdings Corp. Reports Second Quarter 2008 Results," <http://pr.vonage.com/releasedetail.cfm?ReleaseID=326895>, accessed October 7, 2008. As of June 30, 2008, the largest independent incumbent local exchange carrier, Embarq, claimed approximately 6 million lines. Windstream and Frontier claim approximately 3 million access lines.

545

546 Q. SHOULD THE COMMISSION TREAT STANDALONE VOIP PROVIDERS AS  
547 SUPPLIERS OF ALTERNATIVES TO WIRELINE LOCAL EXCHANGE SERVICE IN  
548 THIS PROCEEDING?

549 A. Yes. Standalone VoIP service is *currently* a substitute for wireline local exchange service  
550 for those 2.9 million residential customers in Illinois who already have high-speed internet  
551 access. These customers can already choose from among providers with brand recognition  
552 and a reputation for quality and reliability. As the number of high-speed access lines in  
553 Illinois continues to grow—more than doubling over the past two years—standalone VoIP  
554 will become an even closer substitute for conventional wireline service. As shown in  
555 Schedule WET-2, the packages and prices offered by standalone VoIP suppliers are  
556 comparable to the bundled services offered by traditional wireline carriers, which suggests  
557 that wireline carriers *currently* take VoIP packages and prices into account when they  
558 construct their competitive offerings. Thus, standalone VoIP providers constitute  
559 unaffiliated “providers” of local exchange services and should be counted in the analysis  
560 of the number, size, and geographic distribution of providers of competitive services.

561 **2. The availability of functionally equivalent services in the relevant geographic area**  
562 **and the ability of telecommunications carriers or other persons to make the same,**  
563 **equivalent, or substitutable service readily available in the relevant market at comparable**  
564 **rates, terms, and conditions**

565 Q. WHAT DOES IT MEAN FOR CUSTOMERS TO HAVE SERVICE ALTERNATIVES  
566 READILY AVAILABLE?

567 A. From an economic perspective, availability in the relevant market should be understood to  
568 mean that competing suppliers of services that are considered the same, equivalent, or  
569 substitutable (hence, belong in the same economic market) are present and actively  
570 pursuing customers through various means (including resale, LWC, UNE-L or the  
571 deployment of their own facilities including wireline, wireless and broadband).  
572 Economically, if alternative service availability is interpreted to mean that suppliers  
573 unaffiliated with the ILEC can supply substitute services whenever a profitable opportunity

574 arises, then such availability implies that the market for the service is contestable and thus  
575 competitive within the meaning of Section 13-502.

576 Q. WHAT SERVICES FROM UNAFFILIATED SUPPLIERS ARE FUNCTIONALLY  
577 EQUIVALENT TO AT&T ILLINOIS' LOCAL EXCHANGE SERVICES AND  
578 REASONABLY AVAILABLE TO END USERS?

579 A. End users are generally unaware of the network arrangements by which their local  
580 exchange services are provisioned. Hence, wireline local exchange services from CLECs  
581 that use their own facilities, AT&T Illinois' resold local services, UNE-L, or LWC are  
582 functionally equivalent to AT&T Illinois' own local exchange service. Similarly, VoIP  
583 arrangements typically involve the same premises equipment and dialing arrangements as  
584 conventional wireline services, and the arrangement is functionally transparent to the  
585 customer. Wireless services are substitutes for AT&T Illinois' local exchange service,  
586 offering local access and usage but with a slightly different mix of characteristics from  
587 wireline service.

588 Q. SHOULD DECLARING THAT SUCH SERVICES ARE "AVAILABLE" DEPEND ON  
589 THE COMPETITORS ACQUIRING SOME BENCHMARK MARKET SHARE, EITHER  
590 INDIVIDUALLY OR COLLECTIVELY?

591 A. No. As long as there are no barriers that prevent a competitor from actively seeking  
592 customers and promoting its services, no additional criteria are needed to determine  
593 whether same, equivalent, or substitutable services are available. A CLEC's market share  
594 may reflect its success in finding customers and making sales, but market share is an  
595 *outcome* of the competitive process, not a necessary condition for it to exist.

596 Q. IS THERE EVIDENCE OF A SUSTAINED ABILITY OF COMPETITORS TO TAKE  
597 CUSTOMERS AWAY FROM AT&T ILLINOIS IN ITS SERVICE TERRITORY?

598 A. Yes. As shown in Table 6, AT&T Illinois has been losing residential customers in the six  
599 Greater Illinois LATAs since 2000.

**Table 6.**  
**AT&T Illinois Residential Access Lines in the Greater Illinois LATAs**  
**(December 2000 - June 2008)**

Year	Total Residential Access Lines	Annual Change	Cumulative Change	Annual % Change	Cumulative % Change
2000	650,718				
2001	597,125	-53,593	-53,593	-8.24%	-8.24%
2002	538,949	-58,176	-111,769	-9.74%	-17.18%
2003	480,754	-58,195	-169,964	-10.80%	-26.12%
2004	457,714	-23,040	-193,004	-4.79%	-29.66%
2005	451,638	-6,076	-199,080	-1.33%	-30.59%
2006	434,562	-17,076	-216,156	-3.78%	-33.22%
2007	422,861	-11,701	-227,857	-2.69%	-35.02%
June 2008	402,150	-20,711	-248,568	-9.80%	-38.20%

Source: Residential Access Lines from AT&T Illinois internal records.

Note: Beginning in 2005, line counts include AT&T CLEC lines.

600 Q. IS THERE EVIDENCE OF A LONG-TERM COMMITMENT ON THE PART OF  
 601 COMPETITORS TO SERVE RESIDENCE CUSTOMERS?

602 A. Yes. The most commonly accepted indicator of such a long-term commitment is evidence  
 603 that competitors have undertaken sunk investments, such as in their own facilities or  
 604 operational collocation arrangements at ILEC central offices. Data on measures of  
 605 facilities-based CLEC activity are presented in Table 7 and Table 8 below.

**Table 7**  
**Facilities-Based CLEC Lines, by LATA**

LATA	Resold Residential	LWC/ Residential	Facilities-Based Residential
Champaign	62	1,641	9,132
Davenport	6	739	8,457
Peoria	118	1,549	9,143
Rockford	64	1,260	14,947
Springfield	117	1,812	14,624
St. Louis	570	5,953	36,638

Source: AT&T Illinois

606

**Table 8**

**Number of Wire Centers with Collocation Arrangements, by LATA**

<u>LATA</u>	<u>Physical Collocations</u>	<u>Virtual Collocations</u>
Champaign	14	2
Davenport	8	4
Peoria	20	8
Rockford	14	3
Springfield	15	13
St. Louis	21	3

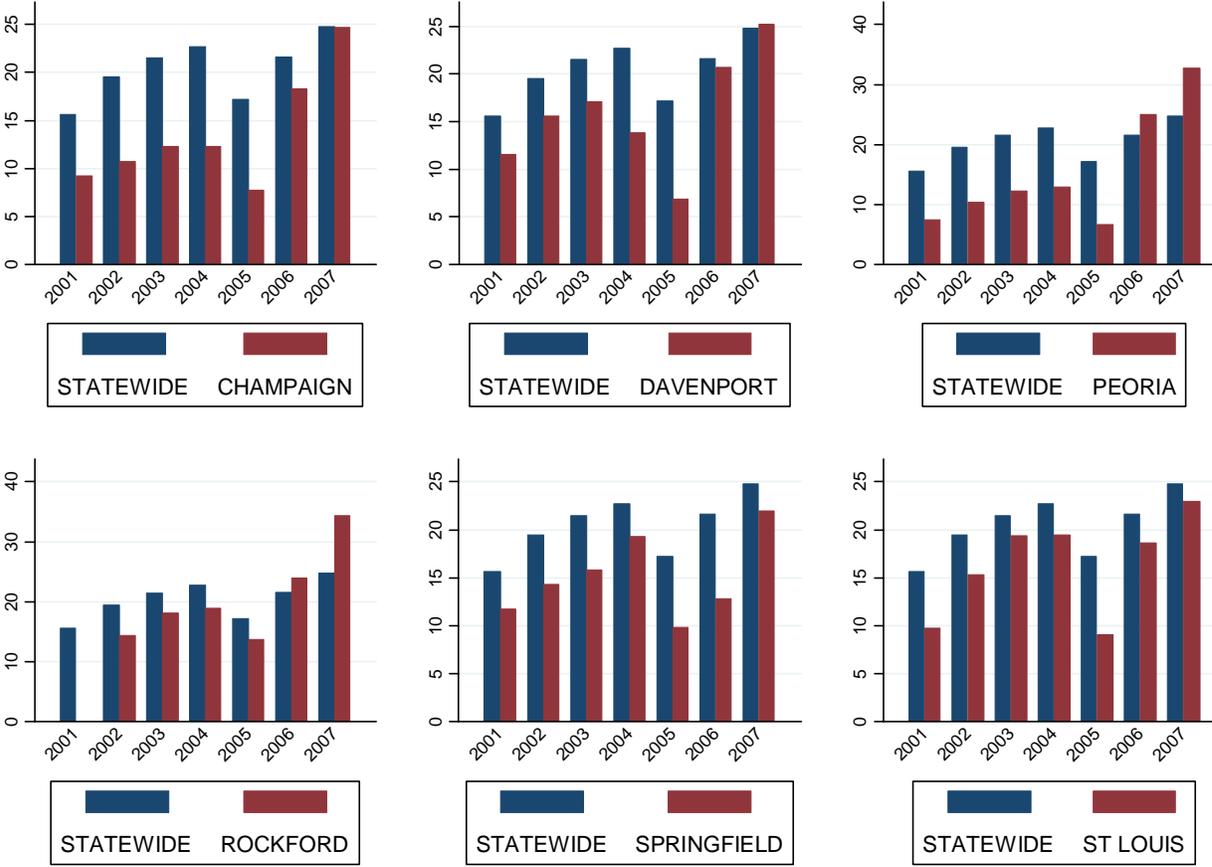
Source: AT&T Illinois

607 These data indicate that customers have alternatives to AT&T Illinois' local exchange  
608 services and that the suppliers of these services have every expectation of remaining in the  
609 market.

610 Q. DOES THE FACT THAT THE UNE-P HAS BEEN ELIMINATED AFFECT YOUR  
611 OPINION?

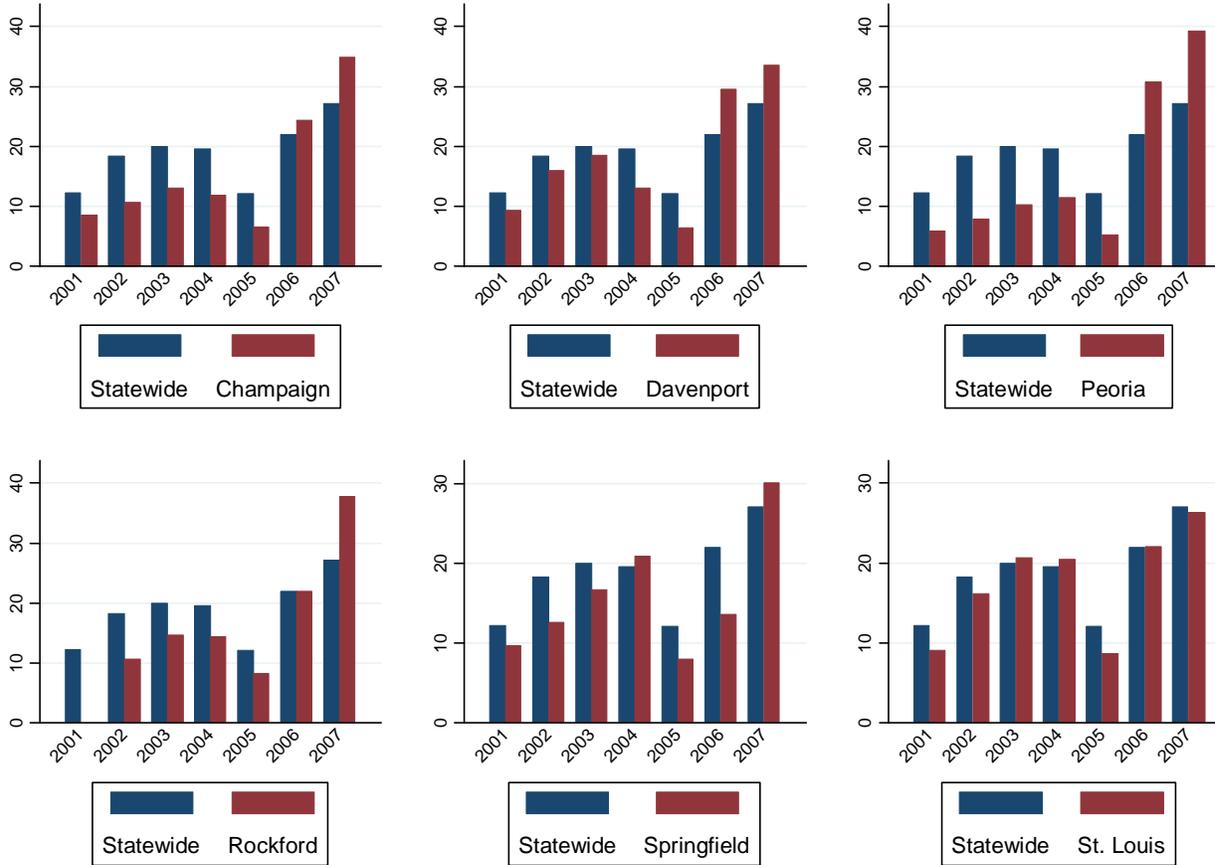
612 A. No. In its Order in Docket No. 06-0027, the Commission expressed concern that "a future  
613 discontinuation of the Section 13-801 UNE-P platform could have significant impact on  
614 the state of competition for at least some residential services in MSA-1" [at 92]. As  
615 shown below, CLEC shares of total and residential switched access lines are significantly  
616 higher in December 2007 than in December 2005 across the state and in every one of the  
617 six Greater Illinois LATAs.

**Figure 5.**  
**CLEC Market Share by LATA (%)**



Source: ICC Annual Reports on Telecommunications in Illinois, 2001 – 2007.  
 Note: Data for 2006 and 2007 include Estimated Unreported Residential E-911 Capable VoIP Lines.

**Figure 6.**  
**Residential CLEC Market Share by LATA (%)**



Source: ICC Annual Reports on Telecommunications in Illinois, 2001 – 2007.

Note: Data for 2006 and 2007 include Estimated Unreported Residential E-911 Capable VoIP Lines.

619 **3. The existence of economic, technological, or any other barriers to entry into, or**  
 620 **exit from, the relevant market.**

621 Q. WHAT IS A BARRIER TO ENTRY OR EXIT?

622 A. A barrier to entry (typically in the long run) is a cost that an entrant incurs but not the  
 623 incumbent against which it must compete.<sup>19</sup> This asymmetric experience of cost can  
 624 prevent the potential entrant from competing with the incumbent *even if* its costs elsewhere

<sup>19</sup> For example, see Baumol *et al.*: “An entry barrier is anything that requires an expenditure by a new entrant into an industry, but imposes no equivalent cost upon an incumbent.” *op cit.*, at 282.

625 were exactly the same as the incumbent's and both faced identical prices. The barrier to  
626 entry may thus prevent entry by an otherwise *equally-efficient* competitor, but also lower  
627 consumer welfare in the process.<sup>20</sup>

628 A barrier to exit is a cost (typically experienced only when exiting the market) that is so  
629 prohibitive that it can reduce, or obliterate altogether, a firm's incentives to enter the market  
630 in the first place. Therefore, a barrier to exit effectively poses a barrier to entry as well.

631 Q. WHAT BARRIER TO ENTRY WOULD YOU CONSIDER MOST SIGNIFICANT IN  
632 TELECOMMUNICATIONS, GENERALLY, AND IN A LOCAL EXCHANGE  
633 MARKET, IN PARTICULAR?

634 A. Theoretically, significant sunk entry costs of constructing a local exchange network would  
635 be the greatest barrier to entry in such markets.<sup>21</sup> However, after implementation of the  
636 Telecommunications Act, entry into local exchange telephone service became possible for  
637 new wireline entrants without having to invest in network facilities. At the same time, new  
638 technology allowed cable and wireless companies to roll out facilities that essentially  
639 duplicated the wireline companies' local telephone networks. Thus, the historical sunk cost  
640 barrier to entry — a market feature that caused economists and regulators to treat local  
641 telephony as a natural monopoly — no longer determines the structure of the market.

642 Q. WHAT EMPIRICAL EVIDENCE IS THERE REGARDING BARRIERS TO ENTRY?

643 A. The large number competitors in Illinois that have deployed their own facilities is a clear  
644 signal that entry barriers are not significant and that local exchange markets in Illinois are  
645 considered worth competing for over the long haul. The most compelling evidence here is  
646 the expansion of cable telephony and wireless service, both of which entail the

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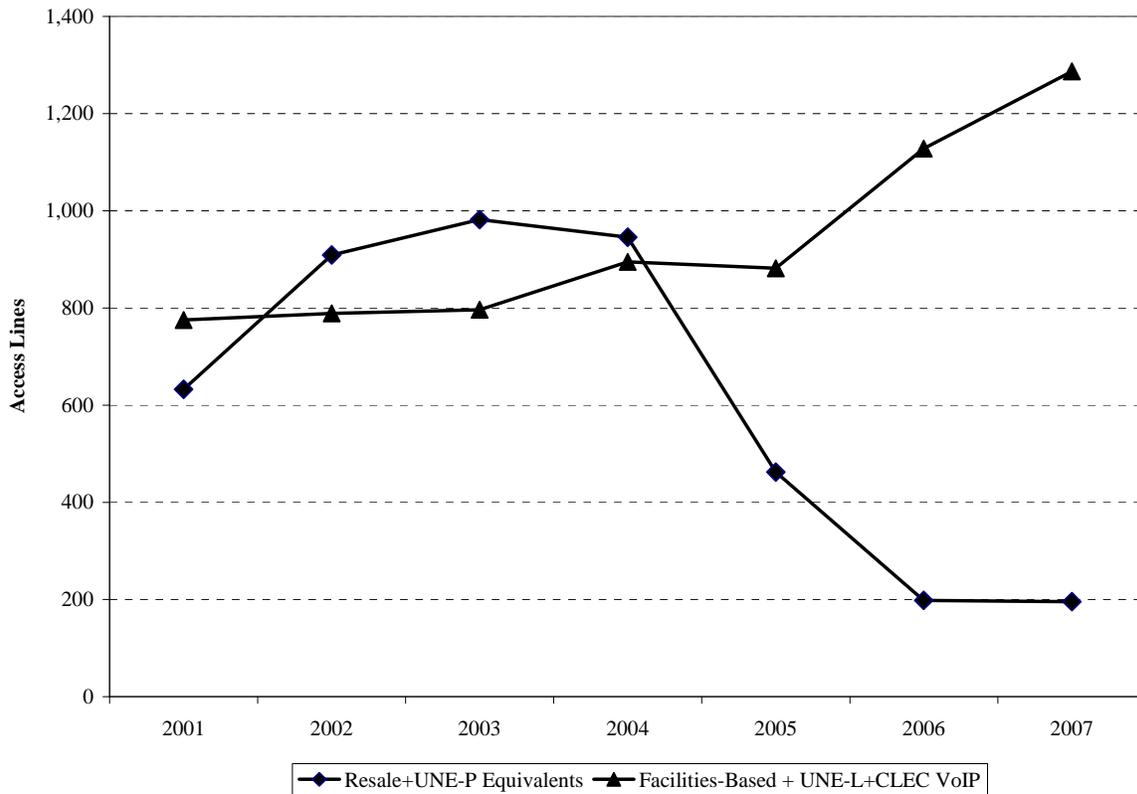
<sup>20</sup> *Id.* Also see Christian C. von Weizsäcker, "A Welfare Analysis of Barriers to Entry," *Bell Journal of Economics*, 11 (2), Autumn 1980, at 399-420. It is important to note that when the incumbent firm has lower costs, i.e., the potential entrant is *less* efficient, then the difference in costs between the two firms cannot be regarded as an entry barrier. The deterrence of a less efficient entrant does *not* lead to a loss of consumer welfare.

<sup>21</sup> For a comprehensive treatment of sunk costs and barriers to entry, see Jean Tirole, *The Theory of Industrial Organization*, Cambridge, MA: The MIT Press, 1988, at 314-323.

647 construction of network facilities and the expenditure of sunk costs, both of which imply a  
 648 commitment to remain in the market in the long run. See Figure 3 and Table 3.

649 For wireline competitors, the absence of entry and exit barriers is shown by the decline in  
 650 resale and its equivalents as modes of entry and the increase in facilities-based entry. That  
 651 is, holding all else constant, as both their customer base and business confidence grew,  
 652 wireline competitors have transitioned from leased to owned network facilities to provide  
 653 services.

**Figure 7**  
**Illinois CLEC Retail POTS by Type (Thousands)**



Source: ICC Annual Report on Telecommunications Markets in Illinois, September 2008, Tables 5 & 6.

654 Largely driven by the movement away from UNE-P and by the expansion of cable  
 655 companies into telephony, there is evidence, at both the national level and in Illinois (see  
 656 Figure 7) showing a shift from pure resale (and its equivalents) to platforms that make at  
 657 least some use of CLECs' own facilities.

658 Q. WHAT DO YOU CONCLUDE FROM YOUR ANALYSIS OF THE DATA ON  
659 COMPETITIVE ACTIVITY FOR BASIC LOCAL EXCHANGE SERVICE IN AT&T  
660 ILLINOIS' SERVICE TERRITORY IN THE GREATER ILLINOIS LATAS?

661 A. My principal conclusion is that barriers to entry and exit are not of any competitive  
662 consequence in those markets. Despite the discontinuance of UNE-P, CLEC shares of  
663 wireline customers (including cable customers) are increasing statewide and in every  
664 LATA. Moreover, these trends are complemented by evidence of an impressive shift from  
665 resale and UNE-P to partial or full use of CLEC facilities to serve residential customers.  
666 These are all clear signals of the growing ability of wireline competitors in AT&T Illinois'  
667 service territories to compete with AT&T Illinois for residential customers and to stay  
668 committed to competing over the long haul.

669 **4. The extent to which other telecommunications companies must rely upon the**  
670 **service of another telecommunications carrier to provide telecommunications service.**

671 Q. DO ALL OF AT&T ILLINOIS' COMPETITORS RELY ON ITS SERVICES TO  
672 PROVIDE THEIR TELECOMMUNICATIONS SERVICES?

673 A. Yes, but only in the following sense. *All* providers of telecommunications services — big  
674 and small, ILEC and CLEC, wireline and wireless — must interconnect with one another to  
675 complete calls. An AT&T Illinois local exchange customer cannot call a Comcast customer  
676 unless Comcast is willing to terminate on its network calls that originated on AT&T  
677 Illinois' network, and *vice versa*. To provide acceptable service to its own customers, each  
678 carrier must agree to terminate such calls on its network, and every carrier has an incentive  
679 to ensure that such interconnection agreements take place. That type of reliance on the  
680 services of other carriers is essentially symmetric across carriers.

681 Q. DO SOME CARRIERS RELY IN A NON-SYMMETRIC WAY ON WHOLESALE  
682 SERVICES PROVIDED BY AT&T ILLINOIS?

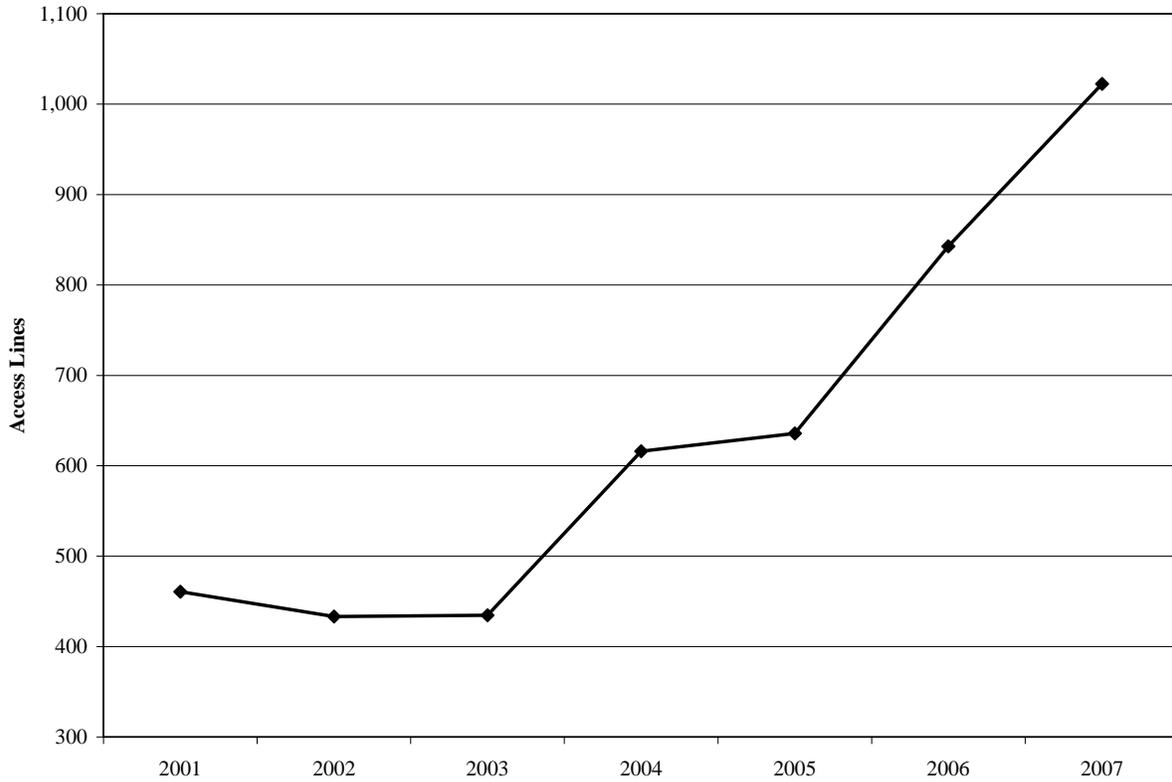
683 A. Yes. Some wireline telecommunications providers purchase UNE facilities — generally  
684 loops and transport — from AT&T Illinois or resell AT&T Illinois' retail services at an  
685 avoided-cost discount. The prices and terms and conditions under which these services —

686 resale and UNEs — are provided are pervasively regulated by the FCC and this  
687 Commission. In addition, Illinois has a statutory imputation test that requires that AT&T  
688 Illinois' retail price for any competitive service covers its incremental cost, including the  
689 price that competitors pay for UNEs. Thus, when a retail service is reclassified as  
690 competitive, competitors are protected (i) by state and federal regulatory oversight  
691 regarding the wholesale prices they pay for essential services and (ii) by statute regarding  
692 the margin between those wholesale prices and AT&T Illinois' retail prices.

693 Q. ARE ALL OF AT&T ILLINOIS' COMPETITORS DEPENDENT UPON USE OF ITS  
694 NETWORK?

695 A. Excepting interconnection, no. Facilities-based competitors including cable companies,  
696 wireless carriers and VoIP suppliers do not use any of AT&T Illinois' network elements,  
697 and the rules codified in the Telecommunications Act of 1996 apply to them in a more  
698 limited manner or not at all. As shown in Figure 8, wireline competitors increasingly  
699 provide residential local exchange service in Illinois without relying on AT&T Illinois'  
700 unbundled network elements or avoided-cost resale.

**Figure 8**  
**Illinois CLEC Facilities-Based Access Lines (Thousands)**



Source: ICC Annual Report on Telecommunications Markets in Illinois, September 2008, Table 6. Facilities-based plus non-ILEC access lines. Includes ICC estimated CLEC VoIP lines, Table 5.

701

702 **5. Any other factors that may affect competition and the public interest that the**  
703 **Commission deems appropriate.**

704 Q. DO YOU BELIEVE THAT THE PUBLIC INTEREST WOULD BE SERVED BY  
705 CONCLUDING THAT AT&T ILLINOIS' TARIFF FILING RECLASSIFYING ITS  
706 RESIDENTIAL LOCAL EXCHANGE SERVICES AS COMPETITIVE WAS  
707 JUSTIFIED?

708 A. Yes. The public interest is clearly served when regulation is reduced in an effectively  
709 competitive market. In such a market, easy entry by competitors (through different modes  
710 of entry that require different degrees of commitment to sunk investments) ensures greater

711 choice and better terms and conditions for customers and disciplines the prices that the  
712 incumbent could charge. Given developments in Illinois' markets over the past ten or so  
713 years, the Commission need no longer be concerned about the magnitude or quality of  
714 competitive entry. Instead, it can focus on ensuring that consumers realize the benefits of  
715 this competition by relying to a greater extent on market forces to determine the  
716 characteristics, prices and other terms and conditions of the services consumers buy.

717 Reclassification of residential local exchange services will, on balance, serve the interest of  
718 consumers, eliminate unneeded regulation, and conserve regulatory resources.

719 On the flip side, it is important to note the detrimental effects on customers of continuing  
720 unnecessary and disparate regulation of retail services of one competitor in the market.

721 Unnecessary regulation is not benign: as the Commission observed in its Order in Docket  
722 No. 06-0027, price regulation has likely foreclosed competition for a portion of Illinois  
723 local measured service customers.

724 ...it is reasonable to conclude that the regulation of AT&T Illinois' price levels  
725 for the network access line and local usage has effectively created an economic  
726 barrier to enter the market for local measured service at comparable rates, at  
727 least for some customers....[at 95]

728 The ability of every competitor to charge market-based prices for all services and packages  
729 of services is an important element in the competitive landscape. Without it, consumers  
730 have more limited options and can be denied the benefits of full-blown competition among  
731 all service providers.

732 Most important, regulated competition distorts market outcomes in unpredictable,  
733 unintended ways. While equity among competitors in regulated markets is important, from  
734 the consumers' point of view, other problems with regulated competition are more  
735 important. In telecommunications, the market outcome that most affects consumers for  
736 generations to come is the competition among technologies and platforms. Tight regulation  
737 of ILEC wireline services combined with loose regulation of CLEC telephony and no  
738 regulation of wireless or standalone VoIP telephony may tilt the outcome of this

739 competition in an unintended direction. And regulation that tilts customer choice among  
740 technologies can have long-lasting detrimental effects on consumers.<sup>22</sup>

741 **V. CONCLUSION**

742 Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

743 A. Yes.

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<sup>22</sup> For example, consider our 20<sup>th</sup> century experience with transport regulation, where piecemeal regulation of trucking, rail and barge prices has led to bankruptcies and reorganizations of railroads, canals and barge lines.